POVERTY AND THE ECONOMY December 2011

SUMMING UP

The global economic situation has two key aspects:

1. The global economic turmoil continues to create uncertainties in the high income economies. However, thus far Indonesia's economy has remained intact with strong GDP growth of 6.5 percent in the third quarter of 2011. This relatively robust rate of growth has been supported by a flourishing economy on Java and the commodity-based export of coal, palm oil, rubber and oil in the eastern provinces.
2. For the first ten months of 2011, inflation in both urban and rural Indonesia has been far lower than in the past. The inflation rate for food has been especially low, and this is particularly important to the poor because they spend about 65 percent of their expenditures on food.

The profile of the poor in Indonesia has five important aspects:

1. Most poor people in Indonesia live in rural areas. In September 2011 the poverty headcount in rural areas (15.6 percent) was higher than that for urban areas (9.1 percent) and for the country as a whole (12.4 percent)
2. While most poor people live on the island of Java, the incidence of poverty is higher in eastern regions of Indonesia. In 2011 the three provinces with the largest number of poor people were all on Java: East Java, Central Java and West Java. However, the incidence of poverty as measured by the poverty headcount in these Java provinces was lower than that of several outlying eastern provinces. In 2011 Papua and Maluku Provinces had the highest incidence of poverty in the country.
3. Poverty rates are higher in rural areas because most of the poor work in agriculture. In 2010 60 percent of the poor worked in agriculture, as compared to 40 percent for the non-poor. In recent years the share of the poor working in manufacturing has actually fallen: from 8.4 percent in 1993 to 6.7 percent in 2010.
4. Poverty rates are also higher in rural areas because of lower education. In 2011 63 percent of all working males in rural areas had a primary education or less, as compared to 34 percent of working males in urban areas. These numbers have not changed very much since 2003.
5. In their consumption the poor depend heavily on one food item: rice. The poor spend almost ¼ of their total expenditures on rice, while the non-poor spend only 10 percent of their expenditures on this food item.

Global Conditions

The global economic turmoil continues to create uncertainties in the future of the high income economies. The European debt crisis has escalated as investors keep on demanding higher risk premiums. As a result, the EU has failed to maintain the value of its bonds and global output has contracted from 5.1 percent in 2010 to 4 percent in 2011. At present, the Euro zone and the United States are projected to grow 1.5 – 1.6 percent, while Japan still struggles with a negative growth of 0.5 percent. These developments will eventually affect the Indonesian economy because the EU, along with Japan and the United States, represent Indonesia's main trading partners.

However, thus far Indonesia's economy has remained intact with strong GDP growth of 6.5 percent in the third quarter of 2011. This relatively robust rate of growth has been supported by a flourishing economy on the island of Java. Java has benefited from the rise of investment and capital good demand as construction and infrastructure works continue to expand. Java has also benefitted from large inter-regional trade, playing a central role in the distribution of consumer and manufacturing goods to other islands in Indonesia. In the eastern provinces, growth has mainly come about through large government expenditure on infrastructure and the commodity-based export of coal, palm oil, rubber and oil. These commodity-based export industries are quite profitable but are not very labor-intensive in terms of employment.

Inflation in Indonesia

For the last 10 months of 2011, inflation in both urban and rural Indonesia has been far lower than in the past. In year-to-year terms the current rate of headline inflation in Indonesia is about 3.8 percent. The inflation rate for food has been especially low, and this is particularly important to the poor. While in year-to-year terms the price of rice has increased by 13.3 percent, prices of other components of the food basket have declined. This is important to the poor in Indonesia, because they spend about 65 percent of their total expenditures on food versus only 52 percent for the non-poor.

To accurately measure the impact of inflation on the poor, it is important to calculate measures of inflation that are different from the standard urban and rural consumer price indices

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(CPI). Specifically, it is important to calculate an "urban CPI for the poor" and a "rural CPI for the poor." These two additional CPIs are needed because food represents such a large share of total consumption for the poor, and most of the poor live in rural areas.

Table 1 shows calculations for the standard urban and rural CPIs as well as the two new CPI measures for the urban and rural poor. Between 2007 and 2010 both the urban CPI for the poor and the rural CPI for the poor increased at faster rates than that for the standard urban and rural CPIs. Between 2007 and 2010 the urban CPI for the poor rose at 7.5 percent per year (versus 6.6 percent for the standard urban CPI) and the rural CPI for the poor rose at 10.7 percent per year (versus 10.1 percent for the standard rural CPI). In 2011 the urban CPI for the poor also grew at a faster rate than that for the standard urban CPI (3.5 percent versus 2.6 percent), but both rates of inflation were much more moderate than in previous years. For the first 10 months of 2011 the reduced rates of inflation have benefitted the urban and rural poor, who spend about 65 percent of their total expenditures on food

Table 1: CPI and CPI for the Poor (annual % increase)

	2007–2010	Jan.–Oct. 2011
Urban CPI—Headline Inflation	6.6%	2.6%
Urban CPI for the Poor	7.5%	3.5%
Rural CPI	10.1%	2.9%
Rural CPI for the Poor	10.7%	1.9%

Profile of the Poor in Indonesia

In Indonesia the poor are identified by the Central Statistical Agency, Badan Pusat Statistik (BPS) on the basis of a consumption bundle including both food (to satisfy 2100 calories per person per day) and non-food goods. Poverty lines are established for urban and rural households on the basis of a consumption bundle of 52 food items and 47 non-food items but the relative weights of these bundles vary across provinces. In September 2011 the average national poverty line was 263,594 rupiah per person per month (about $29.28 per person per month)[1] and 12.4 percent of the population was considered poor.

There are important geographic differences in the distribution of the poor in Indonesia. As in many Asian countries, the majority of the population lives in rural areas and therefore so does the majority of the poor. In 2011 the national poverty headcount in rural areas (15.6 percent) was much higher than that for either urban areas (9.1 percent) or for the country as a whole (12.4 percent) (Table 2). However, Indonesia is undergoing rapid urbanization. In 2011 about 40 percent of the population lived in urban areas. By 2025 this figure is projected to increase to 68 percent of the population.

There are also key regional disparities in the distribution of the poor. While the island of Java contains the largest number of poor people, its national poverty headcount is less than that of other regions. For example, Java accounts for about 58 percent of the population of Indonesia and about 57 percent of the total poor. In terms of total numbers, most of the poor therefore live on Java. In 2011 the three provinces that had the largest number of poor people were all on Java: East Java (4.6 million poor), Central Java (5.2 million poor) and West Java (5.3 million poor). However, in terms of the incidence of poverty, Table 2 shows that national poverty headcounts for these three Java provinces are not that high, ranging from 10.6 percent in West Java to 16.2 percent in Central Java. By contrast, the provinces in the eastern regions have many fewer people but a higher incidence of poverty as measured by the poverty headcount. In 2011 Papua had a national poverty headcount of 31.2 percent and Maluku 22.5 percent. In terms of the incidence of poverty, these eastern islands are among the poorest provinces in the country.[2]

One of the reasons why poverty headcounts are higher in rural areas and less populated eastern provinces has to do with the employment patterns of the poor. As in many developing countries, most of the poor in Indonesia work in agriculture. Table 3 shows that while 41 percent of the total labor force worked in agriculture in 2010, almost 60 percent of the poor work in agriculture. None of the other sectors of the economy employ over 16 percent of the poor. These data suggest that one of the keys to reducing poverty in Indonesia is to increase the labor productivity of people working in agriculture.

The data in Table 3 reveal two other key points about the employment of the poor. First, over the years (1993 to 2010), the percentage of the poor employed in agriculture has always been about 20 percentage points higher than that for the labor force as a whole. This serves to underscore the importance of agriculture in the lives of the poor. Second, over the same period of time the percentage of the poor employed in manufacturing has actually fallen. Between 1993 and 2010 the share of the poor employed in manufacturing fell from 8.4 percent to 6.7 percent.[3] Since the share of poor people working in manufacturing would normally be expected to increase over time, more work needs to be done to identify the reasons for this disturbing trend.

[1] The average exchange rate for 2011 was $1.00 = Rupiah 9,000

[2] The fact that most of the poor in Indonesia live on one densely populated island (Java), while rates of poverty are much higher in sparsley populated outlying areas (Papua) presents policymakers with a very difficult choice. Should policymakers address poverty where most of the poor live, or should they try to tackle poverty where poverty rates are highest?

Table 2. Percent of the Population Below the National Poverty Line (Poverty Headcount) in 2011

	Urban		Rural		National		Percentage Change		
	Mar	Sep	Mar	Sep	Mar	Sep	Urban	Rural	National
Aceh	13.69	13.03	21.87	22.01	19.57	19.48	-5.07	0.64	-0.46
Sumatera Utara	10.75	10.1	11.89	11.53	11.33	10.83	-6.44	-3.12	-4.62
Sumatera Barat	7.42	7.61	10.07	9.85	9.04	8.99	2.50	-2.23	-0.56
Riau	6.37	6.01	9.83	9.56	8.47	8.17	-5.99	-2.82	-3.67
Jambi	11.19	9.95	7.53	6.99	8.65	7.9	-12.46	-7.73	-9.49
Sumatera Selatan	15.15	14.94	13.73	13.39	14.24	13.95	-1.41	-2.54	-2.08
Bengkulu	17.74	16.3	17.39	17.83	17.5	17.36	-8.83	2.47	-0.81
Lampung	12.27	11.32	18.54	18.39	16.93	16.58	-8.39	-0.82	-2.11
Bangka Belitung	4.11	3.35	7.35	6.91	5.75	5.16	-22.69	- 6.37	-11.43
Kepulauan Riau	7.35	7.09	7.65	5.46	7.4	6.79	-3.67	-40.11	-8.98
DKI Jakarta	3.75	3.64	-	-	3.75	3.64	-3.02	-	-3.02
Jawa Barat	9.26	9.09	13.32	13.39	10.65	10.57	-1.87	0.52	-0.76
Jawa Tengah	14.12	14.67	17.14	17.5	15.76	16.21	3.75	2.06	2.78
DI Yogyakarta	13.16	12.88	21.82	22.57	16.08	16.14	-2.17	3.32	0.37
Jawa Timur	9.87	9.66	18.19	17.66	14.23	13.85	-2.17	-3.00	-2.74
Banten	4.61	4.54	9.75	9.74	6.32	6.26	-1.54	-0.10	-0.96
Bali	3.91	4.2	4.65	5.17	4.2	4.59	6.90	10.06	8.50
Nusa Tenggara Barat	23.67	23.42	16.9	16.99	19.73	19.67	-1.07	0.53	-0.31
Nusa Tenggara Timur	12.5	10.47	23.36	22.93	21.23	20.48	-19.39	-1.88	-3.66
Kalimantan Barat	6.33	6.7	9.59	9.25	8.6	8.48	5.52	-3.68	-1.42
Kalimantan Tengah	3.91	3.74	7.89	8.1	6.56	6.64	-4.55	2.59	1.20
Kalimantan Selatan	3.84	3.83	6.34	6.45	5.29	5.35	-0.26	1.71	1.12
Kalimantan Timur	4.06	3.8	11.21	11.26	6.77	6.63	-6.84	0.44	-2.11
Sulawesi Utara	7.46	7.51	9.37	9.25	8.51	8.46	0.67	-1.30	-0.59
Sulawesi Tengah	9.46	10.05	17.89	17.96	15.83	16.04	5.87	0.39	1.31
Sulawesi Selatan	4.61	4.48	13.57	13.63	10.29	10.27	-2.90	0.44	-0.19
Sulawesi Tenggara	4.8	4.51	18.24	18.43	14.56	14.61	-6.43	1.03	0.34
Gorontalo	5.37	4.06	25.65	25.21	18.75	18.02	-32.27	-1.75	-4.05
Sulawesi Barat	10.77	12.21	14.83	14.06	13.89	13.64	11.79	-5.48	-1.83
Maluku	10.24	9.59	30.54	30.03	23	22.45	-6.78	-1.70	-2.45
Maluku Utara	2.8	2.95	11.58	12.61	9.18	10	5.08	8.17	8.20
Papua Barat	6.05	5.71	39.56	38.3	31.92	28.53	-5.95	-3.29	-11.88
Papua	4.6	4.75	41.58	40.53	31.98	31.24	3.16	-2.59	-2.37
Indonesia	9.23	9.09	15.72	15.59	12.49	12.36	-1.54	-0.83	-1.05

Table 3. Sector of Occupation of the Poor, 1993–2013

	1993		**1996**		**1999**		**2003**		**2010**	
	Total	**Lowest Quintile**	**Total**	**Lowest Quintile**	**Total**	**Lowest Quintile**	**Total**	**Lowest Quintile**	**Total**	**Lowest Quintile**
Agriculture	50.6	71.6	46	66.1	45	66.6	47.6	70	40.6	59.4
Manufacturing	10.5	8.4	10.9	8.5	11.4	9	11.8	8.2	8.7	6.7
Trade	15.7	8.4	16.7	9.6	19.4	10.8	17.9	9.4	14.3	9.3
Services excluding trade	17.4	6.9	19.8	8.3	19.1	9	10.9	4.5	25.9	15.2
Other[1]	5.8	4.7	6.6	7.5	5.1	4.6	11.8	7.9	10.5	9.4
Total	100	100	100	100	100	100	100	100	100	100

[1] Other includes: mining and quarrying, electricity, gas and water, and construction

Source: Susenas, various years.

Another reason why poverty headcounts are higher in rural areas and eastern provinces has to do with education. The more years of education a person has, the less likely they are to be poor and in Indonesia there are striking differences in education between urban and rural areas. In 2011 while only 34 percent of working age males in urban areas had a primary education or less, in rural areas the figure was 63 percent. The lower educational rates of males (and females) in rural areas is a key factor in explaining lower rural incomes and higher rural poverty rates. There is a need to raise education participation rates—especially at the primary and secondary levels—throughout rural Indonesia.

Poverty headcounts are also higher in rural areas because of the increasing degree of landlessness and near-landlessness in Indonesia. In other words, farmers are cultivating less land and those with little or no land are more likely to be poor. In 1993 31 percent of all agricultural households were landless and 33 percent had holdings of less than 0.5 hectares. By 2003 the rate of landlessness and near-landlessness had increased from 52.7 to 56.5 percent, with the rate of landlessness increasing faster on Java. To meet the problem of landlessness it is important to improve rural infrastructure (roads) and move poor farmers out of agriculture and into rural non-farm activities.

With respect to consumption, one important aspect of the consumption of the poor stands out. In Indonesia the poor spend far more of their total expenditures (24 percent) on rice than do the non-poor (10 percent). This means that high rice prices have a particularly adverse impact on the poor. Even though most of the poor live in rural areas and work in agriculture about 76 percent of them (both rural and urban poor) are net rice consumers.

[3] According to Table 3, over the period 1993 to 2010 the share of the total labor force employed in manufacturing also fell: from 10.5 to 8.7 percent.

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