

FACTORS THAT INFLUENCE INCOME INEQUALITY IN WEST JAVA PROVINCE IN 2010 – 2010

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ABSTRACT

The challenges of all developing countries such as Indonesia among others are how to increase economic growth, to reduce inequality and to alleviate poverty. Income inequality happens because of either economic or non-economic problems. This study aimed to analyze factors that influence the income inequality in West Java province. There are 7 cities that has been analyzed in this research which are; Bogor, Sukabumi, Bandung, Tasikmalaya, Cirebon, Bekasi and Depok. The data used were panel data started from years 2010 - 2015. This research used income inequality as the dependent variable, and economic growth, human development index, minimum wages, and inflation as the independent variables. The data were analyzed using panel data analysis with Fixed-Effect Model regression. The regression result showed that all independent variables significantly influence the dependent variable. All independent variables can explain income inequality in West Java about 70 %. The study results showed that inflation and human development index significantly influence income inequality in West Java. Economic growth and minimum wage did not significantly income inequality in West Java.

Keywords: Income Inequality, Gini, Ratio, Economic Growth, HDI, Minimum Wage, Inflation.

INTRODUCTION

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). 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.

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.

Economic growth is a tool to measure the development of a country. It also measures the welfare of society. In fact, the massive economic growth does not mean that all people benefit from the growth because the resource is owned by the who is on the top of income distribution. This condition happens because problem of income inequality. There is a big gap between the rich and the poor.

Income inequality means the disproportionate distribution of total national income among households (Todaro & Smith, 2011). Income inequality is one of problems faced by developing countries, in which the economy is still growing or the income is increasing. According to Kuznets' theory, the income inequality follows an inverted "U" shape as it rises and then falls again based on the increase of income per-capita. Therefore, in the development stage of economic growth tends to make income inequality increase and decrease later.

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 increased 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.

Human Development Index is the composite index to measure human development counted based on 3 key dimensions of human development which are: a long and healthy life, access to knowledge and a decent standard of living. Education and health which are component of HDI influence income per person and influence income inequality. People with higher education and good health tend to earn higher income. When there was unfair HDI, inequality will increase. Region that has higher HDI will grow faster and there will be disparities in income. Thus, the increase in HDI could increase the inequality.

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.

Minimum Wages is the wage set by the Government for the labors. The minimum wage is affecting the outputs produced in a province. In other words, minimum wages are highly affecting the income of a province. A study by Sungkar, Nazamuddin and Nasir (2015) found that the minimum wage gives a positive impact toward income inequality. The minimum wage policy will affect the production cost. According to labor demand theory, if the wage set by the government is above the optimum wage, the firm tends to reduce the number of the workers. As a result, workers are transferred into informal sector which is out from the labor force. Thus, the minimum wage tends to increase income inequality.

Another factor that influences income inequality is inflation. Inflation is the rate of price changes where the price tends to increase. Inflation causes the increase of price, decrease in purchasing power and reduces the value of money. 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). Inflation affects inequality by increasing cost and redistributes resources from person with fixed nominal income. Inflation redistributes resources from group of income. Study by Kaasa (2003) and Lestari (2016) found that inflation gives a negative impact toward income inequality. The

effects of inflation toward income distribution are depending on the types and degrees of inflation

Based on the information and phenomenon, the researcher would like to analyze the problems and formally test the impact of economic growth, human development index, minimum wage and inflation on income inequality in this study.

Based on that study backgrounds, 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?

And 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

LITERATURE REVIEW

Kaasa (2003) stated that the main cause which influences income inequality in transition economies are economic growth, macroeconomics factor, demographic factors, historical factors, natural factors and political factors. The results of this research found that income inequality in transition economies is affected by the economic growth and the level of overall development (GDP per capita, shares of three main sectors representing changes in economies sector structure) and by macroeconomic factors (such as inflation and unemployment). All components in the research have significant and negative influences towards income inequality.

The relationship between economic growth and income inequality has a negative correlation, meaning that if the economic growth increases, income inequality will decrease (Wahyuni, 2004). The researcher reviewed the debate

about growth and inequality theories through the studies in some countries' experiences and analyzed whether there is a relationship between growth and gaps in these countries. Economic growth will give opportunities for the poor people to contribute in the economy which later on can reduce income inequality. Investment and credit market for the poor is an effective policy to help the poor and will promote equality in the future.

Musfidar (2012) analyzed 3 factors that influence inequality. Population, minimum wage, industrial sector have influenced income inequality in South Sulawesi. The result stated that population do not significantly influence income inequality. The minimum wage significantly influences income inequality. It means when the minimum wage set by the Government increases, the disparity will also decrease. Lastly, industrial sector gives big contributions toward regional income significantly that may influence income inequality.

Putri, Amar, & Aimon (2013) analyzed the effect of economic growth, labor productivity, investment and human development index (HDI) against income inequality in Indonesia. The result stated that economic growth affects income inequality in Indonesia significantly. Labor productivity significantly affects income inequality in Indonesia. Investment significantly affects income inequality in Indonesia. Human development index significantly influences income inequality.

Sungkar, Nazamuddin and Nasir (2015) analyzed the effect of minimum wage policy toward income inequality in Indonesia. The study attempted to show the relationship and the impact of the minimum wage on income inequality in Indonesia by using Ordinary Least Square (OLS) and autoregressive methods. The result showed that both variables significantly have positive correlation, which means that increasing on minimum wage will lead to a greater income inequality or a worse situation of income gap.

Another researcher analyzed whether the population, agricultural land area and economic growth affected the inequality of income distribution in North Sulawesi. Bantika (2015) found that population and economic growth gave significant effect to the ini Ratio. In other words, an increase in economic growth would lower the Gini Ratio, while an increase in the population would also increase the Gini Ratio in North Sulawesi.

The similar study in another country found uncertain effects on GDP towards income inequality. Teweldemedhin (2015) examined factors influencing income inequality in Namibia, by applying hybrid Cobb Douglas and Principal Component Analysis (PCA). The researcher was describing some factors which influence income inequality which are economic growth, macroeconomics factors, and demographic factor, and political factor, historical, cultural and natural factors. The results of the research stated that education policy matters, that include well-designed labor market policies and institutions can reduce inequality. The policies aimed at boosting GDP per capita have an uncertain impact on income inequality.

Economic growth, inflation, and population significantly influence income inequality in East Java (Lestari, 2016). Dependent variables of this research are Williamson Index from 38 regencies and cities in East Java, while independent variables are population, inflation and economic growth. The researcher used Multiple Linear Regression Analysis with data panel model derived from the theory of Williamson Index. Inflation gives negative impacts towards income inequality in East Java, while population and economic growth give positive impacts towards income inequality.

RESEARCH METHOD

This research used the quantitative approach to examine the relationship between the variables of the research. The data used in this research will be secondary data. The data used in this research are qualitative data which came from the Indonesian Statistics, containing panel data from 2010 until 2015 from 7 cities in West Java provinces.

This research contains the dependent variable and independent variables. The dependent variable of this research is income inequality, and the independent variables are economic growth, human development index, minimum wages, and inflation.

ANALYSIS TECHNIQUE

To estimate the panel data, there are some models that can be used which are Pooled OLS model (common effect model), fixed effects model or least squares dummy variable (LSDV) model, and random effects model (REM).

There are three tests to choose between 3 models in the panel data (Sriyana, 2014). To choose between Common Effect and Fixed Effect, the researcher used F-test to test the significance of Fixed Effect. LM test were used to test the significance of Fixed Effect, and Hausman Test were used to test the significance of Random Effect. Chow Test or redundant fixed effect test is used to choose between common effect model and fixed effect model while Hausman test is used to choose between fixed effect model and random effect model.

The relationship between the dependent variable and independent variables in this research in the theoretical model is:

$$Y_1 = f (X_1 , X_2, X_3, X_4)$$

Where:

Y_1 = Income Inequality

X_1 = Economic Growth

X_2 = Human Development Index

X_3 = Minimum Wage

X_4 = Inflation

To analyze the factors that influence income inequality in West Java province, the researcher used panel data analysis. The model can be presented as follows:

$$Y_{it} = \beta_{0it} + \beta_1 X_{1it} + \beta_2 X_{2it} + \beta_3 X_{3it} + \beta_4 X_{4it} + \varepsilon_{it}$$

$$i = 1, 2, \dots, 7$$

$$t = 1, 2, \dots, 6$$

The tests used to estimate the regression result are:

a. T-test

T test is used to know the influence of the significance of the independent to the dependent variable individually.

b. F-test

While t-test is conducted to test the influence of each independent variable, F-test is used to test the significance of the independent variables as a whole. When the probability of F-statistics is greater than 0.05 so that H_0 is accepted, and when it is lower than 0.05 H_0 is rejected. If F-test is greater than F-critical, reject H_0 . It means that all independent variables significantly influence the dependent variable.

c. Coefficient Determination (R^2)

R^2 test measures the influence of independent variables to dependent variable in the research model used. The value are between 0 – 1. The value that is close to 1 meaning that all independent variables give all information needed to predict the dependent variable, and vice versa, when the value which is close to 0 meaning that the independent variables have low influences on the dependent variable or it means that the independent variable cannot explain the fluctuation of the dependent variable.

RESULT AND DISCUSSION

Economic Growth

Economic growth is the measurement of economic development. Economic growth is a summary of various economic sectors' growth that describes the levels of economic changes that happen in the country. For the provinces, this indicator is important to know the development that has been achieved and it is useful for determining the direction of development in the future.

The economic growth of West Java cities was not spread evenly. In 2010, the lowest economic growth was in Cirebon city with the number of 3.81%, while the highest was in Bandung city with the number of 5,45 %. In 2011, the lowest economic growth was in Tasikmalaya city with the number of 5.02%, while the highest was in Bandung city with the number of 7.91 %. In 2012, the lowest economic growth was in Tasikmalaya city and Sukabumi city with the number of 5.80 %, while the highest was in Bandung city with the number of 8.53%. In 2013, the lowest economic growth was in Cirebon city with the number of 4.90%, while the highest was in Bandung city with the number of 7.84 %. In 2014, the lowest economic growth was in Sukabumi city with the number of 5.43 %, while the highest was in Bandung city with the number of 7.71 %. In 2015, the lowest economic growth was in Sukabumi city with the number of 5.10%, while the highest was in Bandung city with the number of 7.63 %. From all regions, the highest economic growth was in Bandung City and the next is Depok City. This might happen because the two cities have better infrastructures.

Human Development Index (HDI)

While the gross domestic product is a composite measurement of a country's economy performance, HDI is a measure of the achievement of human development indicators which is education, health and standard of living. Human Development Index can affect the income disparity in Indonesian provinces since it has effects on the human productivity. It can be assumed that the provinces with higher HDI will generate more income.

Uneven HDI in West Java cities has caused uneven growth in West Java cities because different levels of human resource quality. The better HDI in West Java cities has indicated the better human capital in the city and vice versa. The highest HDI in West Java cities are Bandung city, Bekasi city and Depok city while the lowest HDI city is Tasikmalaya. The lowest HDI created higher income inequality as happened in Tasikmalaya city.

Minimum Wages

Minimum wages is a wage set by the third party which is the Government. The minimum wage varies between cities depending on the regional government policies and regulations. The purpose of the Government for setting up the minimum wages is to protect the labors in order to be able to fulfill their daily needs properly. Because the minimum wages is set based on the proper daily need survey consisting of beverages and etc.

The minimum wages always increases each year; it is adjusted with the price levels and daily needs that are always changing. The highest rate was in Bekasi city that is Rp 2.954.031 per month in 2015, while the lowest minimum wages were in Tasikmalaya city and Cirebon city.

Inflation

Inflation is the rate increases of general prices. There was a redistribution effect of inflation in which affects the distribution of income (Nanga, 2005). Income redistribution caused by the increase of real incomes of several people while the other decreases. In other words, inflation affects income inequality.

The inflation in West Java cities is categorized as moderate inflation which is under 10 %, except in 2013 where the inflation in Depok city reached 10.97 %. It was increasing sharply in 2013 and 2014. When the inflation increases, income inequality will decrease. It has been proved in Depok, when the inflation increased from 4.11 % in 2012 into 10.97 in 2013, income inequality was decreasing from 0.40 in 2012 to 0.39 in 2013.

Panel Data Analysis

Based on Chow Test and Hausman Test in Eviews9.0, the best model is fixed effect model. The regression result of Foixed Effect Model is as follow :

Dependent Variable: GR?
 Method: Pooled Least Squares
 Date: 01/30/17 Time: 11:31
 Sample: 2010 2015
 Included observations: 6
 Cross-sections included: 7
 Total pool (balanced) observations: 42

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-1.459899	0.560377	-2.605207	0.0140
EG?	0.011263	0.010094	1.115772	0.2731
INF?	-0.005671	0.001891	-2.998591	0.0053
HDI?	0.024349	0.007993	3.046272	0.0047
MW?	0.003446	0.017041	0.202251	0.8410

Effects Specification

Cross-section fixed (dummy variables)

R-squared	0.700024	Mean dependent var	0.385000
Adjusted R-squared	0.603257	S.D. dependent var	0.044844
S.E. of regression	0.028246	Akaike info criterion	-4.075598
Sum squared resid	0.024733	Schwarz criterion	-3.620494
Log likelihood	96.58755	Hannan-Quinn criter.	-3.908784
F-statistic	7.234145	Durbin-Watson stat	2.182544
Prob(F-statistic)	0.000009		

Source : Eviews 9.0

T-test

T-test is used to know the influence of the significance of the independent to dependent variables individually.

Thus, the hypothesis of this research will be:

$H_0: \beta_1 = 0$: Independent variable does not significantly influence income inequality

$H_1: \beta_1 \neq 0$: Independent variable significantly influences income inequality

1. Economic Growth

T-statistics from economic growth variable is 1.115772 with p-value of 0.2731. By using the alpha 0.05, and then accept H_0 , this means that economic growth does not significantly influence income inequality.

2. Human Development Index

T-statistics from human development index variable is 3.046272 with p-value of 0.0047. By using the alpha 0.05, and then reject H_0 , this means that human development index significantly influences income inequality.

3. Minimum Wage

T-statistics from minimum wage variable is 0.202251 with p-value of 0.8410. By using the alpha 0.05, and then accept H_0 , this means minimum wage does not significantly influence income inequality.

4. Inflation

T-statistics from inflation variable is -2.998591 with p-value of 0.0053. By use alpha 0.05, and then reject H_0 , this means that inflation significantly influences income inequality.

F-Test

F-Test was conducted to test the influence of independent variables as a whole. The regression results from Eviews showed that independent variables (economic growth, human development index, minimum wages, and inflation) have the significance of F-statistics about 7.234145 and the probability is 0.000009 which is lower than 0.05. The regression results showed that all independent variables significantly influence the dependent variable as a whole.

Coefficient Determination

Coefficient Determination of this model is 0.700024 or 70 %. It showed that independent variables which are economic growth, human development index, minimum wage and inflation can explain income inequality in West Java province about 70 %. The value of R-square is close to 1 which means that all independent variables give all information needed to predict the dependent variable.

Discussion

1) Impact of Economic Growth towards Income Inequality

The probability of economic growth is 0.2731, means that economic growth does not significantly influence income inequality in West Java. It means that the analysis of economic growth's impact is not necessary. Some studies found that the growth influences inequality while the other stated that inequality influences the growth (Kaasa, 2003). In this research, the economic growth does not significantly influence income inequality. It can be implied that it is not necessary to maintain unequal income distribution to grow rapidly. Inequality can impair growth if those with low incomes suffer poor health and low productivity as a result, or if, as evidence suggests, the poor struggle to finance investments in education. Inequality can also threaten public confidence in growth-boosting policies like free trade

According to Kuznets' theory, income inequality will increase by the increase in per capita income until it reaches certain points and income inequality will decrease. Factors that determine whether income inequality increases or decreases are not only the rate of growth, but also the kind of growth, whether it is traditional sector enrichment, modern sector enrichment or modern sector enlargement. With the modern sector enrichment, income will increase and inequality will increase steadily. Lorenz curve shifts downward and is away from the perfect equality line. With the traditional sector enrichment, income for a group of people in the traditional sector will increase and the inequality will decrease. With the modern sector enlargement, absolute income increases while the absolute poverty decreases and inequality may increase or worsen. Therefore, it is implied to keep the balance between two sectors which are the big industry in West Java and good arable land that is perfect for cultivation. It is important to keep the balance between traditional and modern sectors in West Java to overcome the problems of poverty and income inequality in this province.

2) Impact of Human Development Index towards Income Inequality

The probability of Human Development Index is 0.0047, which means that Human Development Index significantly influences income inequality in West Java. HDI gives a positive impact toward income inequality. The coefficient is 0.024349, which means when HDI increases for 1 unit, income inequality will increase about 0.024349 unit .It means that education and health influence the income level and then human development index significantly influence income inequality in Indonesia.

Education has had greatest impact on domestic growth (Khodabakhshi, 2011) . HDI affects the productivity, the higher the HDI the higher the productivity and vice versa. HDI in West Java varies among the cities and regencies. As the productivity affects the income level, HDI significantly influences the income inequality. In 2014, workers in the whole West Java were still dominated by less educated workers by 49,2 percent, while well educated workers only reached the proportion of 33,7 percent . On the other hands, workers in Bogor, Depok and Bekasi are dominated by well-educated persons. The city with the highest proportion of well educated workers is Bekasi city which is 77, 8

percent, and followed by Depok city by 62, 4 percent. Unfair human capital between West Java cities create unbalanced income and growth between cities, as a result disparities is increases .Because there was a large gap of HDI levels between cities in West Java, an increase in HDI will create a rise in income inequality.

3) Impact of Minimum Wages towards Income Inequality

The probability of the minimum wage is 0.8410, which means that the minimum wage does not significantly influence income inequality in West Java. It means that the analysis of the minimum wage impact is not necessary.

Minimum wages are affected on those working in formal sectors. There are 19, 23 million workers in West Java distributed in all of economic sectors. Most of them are working on trade sectors by 25.6 percent, manufacturing sectors by 20.3 percent, and agriculture sectors by 19, 9 percent (Badan Pusat Statistik Provinsi Jawa Barat, 2015). As the most of West Java citizen's works in trading and agriculture sectors, they are not protected by minimum wage policy and their income could not affected by minimum wage.

The minimum wage that is set too high will hurt labors in formal sector. The minimum wage policy transfers the excess labor in formal sector to informal sector and affects the wage level in that sector. However, the minimum wage also benefits for labors in informal sector, the increase of wages in formal sector will increase the demand of goods in informal sector so that it will increase the wages of informal sector labors (Belser & Rani, 2014) What happens in West Java that the minimum wage does not influence income inequality. Thus, it is implied that the minimum wage policy was ineffective to reduce problems of income inequality in West Java, or the minimum wage policy set by the government was not in a proportional value. It is important to harmonize between formal and informal sectors to reduce the inequality in West Java.

4) Impact of Inflation towards Income Inequality

Inflation gives a negative impact towards income inequality in West Java. The coefficient is -0.005671, which means when the inflation increases by 1%, the income inequality will decrease about -0.005671 units with an assumption that another variable is constant. The probability of inflation is 0.0053, which means that inflation significantly influences income inequality in Indonesian provinces.

Inflation raises the price levels, and decreases purchasing power and the value of money. Inflation benefits for traders because of the price increase, also it benefits for businessmen which mostly have debts in banks. The costs of inflation depend on types. Unanticipated inflation creates more significant redistributions of wealth rather than anticipated inflation. Inflation influences inequality by affecting industrial sector performance by increasing production cost and redistribute resource from person with fixed nominal income. Inflation

redistributes income from lower income groups and upper income groups toward the middle income groups which consist of traders and businessmen. Middle income groups are greater than upper and lower middle income groups. Redistribution of wealth does not only happen in hyperinflation, even moderate inflation leads to redistribution of wealth (Doepke & Schneider, 2004). As a result, by increasing inflation, income inequality decreases.

According to the Phillips' curve when unemployment is high, inflation is low, and it affects negatively on income inequality. Then, a trade-off between unemployment and inflation can cause a trade-off between inflation and income inequality. Because when inflation rises, unemployment will fall and the automatically will decrease income inequality.

CONCLUSIONS AND RECOMMENDATIONS

Conclusion

Based on the results' analysis, factors that influence income inequality in West Java cities in 2010 – 2015, it can be concluded as follows:

1. Gini Ratio as a measurement of income inequality in West Java is fluctuating each year and it tends to increase. Currently Gini ratio in West Java is 0.41, which expresses the medium income inequality.
2. Economic growth in 7 cities in West Java does not significantly influence income inequality.
3. Human Development Index in West Java significantly influence income inequality and it gives positive impacts towards income inequality. The higher the HDI, the higher the income inequality will be. HDI affects labor productivity, the more productive the more income will be. Uneven HDI in West Java creates the imbalance development and income inequality in West Java.
4. Minimum wages do not significantly influence income inequality in cities in West Java.
5. Inflation significantly influences income inequality in cities in West Java and it gives negative impacts towards income inequality. Inflation hits people with fixed nominal income because the value of money decreases. Inflation gives redistribution effects toward income and then inflation significantly influences income inequality.

Recommendations

1. Income inequality in West Java is categorized as a medium inequality. Therefore, it is necessary to set up economic and non-economic policies aimed to boost the economic growth, reduce inequality and alleviate poverty.
2. Inflation and Human Development Index that show significant effects on income inequality can be a guidance to make decisions and create policies that can reduce income inequality problems.

3. To reduce income inequality in West Java, the Government needs to create programs that can boost human capitals in West Java, such as by improving health facilities and providing training programs for the labors so that hopefully the programs can increase their income and reduce the income inequality later.



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