



Inequality Brief May 2024

Inequality Diagnostic Research in Indonesia

Reducing inequality is a part of global commitment under Sustainable Development Goals #10 (SDGs #10). SDG #10 has a comprehensive prosperity-sharing target not only focusing on reducing income inequality indicators, but also promoting social, economic, and political inclusion, equal opportunities, and ending discrimination. The target is derived from the notion that sustainable development cannot be realized if individuals are excluded from the opportunity for an improved quality of life.

Inequalities are multidimensional. It encompasses not only the chances of prosperity but also the outcome. It is not only about the income distribution between individuals, but also access to education, health, physical amenities, and digital services. Consequently, policies aimed at reducing inequality must transcend income redistribution and also focus on enhancing access to education, healthcare, and other public infrastructures both within and between groups.

Prior studies have documented the detrimental impact of persistent inequalities on economic growth and social well-being. Higher inequalities reduce the ability to stay healthy and accumulate physical and human capital (Galor & Moav, 2004; Aghion, Caroli, & Garcia-Penalosa, 1999). It then affects vertical mobility between generations (Corak, 2013). Extreme inequality may also deteriorate social cohesion and increase the possibility of conflict (Lichbach, 1989; Bardhan, 2005) that later can discourage economic growth.

LPEM FEB UI in cooperation with the National Statistics (BPS) has completed Inequality Diagnostic Research for Indonesia. It measures multidimensional aspects of inequality in Indonesia in the last decade while also identifying policies that shape the current state of inequality in Indonesia. The diagnostic follows the framework developed by AFD and ACEIR and financed by the AFD-managed EU Research Facility on Inequality. The research was completed in 2023 and the final report was released during a dissemination event on November 14th in Jakarta.

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LPEM FEB UI will further conduct dissemination events in four cities outside Java to gather local perspectives and feedback from government officials, NGOs, and academicians. These events will be held in Bengkulu (Sumatera region), Balikpapan (Kalimantan region), Palu (Sulawesi region), and Jayapura (Eastern Indonesia region) on the month of June and July 2024. This brief is an introduction to the local dissemination event and summarizes the main takeaways and messages provided in the Multidimensional Inequality Report for Indonesia. It provides an exposition of the current state of inequality in Indonesia and the multidimensional aspect of it. It highlights the progress that has been made and several challenges that remain to be addressed for future policies.

The final report can be accessed [here](#). Any feedback and suggestions can be addressed to Social Protection and Labor Research Group, LPEM FEB UI, via this email address: splabor@lpe-feui.org.

Inequality Diagnostic Research: Main Takeaways

Income inequality in Indonesia has been on a slightly declining trend in the past decade. Gini coefficient slightly declines from 0.409 in 2012 to 0.384 in 2021, showing a general reduction in income inequality within the national population. This improvement in inequality is consistent throughout various measures, including Theil's Indices, Atkinson Indices, and Palma Ratio. Despite the slight reduction, the inequality is still relatively higher than in other emerging countries like India (0.345), Thailand (0.351), and Vietnam (0.368). Within the country, income inequality is higher within Java and in urban areas, implying the need for policy packages to address the problem in these areas.

In terms of labor dynamics, inequality manifests high informality and vocational unemployment. Over the past decade, the percentage of workers in informal sectors in urban areas increased from 42.4% in 2012 to 48.8% in 2021. Such increases may indicate limited formal jobs and mismatching issues in urban labor market. The increase in informal sectors may increase vulnerability for workers and improving the access to the formal sector should improve inequality in urban areas.

Secondly, vocational graduates have a higher rate of unemployment compared to other educational backgrounds in a time when many government policies aimed at vocational education. The unemployment rate among vocational graduates in 2021 is 11.1%, way higher compared to general high school graduates (9.1%). A more comprehensive look at this issue is important to examine whether this is caused by a lack of job-matching ability from the labor market or the lack of quality from the vocational graduates.

On gender issues, the labor force participation rate (LFPR) gap between men and women in Indonesia remains high. In 2021, the men's LFPR is at 82.3%, while the women's LFPR is only at 53.3%. In addition to the low participation rate, the female workers still also centered in informal sectors, resulting in a higher vulnerability to economic shocks compared to the male workers. In 2021, the percentage of female workers in the informal sector is at 63.8% compared to the male counterpart at 56.6%

On education indicators, access to basic education is at its highest nationally. The net primary enrollment rate is at 97.8%, the highest in the last decade. This is mainly due to successful policy packages surrounding basic education services from the Compulsory Education Program, and Smart Indonesia Program, to School Operational Assistance (BOS). However, the most concerning signs came from the pre-primary enrollment rate, which has declined in the last five years, from 37.5% in 2018 to 35.2% in the latest data of 2021.

In the health sector, after its first introduction in 2014, Indonesia has successfully improved access to basic healthcare through the Universal Health Coverage (UHC) program (*Jaminan Kesehatan Nasional/ JKN*). The policy has improved the access to health facilities, although, the high prevalence of smoking behavior may be counterproductive to the main objective of the program. The number of glaring when comparing by education level. Those with the lowest education level have a higher probability of smoking compared to the others.

The effort to provide basic infrastructure access has started through various program from the national and local governments. However, the disparity between regions remains high, in particular outside Java island. In terms of access to decent sanitation, the East Indonesia region has the most cities with a low percentage of household access to decent sanitation compared to other regions in Indonesia. Meanwhile in terms of access to decent drinking water, Kalimantan and the East Indonesia region have the most cities with low percentage of access to decent drinking water compared to other regions in Indonesia.

Policies and Inequality Outcomes

Over the past decade, there has been a clear policy shifts during the Joko Widodo's administration that affected inequality outcomes in Indonesia. Early in his tenure, the policy to reduce subsidies saved trillions of rupiahs, which were then allocated to building physical infrastructures such as highways and airports and increasing social protection spending. This may have caused the slight improvement in inequality during this period.

Indonesia's Universal Health Coverage policy, started in 2014, aimed to provide accessible health insurance to all Indonesians, including poor and vulnerable families. The program mandates that all Indonesians enroll in government-provided health insurance, with the premiums for poor and vulnerable populations being paid by the government through the

national budget. The sustainability of the policy has become an issue due to two reasons. First, the inability to control moral hazard from individuals covered by insurance regarding smoking behavior and sugar consumption, which increases government health expenditure. Second, payment compliance and the "missing middle" issue (Agustina, et al., 2019) may affect the revenue of the UHC provider (BPJS Kesehatan) in the future.

In the labor market, Indonesia faces significant challenges due to high levels of informality and mismatches between workers' skills and job requirements. A substantial portion of the workforce is employed in the informal sector, which lacks the stability, benefits, and protections provided by formal employment. This informality is particularly pronounced in urban areas, where opportunities for formal sector employment are limited. Despite the government's efforts to promote vocational education, the job market's ability to absorb these graduates remains insufficient, highlighting a critical need for better alignment between vocational training programs and labor market demands.

The prevalence of informal employment significantly shapes inequality within the population. Workers in the informal sector often earn less than their counterparts in the formal sector and have less access to social security and other benefits, increasing their vulnerability to economic shocks. Addressing the challenges of labor informality and mismatch is essential for reducing inequality, as it would not only improve the livelihoods of those currently in the informal sector but also create a more inclusive and resilient economy.

Steps Ahead: Reducing Inequalities and Improving Quality of Life

The Inequality Diagnostic Report has mapped out the current state of multidimensional inequality in Indonesia. To improve the condition, several measures need to be taken by the government. This brief suggests two parts of recommendation, including policies suitable for the short-term and long-term.

The Inequality Diagnostic Report has comprehensively examined the current state of multidimensional inequality in Indonesia, highlighting disparities across various socio-economic dimensions such as income, education, healthcare, and access to infrastructure. This policy brief presents two main strategies, both short-term and long-term interventions.

In the short-term, immediate policy actions are necessary to mitigate the most pressing inequalities and to provide targeted support to the most vulnerable populations. These measures should focus on enhancing social safety nets, and refining subsidy allocation targeting to better reach lower-income households. The government also needs to mitigate

the impact future policies, such as, VAT rate escalation and carbon tax, to ensure that the distributional impact of such policies do not widen the inequality gap.

In the long-term, structural reforms are crucial to address the root causes of inequality. First, Indonesia must prioritize revitalizing its manufacturing sector, which has experienced significant deindustrialization over the past two decades. For a nation poised to benefit from a demographic dividend, a robust manufacturing sector is essential for absorbing the expanding labor force and sustaining economic growth.

Furthermore, Indonesia must prepare for the inevitable transition to renewable energy, a shift that is critical for sustainable development but poses substantial challenges for the labor market. This transition requires careful planning to ensure a just and equitable shift from fossil fuels to renewable energy sources. It is imperative to develop strategies that mitigate the socio-economic impacts on workers, particularly those in industries most affected by this transition. By adopting a comprehensive approach to both industrial revitalization and energy transition, Indonesia can enhance its economic resilience and ensure inclusive growth that benefits all segments of the population.