

**THE POLITICAL ECONOMY OF DEVELOPMENT: A
CRITICAL ANALYSIS OF GOVERNMENT'S POVERTY
REDUCTION POLICIES, PROGRAMS AND STRATEGIES IN
INDONESIA**



Asmiati Abdul Malik PhD
Email: asmiati.malik@bakrie.ac.id

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Abstract

This thesis uses the analogy and approaches of institutional economics in political economy to understand the role of government interventions in the market and to analyse its effects on economic development in Indonesia. The study will focus on four things: first, poverty as the negative unintended result of government failure in protecting the national economy and, second; poverty as the result of government failure in understanding what cause and effects of poverty and its linkage with their failure in forming and design strategies, approaches and policies to increase economic development in rural and urban area and also to eradicate poverty and third; linkage between poverty, food security and human development, and fourth; poverty as moral hazard. Therefore, this study will use policy study analysis to gain deep understanding of the weakness of government policy and dynamic legislation framework in Indonesia that is started from planning, drafting, deliberating process, validating and enactment. In the broader scope, there are top-down policy, which mean the policy is made from central government without any involvement from the local government, thus policies are related with: 1). International trade such as: quota, tax and tariff, import restriction, and investment, 2). Central Bank with its monetary policy including: inflation, interest rate, and money value. Another type of policy is down-top policies or autonomic policy, a policy that is made on local government and it is approved with central government, those policies are specially related with the local wisdom and local economic development. However, this type of policy more likely tend to create new type of corruption, nepotism and collusion, since there is a lack of monitoring from the central government itself. In the top-down policies, it is argued that the policies are made as a trade-off between certain politician and big cartel players, and foreign stakeholders that will be analysed by using dependency theories. And in down-top policies, it is argued that the policies are made to give economic and political benefits just for certain clans and business players. And consequently, it gives negative impact on economic development and social welfare that can be seen on the number of poverty and the low of human development in Indonesia. And it will become a big threat for Indonesia especially in facing ASEAN economic Community (AEC), and also challenges if Indonesia wants to take a part in BRIC or even forming new emerging countries such as MINT. Based on that, the hypothesis of this research are: 1) Poverty in Indonesia is structural poverty and 2) Poverty and Inequality has a strong correlation with poor public policies, lack of government will on economic development and human development in Indonesia and moral hazard of Indonesian elites and politician.

Keywords: Poverty, Inequality, Economic Development, Political Economy, institutional Economy, BRICs, MINT.

1. Introduction

Poverty causes, effects, impacts and characteristics are differs in each country. In Indonesia, poverty eradication and economic development has been a major concern since Asia monetary crisis in 1997/1998. The economic crisis that hit Indonesia in

1997/1998 had lead into a serious social, political and economic chaos and one of the major problems was the upsurge of unemployment and poverty rate (Ismalina & Sitalaksmi, 2005; Ito, 2007). BPS data (2013a) noted the increase of unemployment rate about 1.18 million people in a year from 1997-1998, and reached the peak point of 11,24% in 2005, where there were 11,90 million of unemployment in Indonesia and even after 16 years passed of economic crisis, there were still 7,39 million people who cannot get a job, around 6,25% of 118,19 million of the total active labour force in 2013. BPS (2013b) also note poverty rate increased 6,73% between 1996 to 1998 as the impact of monetary crisis in 1997, but even after one and half decade passed, there were still 28.08 million of Indonesian, who were trapped in the poverty cycle, which was 11.37% from the total population still living under poverty line in 2013, and 8% of its concentrated in the city and 14.32% in the rural area. This data shows, that the large number of the poor in Indonesia was found in the rural area.

Poverty itself has a positive correlation with the number of unemployment rate, population, job availability and the type of job (Bang, 1999; Malik 2009). A high population density reflects a positive sign for business and industry, since there are plenty of labour forces available, the labour wage will tend to be cheaper due to high competition in the labour market. This is just a reflection of a very simple model of demand and supply labour model. Although it is considered good for mass industrial plantation, but it also gives negative impact for the poor, because of high competition, job will be scarce and only certain people, who have a good qualification who will get good pay and the one who cannot afford good education will be ended up as cheap labour or a farmer and even unemployed. According to BPS (2013c), there were 206 million of the total population in Indonesia in 2000 and rose up to 237 million of people in 2010, increased 31 million in a decade. The population density itself is 124 people per km² and kept increasing 21,08 % every ten years (Jalal, 2014:9). If the government is not taken this fact seriously, there will be population boom in 2035. Fasli Jalal (2014: 6-7) as the head of National Population and Family Planning Board of Indonesia (BKKBN), noted that population Indonesia's population growth shows decline trend from 2015 until 2035 around 1%, but the number of Indonesia's population in 2035 is staggering, where its predicted around 304.9 million people and the population itself mainly concentrated in Java. This numerous population is considered as a tremendous burden for Indonesia's Economic Development in the future, because it is related with the resource and food availability. Sen (1999)

argued that poverty is strongly linked with the number of population and the availability of resource 'food'. Sen (1999) also noted that poverty and food availability is no matter only economic problem but it is political problem. Although in this case, bonus demography could give positive impact on economic development, in terms of the labour availability; however, it also should be supported by the availability of the skilled labours. Saleh (2013) reported that, Indonesia is facing bonus demography and keep increase at least until 2025, where 44,98% of the total productive age 15- 64 years old. If the Indonesian government failed to increase their skilled labour, then it is strongly argued that, they will be trapped in middle-income trap. Therefore, there should be a reevaluation of Indonesia's government economic development policy. Because, poverty in Indonesia is an outcome of political policy that brings political benefit for certain people, it is not a policy that is based on economic consideration for social welfare. For instance, government policy in subsidies, from 34,33% of the total annual government budget in 2012, 61,17% or Rp. 211,9 trillion of it was allocated for oil subsidies and 27,30% or Rp. 94,6 trillion was used for electricity subsidy (Pradipto, 2013). This is a big problem for Indonesia, and also a very sensitive issue between politicians. A large subsidies budget is hampering economic development, because most of the oil should be imported and it is not balanced with government income in fiscal and export activities. Therefore, most of the time, Rupiah is very fragile towards dollar, and most of the time, Indonesian government when they face current deficit account, which it leads to inflation, they will tend to apply Phillips curve approaches by increasing interest rate. Increasing interest rate will slow down the economic growth, because business will hard to grow since they will be hard to get loan from the bank. This is just a very simple example of bad policy that is applied in Indonesia and this is strongly correlated with the upsurge number of the poor. Therefore, it is very essential and important to conduct a policy research that can be used for the Indonesia government in formulating their political economic policy. This is very important for Indonesia if they want to take a part in BRIC of gain competitive and comparative advantage from International trade within ASEAN region, ASIA or in International and global market competition.

2. Brief Theoretical Background

The revolution of economic thought and political thought are differs. The economic thoughts and ideas usually occur after economic crisis, whereas politic thoughts are more dynamic, following any social, economic and politics events. Economics

science itself emphasize on studying households issues, individual choices, cause and effect, and many elements of life (Baumol and Blinder, 2010; Krugman and Wells, 2009; Mankiw, 2008; Taylor 2012; Tucker, 2009). In a very simplistic way, economics is all about scarcity and allocation of resources (Mankiw, 2008). Taylor (2012; 2) itself pointed out three main questions in economy including, what goods and services should be produce, how its produce and who are the consumers?.

In another hand politics can be understood as any kind of issues that are related with power, government, state, authority, conflict, public life and public policy (Caporaso and Levine, 1992). Despite the scope of each discipline is different, but both make human as their object of study. However, many scholars argue that it is no longer applicable to understand political event only from political perspective and economic problem with economic approach, because these two subject are tightly linked. This can be seen from triangle relationship between the state, market and the society. State is about power, the power to regulate and control the market and the society. Caporaso and Levine (1992: 8) seek power as politics from three conceptions; first 'politic as government', second politics as 'public life' and third as 'authoritative allocation of values'. The power of modern information and media communication technology has changed the world into cosmopolitan democracy, where the power of state is limited and has been replaced with the power of market. Therefore, it is more often political issued is analysed from economic perspective which is known as political economy. There are some concepts and approaches that can be used as the comparison tools in evaluating the problems and issue in political economy, those are including: classical political economy, Marxist economics, institutional economics, Keynesian economics, neoclassical economics, and modern political economy and the one of major debate of these approaches between scholars is related to the government intervention into the market (Stilwell, 2012). It is argued that in order to understand the currents and past issues, problems and challenge of poverty and economic development in Indonesia, the institutionalism economy should be used, since it is more similar with Indonesia's Pancasila economic principle. In Pancasila's economy, the government plays important role and main role in creating social welfare, so in this case, the power of government is very central and strong in the economy and in the market (Boediono, 2007).

There are abundance concepts of poverty itself and many approaches that can be used to understand what is 'poverty'. Some scholars would see that as from economic perspective such as lower productivity, would result low income, and low

income will result lack access in education and health (Damanhuri, 2010). Another will tend to look it as the subject of psychological and cultural problem; in this case, poverty is studied from the poor behaviour and cultural, where it is argued that poverty is also contributed from lazy society (Mohan, 2010). Lazy society will lead into lower production and lack of entrepreneurship. Schumpeter (2003) seeks poverty as the outcome of unemployment, therefore, entrepreneurship skills and ideas are very essential to be developed, since it will give significance contribution to the society through small medium enterprise that is fully supported by government policy that gives economic benefit for business. Furthermore, it is argued that only by applying entrepreneurship ideas economic development can be achieved (Gibb, 2000; Acs, Desai and Hessels, 2008; Knight, 2000; Schumpeter, 2003). In another hand, it is also argued that poverty is matter of political problem, as Sen (2009) argued, they will see this problem will and attitude in forming policies that fail to eradicate the poverty. It is also supported by another Indonesian economist Kwik Kian Gie (1995), who tend to look economic problem in Indonesia was more likely as a result of bad policies and the trade off between big cartel players and politician. Therefore, the definition of poverty it differs based on how which angle it is valued. Boeri (2012) seek this from economic perspective, where poverty has relationship between government policies in increasing minimum wages, it is also a trade off policy to reduce poverty rate between, government, industry and the labour. Poverty itself in a simple term is defined as lack of capability in fulfilling basic, daily and essential needs such as nutritious food, housing, education and health services (Mooney, 2008; Deaton, 2003; Ebrahim, 2007; Sen 1999).

Poverty also can be analysed by using dependency theory that looks the economic development from the terms of trade. Prebisch (1950) noted that there was unbeneficial mutual trade relationship between developing countries or aid countries and developed countries, where the developing countries was forced and designed to accept form of financial aid from developed countries by exporting the primary products which had uncompetitive price for instance exporting raw material. Ruccio and Simon (1988) supports Raul Prebisch argument, that later found out two main streams of idea in dependency theory, first is Marxist and Neo-Marxist and secondly is non-Marxist. Dependency theory itself is considered as radical approaches on political economy as well as structuralism theory. Structuralism theory is focused on economic structuration by controlling market mechanism. Swasono (2003) asserted that economic structuralism emphasised on the structural unbalance and unfair

social economic in neo-classical economy. Neo-classical economy believes that government intervention should be limited and market mechanism should perform naturally, the government intervention is only needed if there is market distortion and this against the socialist economic approaches. The idea of the limitation of government involvement into the market because of the government failure is considered bigger than market failure (Hayek, 2006; Friedman, 2002). In some cases, government policy product that is designed to tackle poverty but in fact create greater poverty rate, for instance import and export policies.

Dependency theory and approach has been used by some scholars such as Swasono (2003), Kwik Kian Gie (2003), Thee Kian Wie (1987), and Raharjo (2011), to analyse the economic development problems in Indonesia. There are three classification of dependency; first is colonial dependency, second financial industry dependency and last is technological dependency. In colonial dependency, Raharjo (2011) notes that Indonesia economy nowadays reflects colonial economy, where the major and central of natural resource management is still under foreign countries management under MNCs actor. Indonesia also still export raw material and does not have capability to process their raw material, therefore, they need to import processed product which is away more expensive than raw material, so in this case Indonesia is targeting as a target market country not a country that base on production (Raharjo, 2011). In this case, Indonesia will not able to gain business value added into their products. Another view in dependency theory seeks the role of foreign aid in tackling poverty rate in developing and least-developed countries, the ideas of helping the poor with foreign aid is considered not applicable and not effective anymore. Kotler and Lee (2009) notes that the social problem is no longer a matter of a problem of resource management but it is considered as moral hazard problem, therefore thinking pattern of the society is needed to be changed and only government involvement in creating inclusive economic development, thus can be achieved. In another hand, financial dependency can be seen from Indonesia's dependence on foreign aid in financing their economic development. Gie (2006) noted that in 1988/1989, around 80,86% of infrastructure budget was taken from foreign aids, and 35% in 1999. Gie (2006) argued that high foreign debt brought financial disastrous for Indonesia's economy in the future, since annual national budget will had deficit since the government should pay high interest rate, and also it will make rupiah is fragile and does not have currency power towards dollar, since most of the foreign debt was taken in dollar. Paul Baran (1960) and Andre Gunder

Frank (1965) asserted that developing countries will never be able to eradicate poverty if they are dependent on a capitalist system and capital, since foreign investment will not increase social welfare but only change social culture in production to fulfil demand from foreign markets without any technological and knowledge transfer. In terms of technological dependency, it can be seen from the correlation of human skills and quality of education. Quality of education determines the quality of human skills. According to Cowen and Tabarrok (2009) economic development is determined by productivity factors include: physical capital, human capital, technological knowledge and organization. Those factors are interlinked, for instance: the accumulation of human capital should be supported by the readiness of physical capital, as well as the application of modern technology and the influence of institutions. This model reflects the reason why some countries could produce more than other countries. Acemoglu and Robinson (2012) emphasized that economic development is determined by inclusive economic institutions that create an inclusive market and they also illustrate poverty as a result of a failed nation as the result of the elites who chose a politician to maintain power not to increase development. Furthermore, Acemoglu and Robinson noted that low educated workers will result in low skill labour and low quality of production, the failure of a nation is not caused by geographical but it is caused by the failure of economic and political institutions. If Cowen and Tabarrok (2009) emphasized on factor productivity in a macro perspective, Romer (1990), focused on firm productivity in developing countries, he asserted that the major problem in developing countries are caused by two obstacles, lower productivity and lower managerial, lower productivity is strongly correlated with economic growth, on the other hand lower managerial will lead to lower productivity that is caused by lower trust, too many bureaucratic rules and nepotism. In this case, trust is very important, Fukuyama (1995) asserted that economic development only could be achieved if the government program and policy is fully supported by the society. Therefore, multifaceted poverty cannot be separated from institutional economy, since pure economy is no longer applicable to understand economic phenomenon these days, it should be used interlinked studies between various subjects and disciplines.

3. Research Objectives.

3.1 Significance of the Research

The research objectives are summarized below:

- a. To identify causes and effects of poverty in Indonesia

- b. To find out the ineffectiveness and effect of government policy in the scope of Indonesian policy related to international trade and investment.
- c. To find out the gap analysis (vertical and horizontal that are involving Indonesia's Government, Entrepreneurs, Food Cartels and Local Society) framework for comparing different causes food security
- d. To find out a roadmap for implementing of application that is supporting for (data, information, metadata, knowledge and instrumental understanding) to create powerful national logistic tools and electronic information that can be used to reduce poverty, and increase economic growth and development especially in the eastern part of Indonesia
- e. To identify model and of goods, services and food production, distribution and supply in Indonesia, its challenges, problems, and opportunities.
- f. To built up framework model how to reduce poverty and achieve food security and increase goods and services production in Indonesia.
- g. To recommended a roadmap of Indonesia Village Development
- h. To positioning Indonesia competitive advantage in ASEAN, ASIA and Global Economy.

3.2 Research Hypothesis

“Poverty and Inequality has strong correlation with poor public policy and lack of government will on Economic Development and Human Development in Indonesia”

3.3 Research Question

- a. What are the problems, causes, characteristic and challenges of poverty in Indonesia?.
- b. What causes poverty and What poverty causes in Indonesia?
- c. How to measure poverty in Indonesia?
- d. What are the linkage between goods and service production, availability, demand and supply, and food security and poverty in Indonesia?
- e. What and how does the international trade and investment policy of Indonesian government effect the economic development and its linkage between the increase numbers of the poor in Indonesia?
- f. What are the relationship between poverty and inequality, education, gender and human development, violence, and democracy in Indonesia?
- g. How effective is government poverty reduction policies in rural and urban area in Indonesia?

- h. How effective is government economic policy to increase the economic growth and development of Indonesia?
- i. Why do economic development and growth in Indonesia is considered slower compared with BRICs countries and Asian Economic Giants such as China, Japan, and South Korea?
- j. What is the future Indonesia's Economic Outlook?
- k. How effective is ASEAN Economic Community 2015 in shaping Indonesia's Economic Development?

4 Research Methodology

7.1 Selected Research Design

The research design is the cross sectional study. The approach takes the form of building on an empirical study of poverty, food security and significant influence of political entrepreneurship approaches and National Logistic System toward economic development in Indonesia. The study itself will use primary data that is gained from Focus Group Discussion (FGD) and interview with local authorities, Indonesia government and society. And secondary data will be taken from books, journals, Statistic data from Ministry of Agriculture, Ministry of Trade and Ministry of Tax and Ministry of Finance.

7.2 Research Ethics

This research will be conducted by interview and Focus Group Discussion to the candidates, and during the research, the researcher avoids any sensitive case for candidates that are related to cultural, religion and racism.

7.3 Time Scales

This research is expected to take up to 36 months from September 2015 – September 2018 as follows:

- September 2015 – February 2016 – survey of literature & interpretive models
- March – August 2016 - Data collection
- September 2016 – February 2017 – collate and code data. Agree interpretive model
- March – August 2017 – develop & present preliminary findings and analysis
- September 2017 – February 2018 – first draft
- March – September 2018 – final write up.

7.4 Expected Outcome

The outcome of this study is a complete research report that will be given to the supervisor to be viewed and also to be valued and after that it will be given to any scholars who need it as an academic sources and for the government to be used as preferences for their policies construction and review.

7.5 Scope of Limits to the Research

Due to time and budget concern, the research will be divided into two areas of research: western and eastern part of Indonesia. Western part of Indonesia more focused on Jakarta region and from the eastern part will be focused on South Sulawesi and Papua's area. Jakarta as the representative of western part of Indonesia is more developed than eastern part, and the case of poverty case and characteristics also differ, therefore the government policy also differs.

The application of theoretical approaches will be more emphasized on political economic theories, since there are many applicable technics, methods and theory, the writer is limited by the number of words, therefore, it is not possible for the writer to review whole multidiscipline approaches in detail in reviewing and understanding poverty in Indonesia. The study also will focus on the period 1997-2014, between this time, this study will analyse poverty eradication policies, government intervention in international trade including: tariff, quota and import and export restriction, cause and effect of poverty.

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Email: Asmiati.Malik@gmail.com / Asmiati.Malik@bakrie.ac.id