

CHAPTER I

INTRODUCTION

1.1. Background of Study

Income inequality is one of problems faced by developing countries such as Indonesia. Developing countries are countries with low levels of living. A developing country is a country with low levels of income, and lower and upper middle income. Inequality mostly happens in low level income countries (Birdsall, 2007) . Based on the World Bank Data in 2014, Indonesia has been classified as the lower middle income country with Gross National Income per capita's average of \$1,046 –\$4,125. Every developing country is experiencing a development process. Development is a process of change in social, economic and institutional aspects for obtaining the better life. Development in terms of economics means the acceleration of economic growth, reducing of inequality and eradicating poverty. Unequal income distribution in developing countries seems usual because most developing countries have unstable economic and political condition (Kaasa, 2003). Income inequality can be seen as the effect of growth in economy where the economic growth is centralized in certain region. The development focusing mostly on urban area causes the inequality. The imbalance between economic growth and poverty alleviation and unemployment reduction cause the increasing income inequality in Indonesia. Economic disparity and income inequality always accompany development of Indonesia that is only focusing on quantity without quality. Increasing economic growth will increase income inequality (Todaro & Smith, 2011).

One province that is important in development of Indonesia is West Java Province. 18.25 percent of population in Indonesia is located in West Java. The number of population of this province was 46.709.600 in 2015, with the largest population concentration in Bogor and Bandung. The population growth rate in this province was 1.78 % in 2013 with the population density of 1,282 people / km². The population is the biggest number among the other provinces in Indonesia. Most of the West Java citizen works in agriculture, commerce, industry and service sectors. The dominance sector of the agricultural sector is the implication of potential arable land and climate which are good for agricultural cultivation. Besides the agriculture, the provincial government is also developing the industrial sector. Moreover, 80 % of Indonesian industries were located in Java Island which is mostly in West Java and East Java Provinces. The West Java has given big contributions towards Indonesia because of its number of population and industry.

The problem of income inequality also happens in West Java as it happens in almost Indonesia provinces. Inequality in Indonesia, as measured by the Gini coefficient, increases by 11 percentage points between 2000 and 2013. Zero Gini coefficients express the perfect equality, while one Gini coefficient expresses the perfect inequality.

Gini coefficient in Indonesia currently is 0.40 which expresses the medium inequality. The data showed that income inequality in Indonesia keeps increasing. The inequality between Java Island and Non-Java Island, urban and rural, Western and Eastern Indonesia is rising sharply, from 0.36 in 1996 up to

0.40 currently. Income inequality in Indonesia is occurring inter region, inter sector and inter group income. According to Adisasmita (2013), every province in Indonesia has different characteristics driven by some factors which are geographical aspect, natural resource condition, human resource condition, investment and technology. As an archipelago, it is no wonder that every region in Indonesia has different economic potentials and thus led to different income levels in Indonesia. Every province has different population and natural resources. This might lead that growth and development in Indonesia are uneven according to different capacity of every region. Regional policies affect the growth and income of every region.

Income Inequality is keep increasing in West Java. West Java is one province with the higher income inequality. Gini Ratio of West Java is even higher than Indonesia Gini Ratio. The number is keep increasing from 0.35 in 2008 into 0.41 in 2016. In 2016 the highest Gini Ratio was Gorontalo and Yogyakarta that is amounted 0.42 and the next is Jakarta and West Java that reach up to 0.41, while Indonesia Gini Ratio is 0.40.

Income disparity theory by Jeffrey G. Williamson stated that income inequality in a country occurs when there is a province with higher GDP followed by the province with lower GDP (Adisasmita, 2013). Indonesia experiences a huge income gap between Java and another province. Based on the data from Indonesia Statistics, Java and Sumatra islands have contributed more than 80 % of Gross Domestic Product. Java Island is only a small part of Indonesia, which is only 7 % from all Indonesia regions, but Java contributes 57 % of the National

GDP. West Java is the third biggest contributor of the National Income in Java Island after Jakarta and East Java. West Java contributes 13.09 % of National Income in 2016. Income inequality happens because the economic growth mainly focuses in Java Island, especially in industrial regions. Fiscal funding and infrastructure are focusing on Java Island. Java Island also becomes the central of private and foreign investments.

The number of poor people in Indonesia has showed the problem of Income inequality in Indonesia. In 1970, the poor people in Indonesia are more than half of Indonesia citizen with the proportion of 60%. In the last twelve years, the percentage of poor people in Indonesia has been decreasing by 19, 1 % in 2000 which became 12, 0 % in 2012 and 11, 37 % in 2013. The number of the decrease happened over year. Based on the poor people data in 2016 recorded by BPS Indonesia, the number is only 10.86%, but the gross income of the poor people who live in the urban area is on average Rp 364.527 worth of a month and the gross income of poor people who live in rural area is only Rp 343.646 per month. In West Java, the number of poor people has reached until 437.520.000 people in 2013 which is 9.61% of West Java Population. The poverty gap index and poverty severity index in West Java is respectively 1.62 and 0.42. The poverty line showed that the growth impact does not spread evenly to West Java citizens.

Another factor that determines income and economic development in developing countries such as Indonesia is human development index. Human development indices provide a measurement and evaluation of the country achievements in different areas of human development, which are education,

health and economic growth. In 2015, the highest HDI in Indonesia was East Kalimantan which is 74.17 and the lowest is Papua which is 57.25. West Java is in the average HDI in Indonesia which is 69.50. Based on the data, West Java's Human Development Index was increasing over the years. HDI was increase from 66.15 in 2010 to 69.50 in 2015. It means there was improvement of human resource in West Java. By increasing HDI; West Java should be more developed province and can reduce the inequality and alleviate poverty.

Minimum wage could be a factor that influences income inequality, since city with higher minimum wage has higher income. From the regional minimum wage in seven cities in West Java in 2015, the highest wage is in Bekasi City with the wage of Rp 2.954.031 and the lowest is in Cirebon with the minimum wage of Rp. 1.415.000. However, in 2015 the highest income inequality measured in Gini Index is Tasikmalaya city and Bogor city was respectively amounted to 0.49 and 0.47 and the lowest is in Depok city by 0.40.

Another factor that influences income inequality is inflation. Inflation increases the price level and decreases the purchasing power. The higher inflation rate in West Java in 2015 was Bogor with the inflation rate is 3.60 % and the lowest is in Cirebon with the inflation rate of 1.87 %. Inflation causes inequality because it is affecting industrial performance in real sectors by increasing production price and redistributing resources from persons with fixed nominal income (Kaasa, 2003).

Based on the information and phenomenon, the researcher would like to analyze the problems in the study entitled **“Factors that Influence Income Inequality in West Java Provinces in 2010 – 2015”**.

1.2. Problem Formulations

The research problems of the research are:

1. What is the effect of economic growth toward income inequality in West Java?
2. What is the effect of human development index toward income inequality in West Java?
3. What is the effect of minimum wage toward income inequality in West Java?
4. What is the effect of inflation toward income inequality in West Java?

1.3. Research Objectives

The research objectives of this research are:

1. To analyze the effect of GDP per capita growth toward income inequality in West Java
2. To analyze the effect of human development index toward income inequality in West Java
3. To analyze the effect of minimum wage toward income inequality in West Java
4. To analyze the effect of inflation contribution toward income inequality in West Java

1.4. Research Contributions

The Research contributions of this research are:

a. For Investor

This research can be guidance for those who are choosing a potential place to invest in.

b. For Academician

This research can be a reference for future researcher who will study in the same field.

c. For Government

This research can be a reference to solve the income inequality problems in Indonesia.

1.5. Systematics of Writing

This research has been divided into five chapters. This section presents the description of each chapter in the research.

Chapter I : INTRODUCTION

This Chapter contains the study background, problem formulation, objectives and contributions of the research.

Chapter II : REVIEW OF RELATED LITERATURE

This Chapter describes the previous studies related to this research. The theories used in this research are related to economic growth theory and income inequality theory

Chapter III : RESEARCH METHOD

This chapter describes the type of study of the research, population and sample, data collection method, research variable, and analysis technique of this research

CHAPTER IV : DATA ANALYSIS AND DISCUSSIONS

This chapter describes and explains the results of the research.

CHAPTER V : CONCLUSIONS AND RECOMMENDATIONS

This chapter gives concluding remarks of the research and some policy implications and recommendations of the research.

