

CHAPTER I

INTRODUCTION

A. Research Background

After the monetary crisis that occurred in 1998, Indonesia has shown remarkable performance in improving its economic condition. This can be seen from the trend of GDP per capita which more than doubled, from US\$ 2,084 in 1998 to US\$ 4,285 in 2018. The World Bank also recorded Indonesia's annual GDP growth is consistent at 5-6% in the past decade. This number is above the world average GDP growth which is at 3% in 2018. Figure 1.1. shows the GDP per Capita of Indonesia from 1998 to 2018.

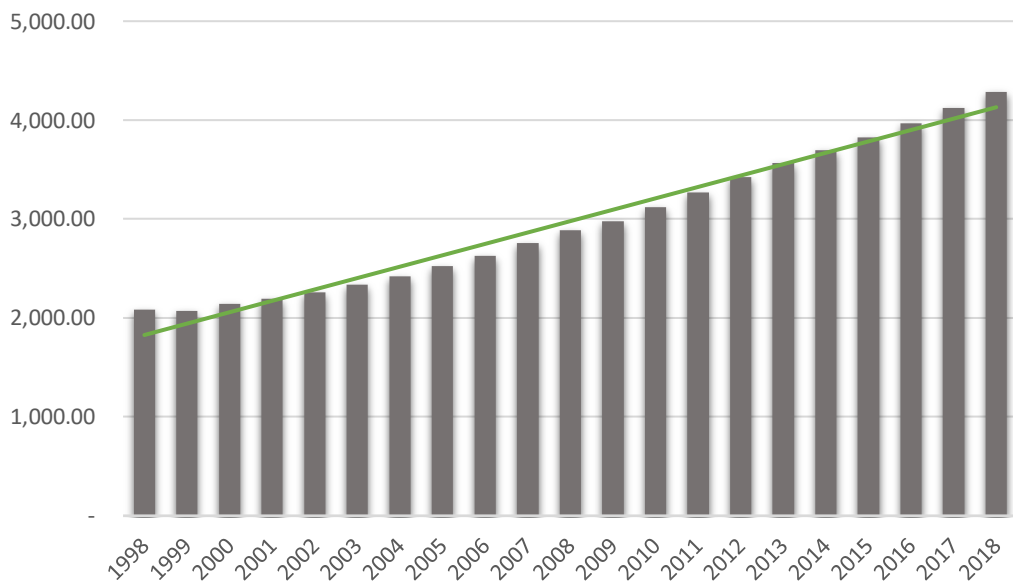


Figure 1.1. GDP per Capita (constant 2010 US\$)
Source: data.worldbank.org

The number of impoverished Indonesians has also decreased with increasing Indonesian GDP per capita. When compared with the conditions in

1998, there were 24.2% of the population of Indonesia's total population living below the poverty line. While data from the Central Bureau of Statistics shows that in 2017, Indonesia has succeeded in eradicating the number of underprivileged people to 10.12%. The figure below shows the decline trend of poverty headcount in Indonesia since 1998.

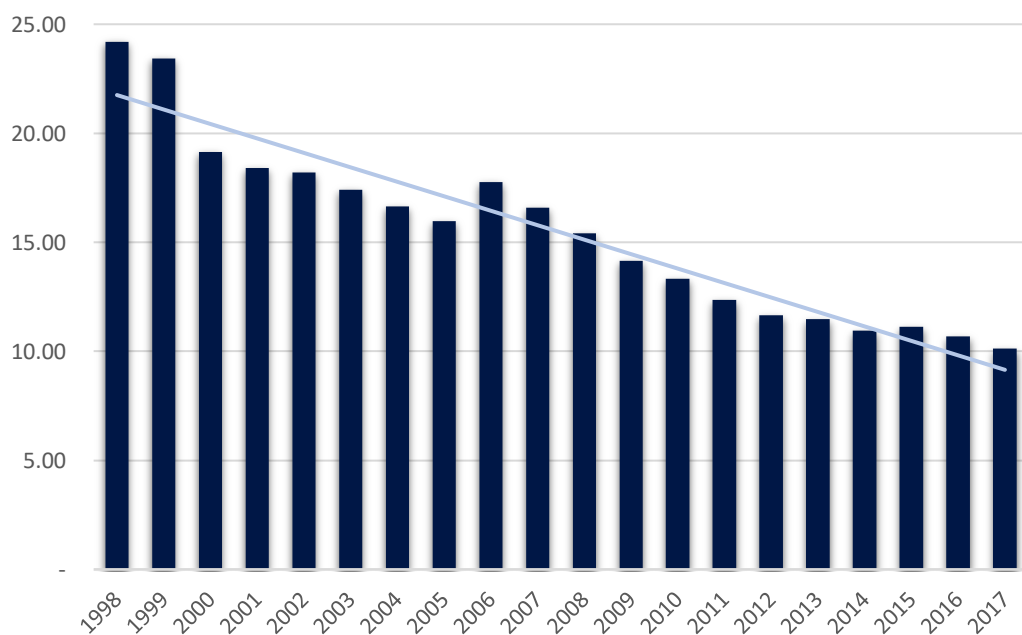


Figure 1.2. Poverty Headcount (% population)
Source: bps.go.id

However, apparently, an increase in GDP per capita and a decrease in poverty have not been able to represent the welfare of the people in this fourth most populous country as a whole. Because, when viewed using other indicators, there is an increasing trend at the level of inequality in this country. In 2017, the gap was at a higher level (0.39) than in 1998 (0.31), even though, the Gini ratio in 2017 has been lower than in 2012 and 2014 which reached 41%.

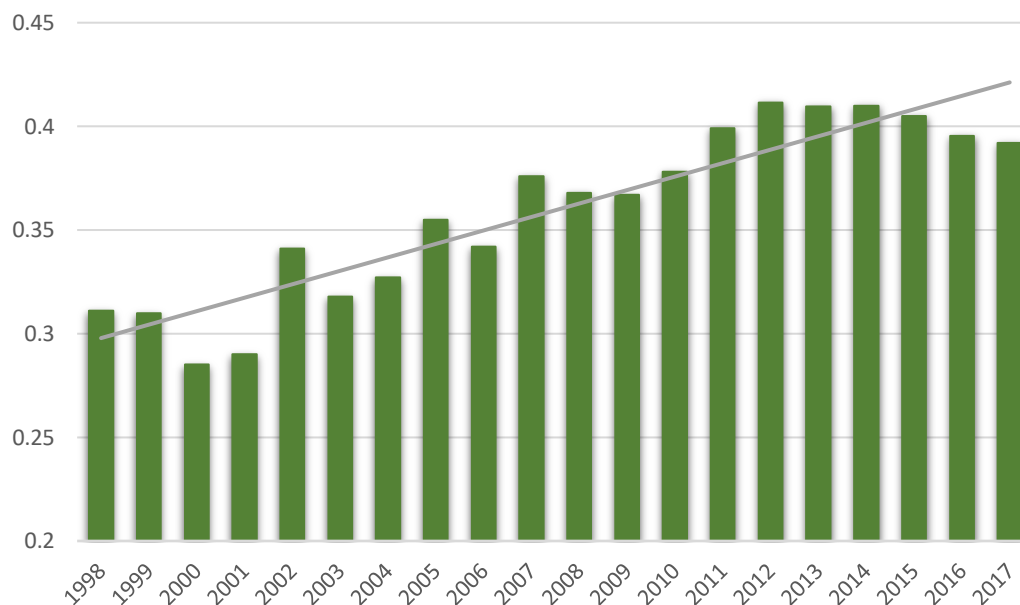


Figure 1.3. Gini Ratio
Source: data.worldbank.org and bps.go.id

The gap that occurs indicates an imbalance in the distribution of income received by the community. There is a significant difference in the proportion of income among societies in several tiers. This income difference can have implications for the level of consumption which of course has an impact on the quality of life of each individual. In 2015, the total consumption of the people in the lowest wealth was only 7% of the total consumption of the Indonesian people. This is very far when compared to consumption from the highest quintile which reaches 49%, almost half of the total consumption of all Indonesian people. The consumption distribution among income groups is shown on the Figure 1.4. on the next page.

The government has seen inequality as a problem that impedes economic growth. The government also targets the decline in the Gini ratio in 2019 to be in the range of 0.385 (Azka, 2018). Since certainly, the increase in

state wealth will not mean if not all people get the opportunity to feel the prosperity.

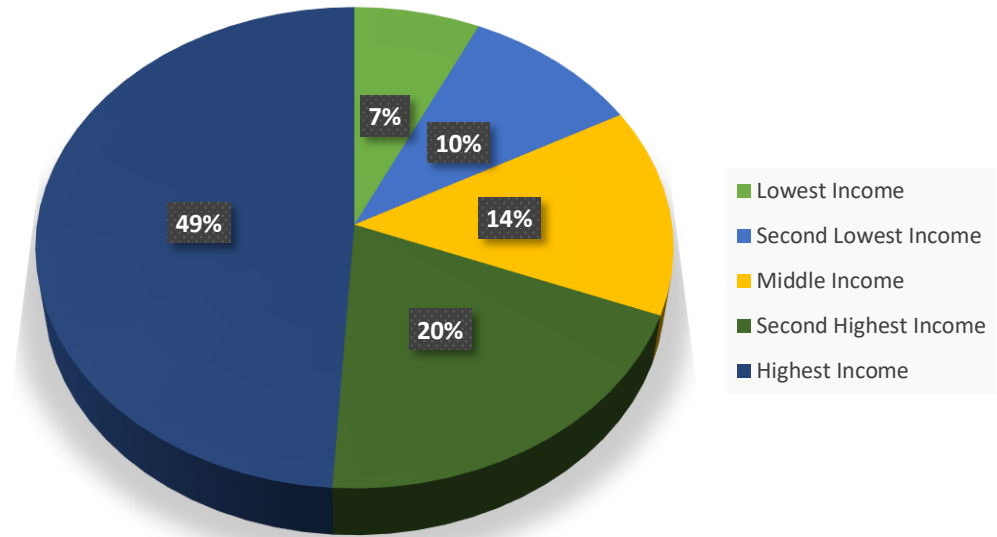


Figure 1.4. Consumption Distribution among Income Groups in Indonesia
Source: World Bank, 2016

Islam juga tidak membiarkan distribusi kekayaan tanpa ketentuan. In Islam, wealth also has a social role. Wealth can make individuals attain a nobler and be more comfortable in life. However its wealth distribution must be spread fairly to each human in society so it can cater for all needs. Quran (59:7) concerns about this.

مَا آفَاءَ اللَّهِ عَلَىٰ رَسُولِهِ مِنْ أَهْلِ الْقُرَىٰ فَلِلَّهِ وَلِلرَّسُولِ وَلِذِي الْقُرْبَىٰ وَالْيَتَامَىٰ
وَالْمَسْكِينِ وَابْنِ السَّبِيلِ كَيْ لَا يَكُونَ دُولَةً بَيْنَ الْأَغْنِيَاءِ مِنْكُمْ وَمَا آتَاكُمُ الرَّسُولُ
فَخُذُوهُ وَمَا نَهَاكُمْ عَنْهُ فَانْتَهُوا وَاتَّقُوا اللَّهَ إِنَّ اللَّهَ شَدِيدُ الْعِقَابِ ﴿٧﴾

“And what Allah restored to His Messenger from the people of the towns - it is for Allah and for the Messenger and for [his] near relatives and orphans and the [stranded] traveller—so that it will not be a perpetual distribution among the rich from among you. And whatever the Messenger has given you - take; and what

he has forbidden you - refrain from. And fear Allah; indeed, Allah is severe in penalty.”

To date, the discussion of inequality is still limited to the static inequality index based on the Gini ratio, where the distribution of income is measured at a certain point in time. Whereas to take appropriate action, a deeper understanding is needed of why such inequality can increase. The World Bank in collaboration with the Government of Indonesia conducts research that investigates the problem of inequality and mentions at least four main factors causing inequality, namely inequality of opportunity, uneven employment, high concentration of wealth, and low economic resilience (World Bank, 2016).

Among the four factors above, in the same study, the World Bank stated that almost one-third of the rapid increase in income inequality originated from inequality of opportunity. Inequality of opportunity can lead to inequality of employment that can produce wealth concentrated at a certain point. E. Black and Devereux (2011) also revealed that the more ideal measurement of inequality of income distribution is equality of opportunity, where children of the poor and children of the rich can have equal opportunities for success. Without equal opportunity, poor children often do not have the opportunity to have a fair start in life, thereby reducing their ability to succeed in the future. Opportunity equality is also justified by Islam.

﴿يَأْتِيهَا الَّذِينَ ءَامَنُوا كُونُوا قَوَّامِينَ بِالْقِسْطِ شُهَدَاءَ لِلَّهِ وَلَوْ عَلَىٰ أَنفُسِكُمْ أَوِ الْوَالِدِينَ وَالْأَقْرَبِينَ ۚ إِن يَكُنْ غَنِيًّا أَوْ فَقِيرًا فَاللَّهُ أَوْلَىٰ بِهِمَا ۗ فَلَا تَتَّبِعُوا الْهَوَىَٰ أَن تَعْدِلُوا ۗ وَإِن تَلَوْا أَوْ تَعْرَضُوا فَإِنَّ اللَّهَ كَانَ بِمَا تَعْمَلُونَ خَبِيرًا ﴿١٣٥﴾﴾

“O you who have believed, be persistently standing firm in justice, witnesses for Allah, even if it be against yourselves or parents and relatives. Whether one is rich or poor, Allah is more worthy of both. So follow not [personal] inclination, lest you not be just. And if you distort [your testimony] or refuse [to give it], then indeed Allah is ever, with what you do, Acquainted.” (Qur'an 4:135)

Practically speaking, the phenomenon of inequality of opportunity in Indonesia has ever happened in Indonesia regarding job searching method where more than 55% of individuals in Indonesia got their first job because of channeled by their friends or relatives (World Bank, 2016). This phenomenon reflects that family background plays a quite high role in getting job for getting income. It makes people who were born from poor family where they do not have any network to prestigious company will be less able to get the opportunity to compete in the same level of labour market.

Then, one indicator of equality of opportunity is the degree of intergenerational mobility as measured by intergenerational elasticity rates. Communities with high intergenerational mobility are likely to offer economic opportunities more evenly (Ueda, 2013). The study of intergenerational mobility in Indonesia is still very limited. Existing studies are still limited to certain community groups or less long timeframes. As research conducted by Pakpahan, Suryadarma, and Suryahadi (2010) who estimated the persistence of intergenerational poverty limited to the poor. Wong (2019) also conducted research related to the intergenerational mobility of people living in the slums of Jakarta only. Research on intergenerational mobility for Indonesia has been carried out (Purbowati, 2018) but with a span of only 14 years (2000-2014).

Therefore, in this study entitled “*Measuring Intergenerational Income Mobility: A Case Study of Indonesia*” the author aims to estimate the intergenerational income elasticity of Indonesia more deeply by adding information on the differences in IGE between men and women, as well as IGE in urban and rural areas. This study will also use data with a longer lag of time, 21 years, from 1993 to 2014. Mobility among community income groups is also identified using transition probabilities to see the possibility of upward and downward mobility that occurs. In addition, this study will discuss the influence of education on IGE to analyse whether education can be a transmission channel to increase opportunities for individuals to succeed.

B. Scope of the Research

This study is limited to intergenerational income elasticity studies as a benchmark for the degree of income mobility of the Indonesian people. This study only uses father and child samples taken from the longitudinal survey data named IFLS. Father’s data is from IFLS year 1993-2000 and children’s data is from 2007-2014. There is an age restriction that is applied to minimize life-cycle bias caused by the father's age which is too old or the children's age which is too young. Other factors analysed were limited to the attainment of the latest education level of the children, which is taken from the IFLS in 2014. This education variable will only be analysed to see its role as a transmission channel that bridges the transmission of permanent income from the father to the child.

C. Research Questions

According to the research background explained, the list of research questions is mentioned below.

1. What is the degree of intergenerational income elasticity (IGE) in Indonesia?
2. How are probabilities for intergenerational income transition in the various income group of Indonesian?
3. How is the effect of education on explaining intergenerational income elasticity in Indonesia?

D. Research Objectives

According to the research questions above, the objectives of this research are on the next page.

1. To estimate the degree of intergenerational income elasticity (IGE) in Indonesia.
2. To find out the probabilities for intergenerational income transition in the various income group of Indonesian.
3. To determine the effect of education on explaining intergenerational income elasticity in Indonesia.

E. Contributions

1. Theoretical Benefits

This research is expected to be one of the references and comparisons for studies related to intergenerational income mobility in Indonesia, which are still relatively uncommon. Hence, it can be useful for

the academicians or all readers to be a knowledge enhancer or for the conduct of further research.

2. Practical Benefits

This research can provide an overview for the government or other institutions, about how a father's income is transmitted to the next generation which is related to economic development issues, such as inequality, and others. The results of this study are appropriate for additional consideration of economic development policies or programs or the similar.