Rapid economic growth breeds inequality in Indonesia

Indonesia's economy grew rapidly over the past 30 years, in large part due to sweeping political and institutional reforms, the right mix of economic policy packages, and the development of fairer economic institutions, but progress made in reducing poverty and income inequality is faltering.

Economic growth as measured by gross domestic product—the sum of all goods and services produced in the economy—has slowed from 7.6 percent in 1996 to 4.8 percent in 2015.

Per capita GDP, which measures the country's economic output divided by the number of its people, climbed from $1,095 to $3,834 during the same period, which corresponds to a drop in the incidence of poverty from 28.6 percent in 1980 to 11.1 percent in 2015.

But inequality has worsened.

The Gini coefficient, which measures the income or wealth distribution and is the most commonly used gauge of inequality, rose from 0.33 in 1996 to 0.41 in 2015. Another inequality index, the Palma ratio, which measures the income gap between the poorest and the richest, showed the same trend.

In 1996, the richest Indonesians had six times more income than the poorest. In 2014, the richest had ten times more. The top 10 percent got more than 32.4 percent, with the top 20 percent getting 47.8 percent of income.

Inequality in Indonesia and its economic growth over the past 2 decades is a consequence of the country's shift from agriculture to services without safeguards to protect vulnerable members of society.

Population shifts from agriculture to industry or services, from rural areas to urban, and from informal to formal employment, all contributed to the increasing inequality over the past 2 decades.

Rising inequality poses dangers to the economy as it can lead to social unrest, seen recently in Indonesia, and slow growth. Even when protests or social tensions do not result in excessive conflict, rising inequality can increase resistance to, and undermine, a government's ability to introduce reforms needed for economic growth.

Other developing countries, weaned off economic dependence on agriculture in favor of other industries, also saw income inequality rise because changes came too rapidly and there were no social safety nets.

In Indonesia, services increased their share in the economy and deepened inequality because the sector is capital intensive and the work requires hospitality skills.

Much fewer people enjoyed the benefits of growth in services than those who gained from growth in agriculture or industry.

Agriculture's contribution to GDP fell from 23.2 percent in 1985 to 13.5 percent, while services' contribution rose from 40.9 percent to 46.6 percent. Industry's share of GDP grew from 35.9 percent to 39.9 percent.

The share of employment in agriculture and services also reflected the shift. Farms' share of employment fell from 54.4 percent in 1985 to 34 percent in 2015, while services' rose from 29.7 percent to 45.3 percent. Industry's share jumped from 8.2 percent to 20.7 percent.

The share of agriculture output in GDP has declined continuously since 1980, while that of industry and services has increased significantly.

In the past two decades, Indonesia has seen its people leaving their farm jobs, which also contributed to the rise in inequality because of economic disparities across regions, or between rural and urban areas.

Increasing inequality has been curbed by the growing income of those working in agriculture and in the informal sector, those living in rural areas, and those who do not attend formal or compulsory education.

For fairer wealth distribution, Indonesia should invest in infrastructure and pour more resources into developing its regions and helping poor villages. Another way to spur growth is by making sure local people get jobs in companies that bring in foreign direct investments.

This episode was based on research by Teguh Dartanto, head of the Poverty and Social Protection Research Group at Universitas Indonesia; Edith Zheng Wen Yuan, research associate; and Yusuf Sofiyandi, research assistant.

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