



Looking at the future: a father holds his daughter as he stands on a site where residents have recently been evicted from nearby luxury apartments in North Jakarta. Photo: Tiara Audina/Antropology UI

# TOWARDS A MORE EQUAL INDONESIA

How the government can take action to close the gap between the richest and the rest

In the past two decades, the gap between the richest and the rest in Indonesia has grown faster than in any other country in South-East Asia. The four richest men in Indonesia now have more wealth than the poorest 100 million people. Inequality is slowing down poverty reduction, dampening economic growth and threatening social cohesion. President Jokowi has made fighting inequality his administration's top priority for 2017. He can achieve this by enforcing a living wage for all workers, increasing spending on public services, and making big corporations and rich individuals pay their fair share of tax.

# SUMMARY

Since 2000, economic growth has taken off in Indonesia. There has been a significant increase in the country's score on the UN's Human Development Index (HDI), and the proportion of people living in extreme poverty has fallen from 40 percent to 8 percent. However, the benefits of growth have not been shared equally, and millions have been left behind. If the \$3.10 World Bank 'moderate' poverty line is used, the number of Indonesians living in poverty shoots up to 93 million (36 percent of the population). Many more Indonesians live just above the poverty line, making them vulnerable to falling back into poverty. In the past 20 years the gap between the richest and the rest has risen faster than in any other country in South-East Asia.<sup>1</sup>

Indonesia has the sixth worst inequality of wealth in the world. In 2016, the wealthiest 1 percent of the population owned nearly half (49 percent) of total wealth. The number of billionaires increased from one in 2002 to 20 in 2016. They are all men. In 2016, the collective wealth of the richest four billionaires was \$25bn, more than the total wealth of the bottom 40 percent of the population – about 100 million people. In just one day, the richest Indonesian man can earn from interest on his wealth over one thousand times more than what the poorest Indonesians spend on their basic needs for an entire year.<sup>2</sup> The amount of money earned annually from his wealth would be sufficient to lift more than 20 million Indonesians out of extreme poverty. Urban inequality in particular has been rising, which presents an inequality risk for the future as Indonesia has the highest urbanization growth in Asia. There is also high inequality between rural and urban areas.

The widening of the gap between the rich and the rest is a serious threat to Indonesia's future prosperity. If inequality is not tackled, then reducing poverty will be much more difficult, and social instability could increase. Research also suggests that inequality is hampering economic growth. Conversely, taking action to narrow the gap could lift millions of people out of poverty, lead to a more cohesive society, contribute to sustainable and equitable growth, and help Indonesia to meet its Sustainable Development Goal (SDG) targets.

The drivers of inequality in Indonesia are complex and multi-layered, ranging from structural causes to more specific policy choices. Following a period of relatively equitable growth, market fundamentalism introduced following the financial crisis of 1997 has produced an economy that enables those at the top to capture by far the greatest share of the benefits of growth. This has resulted in an increase in political capture, as those at the top have been able to use the influence that wealth bestows to rig the rules in their favour at the expense of the many. Gender inequality, one of the oldest forms of inequality, is pervasive in Indonesia and acts as both a driver and a consequence of economic inequality.

Low wages and insecure work for those at the bottom further compounds inequality and prevents workers from lifting themselves out of poverty. Unequal access between rural and urban areas to infrastructure such as electricity and good quality roads compounds spatial inequalities. A concentration of land ownership in the hands of big corporations and wealthy individuals means that the benefits of land ownership accrue to those at the top, at the expense of the rest of society.

The taxation system has failed to play its necessary role in redistributing wealth, and is far from reaching its revenue-raising potential to fund inequality-reducing public services. Indonesia's tax collection as a percentage of GDP is the second-lowest in South-East Asia. The IMF has calculated that the country has a potential tax take of 21.5 percent of GDP. If it were to reach this figure it could increase the health budget nine times over. Indonesia's tax base is also the victim of tax dodgers. In 2014 \$100bn flowed from Indonesia into tax havens, equivalent to nearly 10 times the education budget in that year. Tax revenues are needed to fund vital public services to provide equality of opportunity to all. While the government has made strides towards achieving universal health coverage, more funds are needed to remove damaging insurance premiums. Likewise, the education system is underfunded; there are barriers to equal access and it does not provide Indonesians with the skills needed to enter the workforce, meaning that millions of workers are unable to access higher-skilled and higher-paid jobs.

There is a clear public desire for the government to take action to close the gap: 88 percent of Indonesians believe that it is urgent that the government reduces inequality. This has been recognized by President Joko Widodo (Jokowi), who has described levels of inequality as 'dangerous' and made tackling inequality the top priority for his administration in 2017. A new 'Economic Justice' policy package has been launched to tackle inequality, including measures to increase land redistribution, to tax land speculators, improve access to credit for micro, small and medium-sized enterprises, and to increase the skills of Indonesia's workforce. While these measures are welcome, the Indonesian government can and must go further. In particular, it must do more to ensure fair work and wages for the majority of Indonesians and to implement a progressive taxation system that raises more revenues to invest in vital public healthcare and education services.

With political will and the right policy decisions, the government can turn the tide on extreme inequality and ensure a more prosperous and equal future for all Indonesians.

**To close the gap between the rich and the rest, the government should take the following actions.**

### **Inequality**

- Develop a national plan to show clearly how it will tackle inequality and reach its targets to reduce the Gini coefficient, including between urban and rural areas.
- Ensure that local governments commit to reduce inequality.

### **Fair work and wages**

- Set out a roadmap to deliver a living wage, ensure that it is enforced, and further explore the idea of an ASEAN living wage.
- Regulate companies to ensure that more workers are on secure employment contracts.
- Close the gender pay gap and remove barriers to women's equal participation in the labour force. Work with civil society to promote positive social norms and attitudes around women's work.

### **Tax**

- Increase the tax-to-GDP ratio to reach Indonesia's maximum tax potential. This is

estimated to be 21.5 percent by the IMF. Do this by adding a higher-rate tax band at the top of the personal income tax system; launching a review of wealth taxation with the aim of increasing property taxation for the highest value properties; increasing inheritance tax and introducing a net wealth tax; and developing a national action plan to tackle tax avoidance and evasion.

- Refrain from engaging in a ‘race to the bottom’ on corporate taxation by maintaining corporate tax rates, refraining from offering harmful tax incentives, and working at the regional level on tax cooperation with other ASEAN countries.

### **Public spending**

- Building on the strides made towards universal health coverage through the JKN national health insurance scheme, improve equitable access to healthcare by scrapping all premiums for health services and moving to an entirely tax-funded national health system. Double health expenditure to at least 2.2 percent GDP. Work towards increasing this spending to at least 3 percent GDP on health in the coming years.
- Increase education spending to 4 percent of GDP in the short term. Extend compulsory education to 12 years. Conduct a review to assess the continuing barriers to poorer students in accessing secondary education, and launch a three year plan to urgently address these barriers.
- Introduce more and higher-quality vocational training, by using increased tax financing to allocate 10–20 percent of the education budget to vocational training.

### **Gender**

- Systematically analyse proposed policies for their impact on women and girls. Expand current gender budgeting processes and provide support for women’s rights organizations to engage in decision making processes on public spending.
- Commit to initiatives that reduce gender inequality across society, including addressing harmful social norms, supporting women’s leadership and decision making power and ending violence against women and girls.

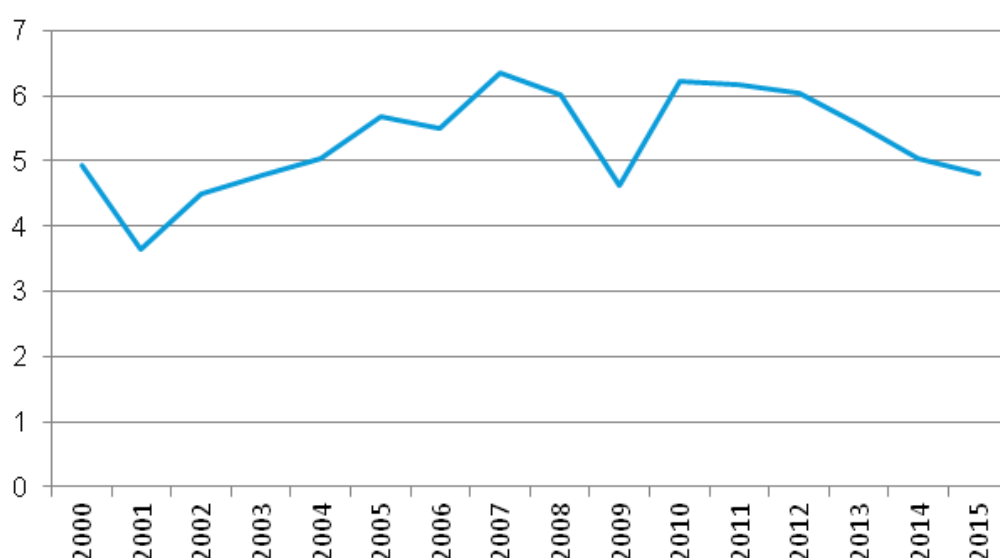
### **The private sector should also play its role in reducing inequality, and businesses should take the following actions:**

- Publish data on their own gender pay gaps;
- Ensure access to decent and safe employment opportunities for women;
- Employ workers on secure employment contracts;
- Support government action towards a national living wage and institute policies to move towards a living wage within their operations;
- Invest in the skills of employees to meet the need for higher-skilled workers;
- Provide on-the-job training, paid apprenticeships and placements, with corresponding professional certification and recognition;
- Engage with local government to ensure that local training centres provide training that matches market requirements.

# 1 EXTREME ECONOMIC INEQUALITY AND ITS IMPACT

Since 2000, economic growth has taken off in Indonesia. There has been impressive growth in gross domestic product (GDP), averaging over 5 percent in the period 2000–16 (Figure 1). Indonesia has been relatively successful in converting this growth into improvements in human development. Despite still being in the medium Human Development Index (HDI) category, and having a lower HDI score than the average for the East Asia and Pacific region, between 2010 and 2014 Indonesia increased its HDI scores and there have been improvements on the health, education and income measures.<sup>3</sup> Furthermore, the proportion of people living in extreme poverty fell from 40 percent in 2000 to 8 percent in 2014.<sup>4</sup>

**Figure 1: Annual GDP growth (%)**

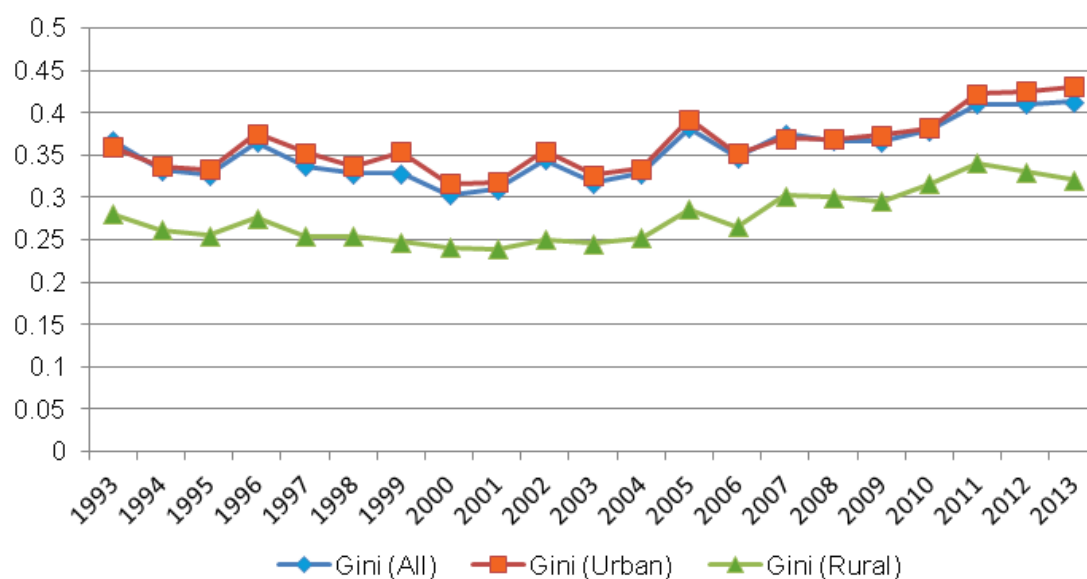


Source: World Bank data.<sup>5</sup>

However, the benefits of growth have not been shared equally, and millions have been left behind, especially women. If the \$3.10 World Bank 'moderate' poverty line is used, the number of Indonesians living in poverty shoots up to 93 million (36 percent of the population).<sup>6</sup> Many more Indonesians live just above the poverty line, making them vulnerable to falling back into poverty. At the same time as the economy has grown, the gap between rich and poor has risen significantly. Both the Gini coefficient and the Palma index for consumption, though underestimating the true scale of inequality,<sup>7</sup> show a marked upward trend over the past 20 years, with inequality in urban areas consistently higher than in rural areas (Figures 2 and 3). In this period, Indonesia's Gini coefficient score rose faster than that of any other country in South-East Asia.<sup>8</sup>

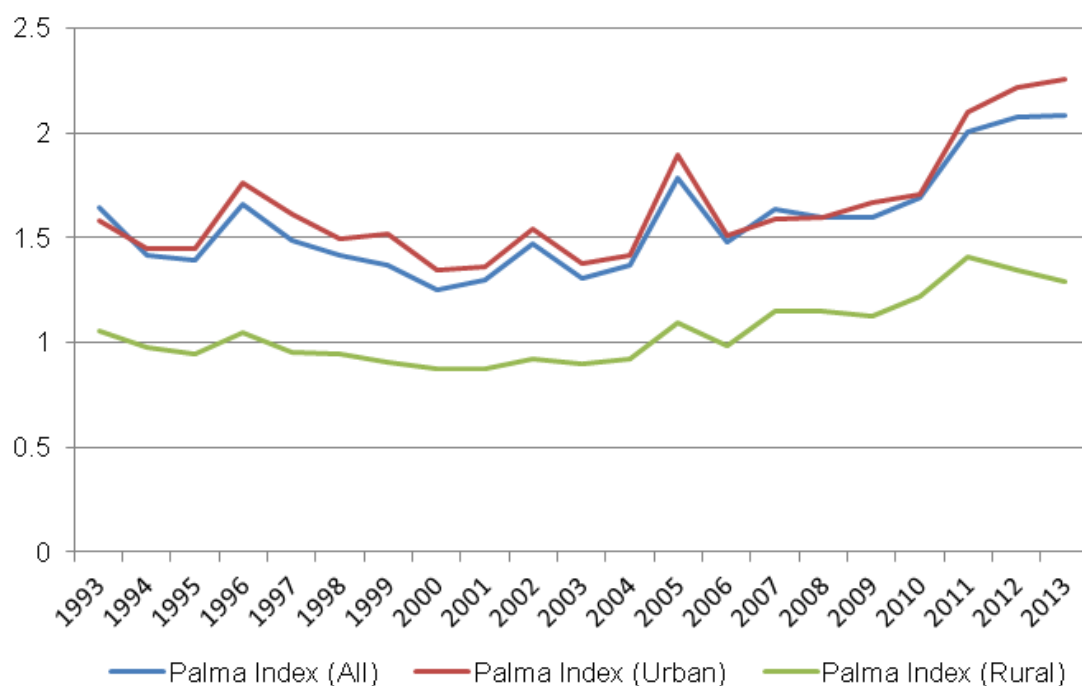
*Over the past 20 years, inequality in Indonesia has risen faster than any other country in South-East Asia*

**Figure 2: Gini coefficient of urban and rural areas in Indonesia (%)**



Source: A.A. Yusuf, Center for Economics and Development Studies.<sup>9</sup>

**Figure 3: Palma index of urban and rural areas in Indonesia (%)**

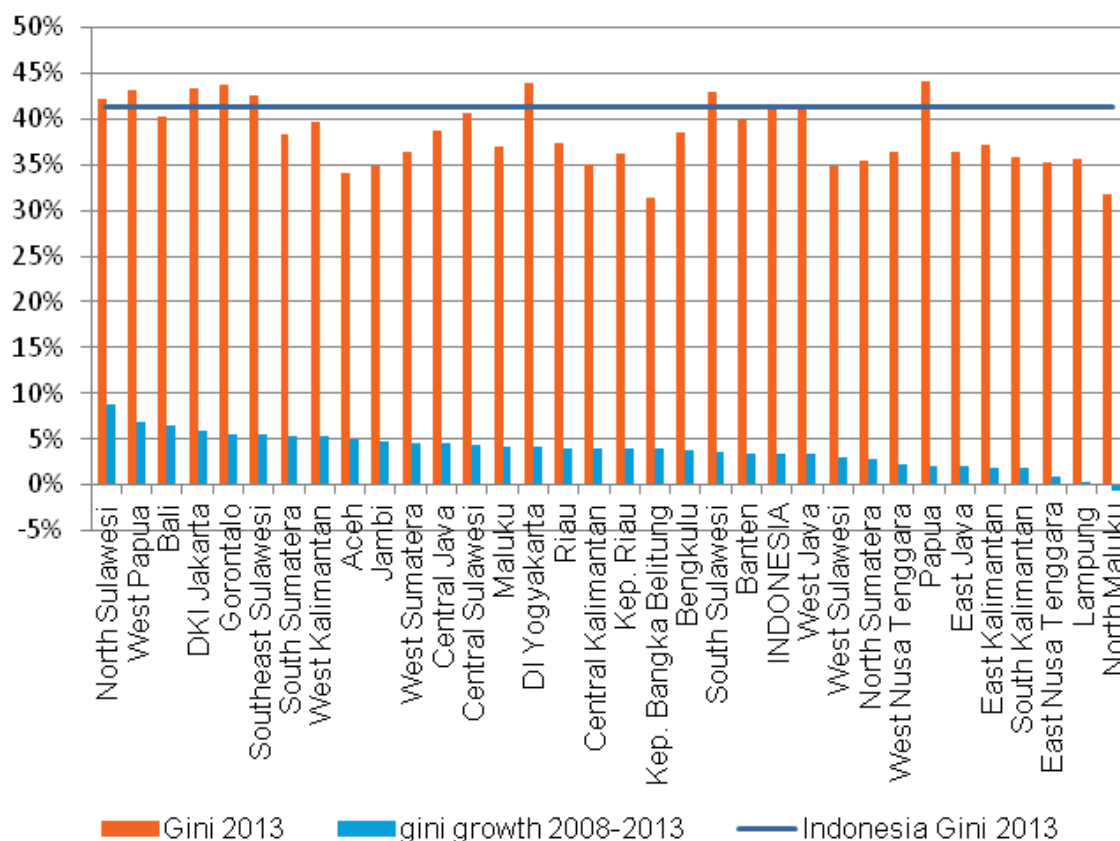


Source: A.A. Yusuf, Center for Economics and Development Studies.<sup>10</sup>

At the sub-national level, income inequality has been getting worse in nearly all of Indonesia's provinces, demonstrating that – despite inequality being higher in urban areas – rising inequality affects the entire country (Figure 4). The Gini coefficient increased in 33 of Indonesia's 34 provinces between 2008 and 2013, with North Sulawesi having the biggest Gini growth at 9 percent. North Maluku was the only province where the Gini measure decreased, albeit by just 1 percent. Urban inequality in Indonesia in particular has been rising, where there are now more people than in rural centres. The richest 10 percent of people in urban centres have more than one-third of total income.<sup>11</sup> This presents an inequality risk for the future, as Indonesia has the highest urbanization growth rate in Asia.<sup>12</sup>



**Figure 4: Gini coefficient for Indonesian provinces, 2013**



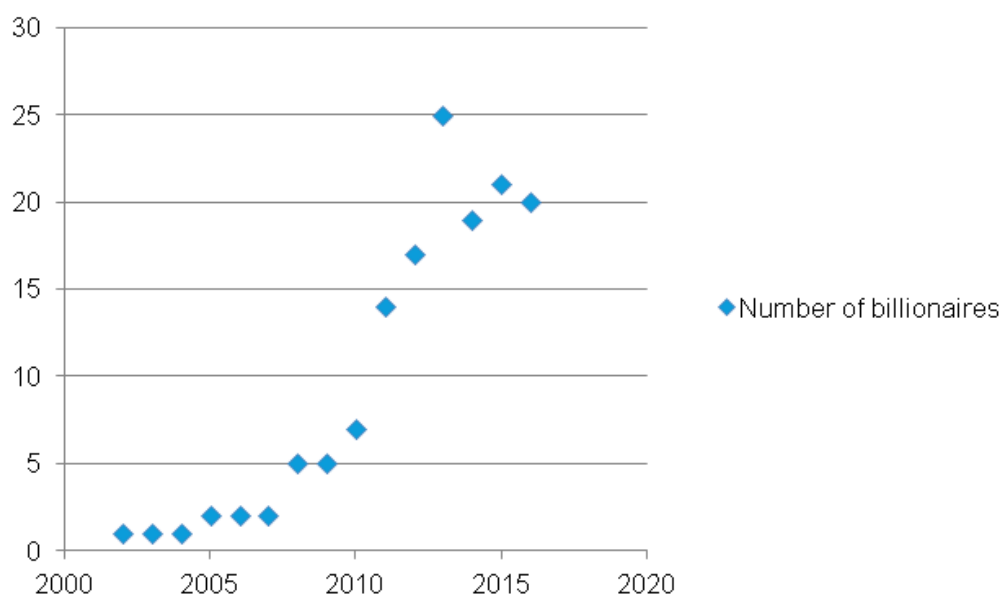
Source: Central Bureau of Statistics consumption data, processed by the author.

Despite a trend of increasing income inequality over the last two decades, there have been recent signs of a turnaround. The Gini coefficient for Indonesia declined by 0.02 points to 0.39 between March 2015 and March 2016, having remained stable at 0.41 for the previous five years.<sup>13</sup> This small reduction has been attributed to many factors, including rising earnings among the middle-income segment and a slight decline in the earnings of the top income segment due to low commodity prices.<sup>14</sup> Furthermore, recent data shows that Indonesia's Gini ratio decreased slightly from 0.397 points in March 2016 to 0.394 points in September 2016. This decline was evident in both urban and rural areas and has been attributed to government spending, among other factors<sup>15</sup>. While this initial indicator of a turnaround in income inequality is welcome, it comes after decades of increases. It is too soon to see if this is indicative of a longer term trend, and inequality remains worryingly high.

The picture of wealth inequality is even starker than that of income. This is in line with the picture globally: an Oxfam report published in January 2017 showed that the 8 richest people on earth now have as much wealth as half of the world's population.<sup>16</sup> In Indonesia the past 15 years have seen a clear concentration of wealth at the top, with the ultra-rich achieving their privileged status either by drawing from the country's economic resources and commodities, such as oil palm, coal and other minerals, or through multimedia, communications technology and finance businesses. The number of billionaires in Indonesia has grown rapidly, from just one in 2002 to 20 in 2016 (Figure 5). All of the 20 Indonesian billionaires listed in the Forbes billionaires list are men, and they have combined wealth of approximately US\$49.8bn. While there is an embarrassment of riches at the top, 84 percent of the population possess less than \$10,000 in wealth.<sup>17</sup>

*The number of billionaires in Indonesia has grown rapidly from one in 2000 to 20 in 2016*

**Figure 5: Number of billionaires in Indonesia**



Source: Forbes (2016) *The World's Billionaires*.

Further evidence demonstrates the staggering scale of wealth inequality. Of the countries where national-level data on the wealth distribution is available, Indonesia is the sixth most unequal country in the world, based on the Gini measure for wealth distribution. It is only surpassed in the region by Thailand (Table 1). Credit Suisse data indicates that in 2016 the wealthiest 1 percent of the population owned nearly half (49 percent) of total wealth, while the top 10 percent held 77 percent of all wealth.<sup>18</sup> The four richest billionaires in Indonesia have more wealth (\$25bn) than that poorest 40 percent of Indonesians combined (\$24bn) – 100 million people.<sup>19</sup> The poorest 40 percent of Indonesians share between them just 1.4 percent of the country's wealth.<sup>20</sup> At the top, it would take the richest Indonesian man 22 years to spend all of his wealth at \$1m per day.<sup>21</sup> In just one day, the richest Indonesian man can earn from interest on his wealth over one thousand times more than what the poorest Indonesians spend on their basic needs for an entire year.<sup>22</sup> The amount of money earned annually from his wealth alone would be sufficient to lift more than 20 million Indonesians out of extreme poverty, thus eradicating extreme poverty in the country.<sup>23</sup>

*The four richest billionaires in Indonesia have more wealth than the poorest 100 million people*

*The amount of money that the richest Indonesian earns annually from his wealth would be sufficient to more than 20 million Indonesians out of extreme poverty*

**Table 1: Countries with the highest levels of wealth inequality**

Country	Wealth Gini %	Rank
Russia	92.3	1
Denmark	89.3	2
India	87.6	3
United States	86.2	4
Thailand	85.9	5
Indonesia	84	6

*Indonesia is the sixth most unequal country in the world*

Source: Credit Suisse Global Wealth Databook (2016); compiled by the author. Out of a sample of 46 countries where data is classified 'fair', 'satisfactory' or 'good'.

Inequality is not a question solely of income and wealth (outcomes). It also concerns inequality of opportunity, such as unequal access to health and education services. Both are mutually reinforcing, with unequal opportunities leading to unequal outcomes, and outcomes affecting opportunities for both current and future generations. This report demonstrates how both inequalities are interrelated.



Ultimately though, inequality is about power.<sup>24</sup> Economic inequality leads to inequality of power in who decides the rules, who controls capital and resources, and who can challenge the status quo. This imbalance of power is also evident in other inequalities such as gender. Indonesia is ranked 88 out of 144 countries in the World Economic Forum's Gender Gap Index, and does even worse on gender equality in economic participation and opportunity (107 out of 144).<sup>25</sup> A high degree of spatial inequality is also evident between urban and rural areas and between the east and west of the country, with poverty rates higher in rural areas,<sup>26</sup> indicating wide inequalities between regions. The focus of this report is on economic inequality, which has grown rapidly and in turn impacts on other inequalities, making each harder to resolve.

*88% of Indonesians believe that it's urgent for the government to reduce inequality*

There is clear public concern about the scale of the gap between the rich and the rest. Some 92 percent of Indonesians believe that the country is either quite unequal or not equal at all, and 88 percent think that it is either urgent or very urgent for the government to reduce inequality.<sup>27</sup> The need to tackle this issue has been recognized by President Joko Widodo (Jokowi), who has described the levels of inequality in the country as 'dangerous' and has stated that 'economic growth is very important for my administration, for my people, but it's more important to narrow the gap'.<sup>28</sup> As legislative assembly speaker Zulkifli Hasan said: 'It's not the far right or far left that are dangerous here. Our main enemy is inequality'.<sup>29</sup>

*'It's not the far right or far left that are dangerous here. Our main enemy is inequality'*

Zulkifli Hasan, Legislative Assembly Speaker

What does the gap between the rich and the rest mean for Indonesia?



Working tirelessly: an elderly scavenger rests on a sidewalk as others rush through the traffic in the capital city of Jakarta. Photo: Tiara Audina/ Anthropology UI.

## MILLIONS ARE KEPT IN POVERTY

Most importantly, inequality prevents the benefits of Indonesia's impressive economic growth from reaching the poorest and the most vulnerable. Economic growth since 2000 has helped lift millions out of poverty, with the proportion of people living in extreme poverty falling from 40 percent in 2000 to 8 percent in 2014.<sup>30</sup> However, the most recent World Bank poverty

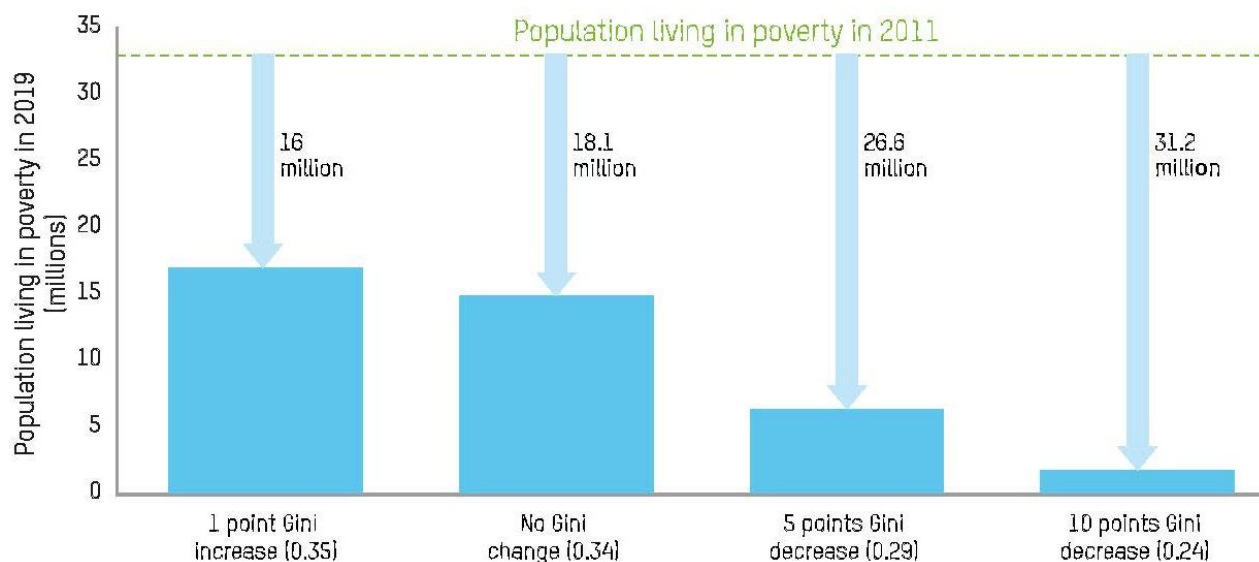
data shows that more than 20 million people continue to live below the extreme poverty line of \$1.90/day.<sup>31</sup> If the \$3.10 World Bank 'moderate' poverty line is used, the number of Indonesians living in poverty shoots up to 93 million (36 percent of the population).<sup>32</sup> Furthermore, many more Indonesians live just above the poverty line, making them vulnerable to falling back into poverty. Fifty-five percent of households classified as poor by the Asian Development Bank in 2014 were not poor a year earlier,<sup>33</sup> showing the high risk of falling back into poverty.

There is a general consensus that increased inequality reduces the rate of poverty reduction. If growth benefits the rich more than the poor, then poverty reduction is slowed.<sup>34</sup> Incidence analysis shows that since 2010 the richest 10 percent in Indonesia have consistently captured over a quarter of all consumption, while the poorest 10 percent have captured less than 4 percent of total consumption. This is true in both rural and urban areas.<sup>35</sup> Evidence from the World Bank suggests that the unequal sharing of the proceeds of growth between 2003 and 2010 in Indonesia led to a slowdown in the pace of poverty reduction, and during this period the number of Indonesians vulnerable to poverty barely fell at all.<sup>36</sup> Moreover, despite the country's rapid economic growth, poverty reduction slowed to a near standstill in 2014.<sup>37</sup>

*Since 2010, the richest 10% in Indonesia have consistently captured over a quarter of all consumption, while the poorest 10% have captured less than one-twentieth*

The growing numbers of millionaires and billionaires, when set against a backdrop of staggering poverty, confirms that it is the rich who are capturing the lion's share of the benefits of the country's much-vaunted economic performance, while millions of people at the bottom are being left behind. Inequality is undermining the potential of growth to lift people out of poverty. In 2014 Oxfam calculated that if Indonesia reduced its Gini coefficient by just 10 points between 2011 and 2019, it could reduce the number of people living in extreme poverty to just 1.7 million. However, if inequality remained at recent levels, there would be 13 million more Indonesians living below the extreme poverty line by 2019.<sup>38</sup> If inequality stayed the same, poverty would fall at a much slower rate.

**Figure 6: Poverty projections 2011–19, Oxfam analysis**



Source: Oxfam (2014). *Even It Up: Time to End Extreme Inequality*.<sup>39</sup> Projections assume economic growth continuing at the same level.

## ECONOMIC GROWTH IS STUNTED

There is now a growing consensus that rising inequality undermines economic growth. In 2014 research by the International Monetary Fund (IMF) concluded that high levels of inequality slow growth;<sup>40</sup> this was consistent with findings by the OECD which showed that reducing inequality leads to an increase in growth over the medium term.<sup>41</sup> The World Bank has warned that rising inequality risks causing a long-term slowdown in growth in Indonesia.<sup>42</sup> Research by the SMERU Research Institute has also found that inequality matters for economic growth in Indonesia. A 2015 study reveals that while lower levels of inequality may not initially be harmful, after a certain threshold is reached inequality has an adverse impact on growth.<sup>43</sup> The research also found that economic inequality is often closely related to other forms of inequality, such as in access to quality education and healthcare. These dimensions of inequality in turn have significant detrimental effects on economic growth, and even on political and social stability.<sup>44</sup>

Inequality not only reduces economic growth, it also affects its sustainability. High levels of poverty resulting from inequality mean that a substantial part of the population is not able to buy goods or pay for services – economic activities that drive and sustain economic growth and development. Additionally, many poor families are unable to send their children to school or afford basic health services, which are essential for improving the skills and productivity of the workforce and for driving growth.

## SOCIAL COHESION IS UNDERMINED

Inequality runs against the grain of Indonesian political culture. President Jokowi, on stating that inequality would be his government's priority for 2017, reminded his audience of the fifth key principle of Indonesian political philosophy: that 'social justice should be for all citizens, not just a few'.<sup>45</sup> In other words, there is a tradition in Indonesia that everyone should be able to access the same opportunities.

Recently, more attention has been given to the link between inequality and conflict. A study looking at the relationship between economic inequality and routine violence, ethnic violence and violent crime in Indonesia found a positive correlation between inequality and the number of incidents of routine violence. It also found that a higher gap between the rich and the rest correlates with an increase in violent crime.<sup>46</sup> Another study found that districts with above-average levels of inequality have rates of conflict 1.6 times higher than districts with lower levels of inequality.<sup>47</sup> Some studies also observe that various other inequalities are linked to violent conflict. For example, districts with larger child mortality differentials between groups tend to be those where deadly conflict occurs.<sup>48</sup>

*Districts with high inequality have rates of conflict 1.6 times greater than those with lower inequality*

The growing number of ultra-rich people set against a backdrop of pervasive poverty threatens social cohesion. The power imbalances that come with a wide gap between the rich and the rest risk reinforcing inequality further, as those at the top have privileged access to and influence over decision making processes to make the economy and policies work in their interest, while the interests of those at the bottom are less likely to receive a hearing. This in turn leads to social instability as politics and the economy work in favour of the few, rather than the many.

## 2 WHAT HAS CAUSED THE RISE OF INEQUALITY IN INDONESIA?

### MARKET FUNDAMENTALISM

Over the last 300 years, the market economy has brought prosperity to hundreds of millions of people across South-East Asia.<sup>49</sup> However, as economist Thomas Piketty demonstrated in his book *Capital in the Twenty-First Century*, without government intervention a market economy tends to concentrate wealth in the hands of a small minority, causing inequality to rise.<sup>50</sup> There is now a growing consensus that ‘trickle-down’ economics, whereby wealth at the top supposedly ‘trickles-down’ to those at the bottom without government intervention, is a myth.<sup>51</sup>

Prior to the Asian financial crisis of 1997, Indonesia had a history of broadly equitable growth. Investment in basic health and education was instrumental in sustaining economic growth and converting growth into poverty reduction.<sup>52</sup> This was financed through tax revenues, and between 1990 and 1995 Indonesia had the second highest tax-to-GDP ratio in the region,<sup>53</sup> a sharp contrast with the picture today (see Figure 9). During the peak of the ‘East Asian miracle’, Indonesia had the highest share of income going to the poorest 10 percent, and the lowest share going to the top 10 percent in the region,<sup>54</sup> and every percentage point of growth reduced the number of people living below the poverty line by around 3 percent.<sup>55</sup> During the period, the economies of countries in Latin America had to grow at up to five times the rate of those in East Asia to achieve the same rate of poverty reduction.<sup>56</sup> While there was a darker side to the ‘East Asian miracle’, with restrictions on basic human and political rights, the mismanagement of natural resources and growing regional inequalities that persist today,<sup>57</sup> economic growth was combined with a high degree of equity in the distribution of income.

*At the peak of Indonesia’s equitable growth, every percentage point of growth reduced the number of people living below the poverty line by 3%*

However, this period of broadly inclusive growth ended with the onset of the financial crisis of 1997 and the resulting Structural Adjustment Program (SAP) measures imposed by the IMF and the World Bank. What followed was a period of exclusive growth, which saw the rich reaping the bulk of the economic rewards, while those at the bottom saw their incomes rise and services improve much more slowly. The adjustment packages included large-scale privatization of public services, the abolition of subsidies for many essential commodities, the removal of effective protection for rice and sugar cultivation, and enforced flexibility in the labour market.<sup>58</sup> After a brief fall in inequality – as the asset-rich at the top were hit by the financial crash – from the turn of the twenty-first century inequality began to rise as the effects of structural adjustment on the economy took hold. The effects of low taxation, low spending, and labour market liberalization on inequality are discussed in later sections.

Many of the richest people in Indonesia made their fortunes thanks to the exclusive government concessions and privatization that came with market fundamentalism. When public assets are privatized, their new owners can sell a more expensive product or service back to the state that sold off the business in the first place. For example, following privatization, the price of water in Jakarta increased from about \$0.13 to \$0.54 per cubic metre – 2.7 times the rate charged by the public water utility company in Surabaya, the country’s second largest city.<sup>59</sup>



Financial liberalization made more finance available to companies to expand commodities production, and those with investments in companies reaped the rewards. The palm oil sector is a good example. About US\$ 12.5bn was invested in oil palm expansion in the period between 2000 and 2008.<sup>60</sup> The ten largest palm oil companies were financed on average 59 percent by equity, and 41 percent through debt,<sup>61</sup> and those with investments reaped the rewards. Most of the ten richest men in Indonesia have palm oil in their portfolios.<sup>62</sup>

A strong exchange rate caused by high commodity prices harmed manufacturing, which contributed to premature deindustrialization. The broad-based nature of manufacturing growth, which benefitted the majority in the period running up to the Asian crisis, has been replaced by growth based on the export of commodities, where a larger proportion of the benefits accrue to a minority, and inequality increases.

## POLITICAL CAPTURE

A key driver of inequality globally is political capture, whereby elites rig the rules of the game in their favour. Economic inequality increases political inequality, as elites can use their heightened political influence to further entrench their advantages, while blocking policies that strengthen the rights of others.<sup>63</sup> For example, command by a narrow group of influential individuals over most of the key strategic sectors for growth provides them with control over large parts of the economy, enabling them to boycott policies and stall the economy in instances where such policies are not perceived to be beneficial to their interests. The concentration of wealth at the top in emerging economies also opens up opportunities for rent seeking (extracting wealth without creating new wealth).<sup>64</sup>

Indeed, in Indonesia wealth can buy political influence, and the country has a long history of elites using their wealth either to support political campaigns or to enter the political fray themselves.<sup>65</sup> This influence enables elites to generate further wealth for themselves, and this further increases inequality. It was under Suharto – Indonesia’s former president – that the country’s modern oligarchs first emerged,<sup>66</sup> and his reign is littered with examples of close friends and family obtaining preferential access to loans, concessions, import licences and state bail-outs.<sup>67</sup> The commodity boom in recent years opened up new opportunities for rent-seeking.<sup>68</sup> An empirical study of 100 countries by economist Branko Milanovic showed how rich elites have a vested interest in increasing inequality, as they are likely to receive higher income gains from a more unequal economy than when growth is more evenly distributed.<sup>69</sup>

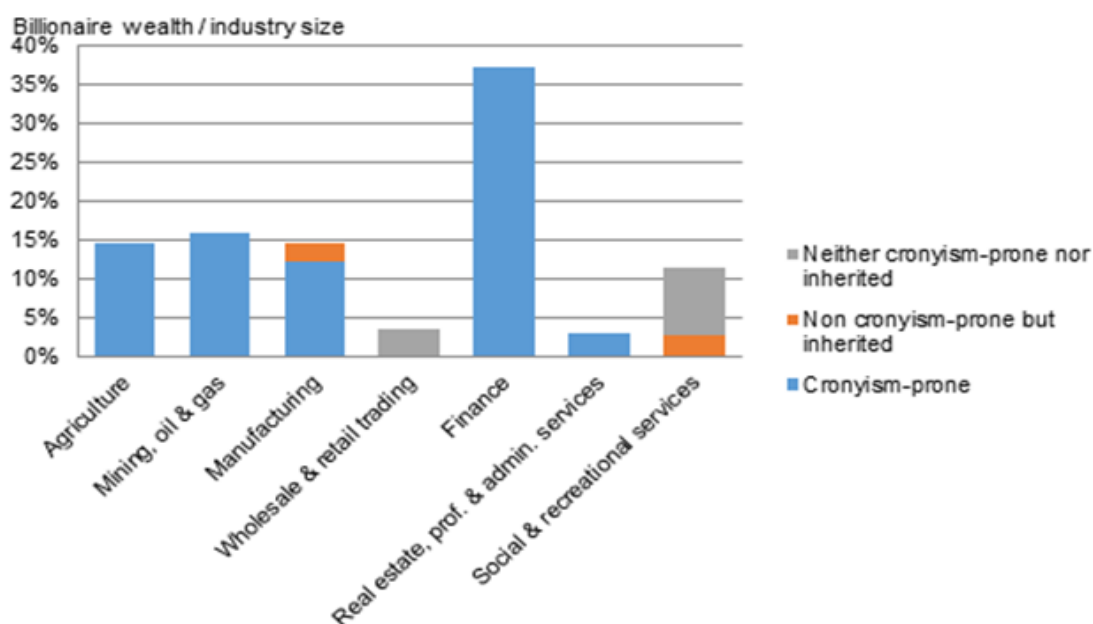
The structure of political financing systems can help to either reinforce or reduce political capture. Indonesia’s political financing rules in this respect are mixed. Officially, there is transparency in the financing of election campaigns as funding has to be reported by candidates and political parties. The identity of donors also has to be revealed and there is a ban on anonymous donations to political parties. However, there is no ban on donations from corporations to candidates or parties, and specifically there is no ban on donations from corporations with government contracts. Furthermore, there are no limits on how much a political party can spend or on how much a donor can contribute to a candidate, which opens up opportunities for elites to wield undue influence over the political process.<sup>70</sup>

Looking at how Indonesia’s billionaires generate their wealth provides an insight into the scale of political capture. Figure 7 shows which industries are generating the most billionaire wealth, relative to their size in the economy. The finance industry generates the most by far. Agriculture and mining also account for a significant proportion of billionaire wealth, which is to be expected since they represent a large share of the economy. Importantly, the figure

shows that the vast majority of billionaire wealth has been generated in industries identified by *The Economist* magazine's cronyism index<sup>71</sup> as being prone to cronyism, because their profitability depends to a significant extent on government intervention (e.g. in the form of regulation, procurement and subsidies). A significant share of the billionaire wealth that comes from other industries is inherited. Very little billionaire wealth in Indonesia is self-made in competitive industries. While the index indicates only which industries are *prone* to cronyism, and so it cannot be concluded that the majority of billionaire wealth has been generated as a result of cronyism, the findings do suggest that political capture has played a role in creating many of Indonesia's modern billionaires, and has thus fuelled inequality.

*The majority of Indonesia's billionaire wealth was generated in industries prone to cronyism*

**Figure 7: Origins of billionaire wealth in Indonesia, relative to sector's size in the economy (2014)**



Source: Forbes (2016), author's analysis<sup>72</sup>

## GENDER INEQUALITY

Gender inequality is the oldest and most pervasive form of inequality, and it continues to shape societies, cultures and economies to deny women their rights. Economic and gender inequality are closely linked and mutually reinforcing: the IMF has found gender inequality and income inequality to be closely correlated, in particular where women have less access to their rights over health and education services.<sup>73</sup>

Indonesia is ranked 88 on the World Economic Forum's Gender Gap Index,<sup>75</sup> behind its ASEAN neighbours such as the Philippines (7), Laos (43) and Thailand (71), and is given a 'medium' score on the OECD's Social Institutions and Gender Index.<sup>76</sup> Inequality of power between women and men – from the household to the macroeconomic level – means that women are less likely to have decision making power or influence over their own lives, and more broadly over how resources are allocated in society. In Indonesia women occupy only one in five parliamentary positions. Of the 50 richest people in the country, only one is a woman, and just 5–10 percent of high-level management positions are occupied by women.<sup>77</sup> At the other end of the scale, the work that women do is systematically undervalued or uncounted, meaning that women are concentrated in the lowest-paid roles and are more vulnerable to poverty.<sup>78</sup> Women's concentration in precarious informal work is discussed later. Indonesia has a gender pay gap of 14.5 percent, meaning that on average women earn 14.5 percent less than men.<sup>79</sup>

*Indonesia is ranked 88 on the WEF's Gender Gap Index, behind the Philippines, Laos and Thailand*

*Of the 50 richest people only one is a woman, and just 5–10 percent of high-level management positions are occupied by women.<sup>74</sup>*



The Indonesian government has shown strong political commitment to tackle gender inequality through multiple initiatives, including adopting the Law on Domestic Violence in 2004, the Victim Protection Law in 2006 and the Law on Anti-Trafficking in 2007. The government has also initiated a gender budgeting process – a strong first step to enabling accountability of government spending to meet gender equality goals.<sup>80</sup> This process ensures that there is greater accountability for budgeting decisions and enables women's voices to be heard, leading to increased prioritization of policies that tackle gender inequality.

However, there is still a lot of room for improvement to ensure enforcement of these laws and to repeal laws that discriminate against women. For instance, although laws against domestic violence and sexual harassment at work do exist, violence against women is still prevalent.<sup>81</sup> Furthermore, according to the National Commission on Violence Against Women, in 2015 alone, national and local governments passed 31 gender discriminatory regulations.<sup>82</sup> Indonesia currently has 322 discriminatory local regulations targeting women, ranging from compulsory wearing of the hijab, to the tolerance of polygamy.<sup>83</sup> With regards to women's legal rights in the economy, legislation on equal pay for equal value is not in place and neither is non-discrimination on the basis of gender when hiring.<sup>84</sup> Women activists and the gender equality campaigners Oxfam works with single out the 1974 Marriage Law as a key driver of gender inequality in Indonesia. The law identifies the man as the head of a household and the woman as the 'mother' of the household; it legalizes polygamy, and sets the legal marrying age for girls at just 16. In this way, it limits women's access to their rights, provides a justification for lower wages for women workers – as they are not considered as the head of the family – and hinders women from accessing finance and credit from formal financial institutions without permission from their husbands or fathers.



The women's economic group of Pangkep District, South Sulawesi. Through the RCL project the women have increased their participation in their village's economy and decision making. Photo; Dini Widiastuti/Oxfam

### Box 1: Promoting gender equality through women's participation in village decision making processes

Encouraging women's participation in decision making to reduce gender inequality is a key part of many of Oxfam's interventions. One example is the Restoring Coastal Livelihoods (RCL) project, which was implemented in four districts in South Sulawesi in 2000–15. Through the RCL, Oxfam supported the establishment and development of 74 women's economic groups and the participation of women in village decision making processes. Through training and engagement with community members, Oxfam also promoted discussion of sensitive gender issues. As a result, 1,208 women gained better knowledge and skills in economic development and coastal management and improved their understanding of power relations within the household and the community. Community representatives in 34 villages have been trained on gender issues, resulting in the adoption of gender-sensitive village development plans (RPJMD).

Previously, women in the targeted districts had only a minor role in village development planning discussions. Mr. Muh Yunus, chairman of the village development agency for Nisombalia village, said: 'In the past, villagers were reluctant to attend the village development planning meeting (*Musrenbang*). They felt that sometimes their aspirations were not realized when they were not in accordance with the vision and mission of the Regent [the head of the local government]. So the community lost interest in joining in. But now, after the process and the importance of community members participating in the *Musrenbang* have been explained to them, many people participate, and debates often occur in village meetings and in workshops, as well as in the *Musrenbang*.'

Today the participation of women is high. 'Before the assistance from Oxfam on RPJMD, the participation of women was nil but now, thank God, the participation of women has increased, and the ratio of women to men is 50:50,' said Mrs. Husnah, an active participant in her community meetings and a member of the Pa'jala Tupa'biring economic group.

With women participating in these decision making processes, their aspirations are now being reflected in village development plans. As Mrs. Husnah explained: 'Previously, proposals in the RPJMD were often focused on physical development, but now we can propose many things, such as conducting training to increase women's skills, for example in seafood processing, classes for the illiterate, proposals on women and children's health, and much more.'

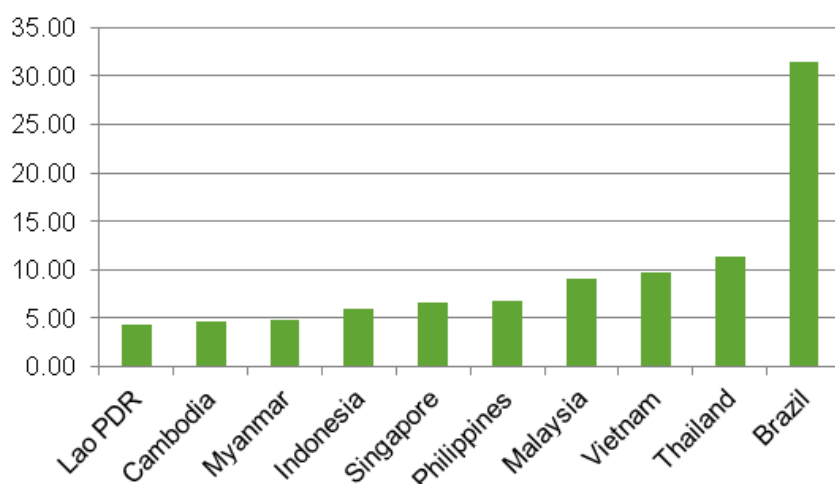
Source: Adapted from *Sipadecengi – Mutually Build, Mutually Maintain (Best Lessons in Restoring Coastal Livelihood Program of Oxfam in Indonesia)*, August 2015, p.65.

## UNEQUAL ACCESS TO QUALITY HEALTHCARE AND EDUCATION

Universal access to free quality public health and education services is a key driver of equality of opportunity and is vital to achieving the Sustainable Development Goals (SDGs) agreed in 2015.<sup>85</sup> As President Jokowi himself has stated: 'All citizens should have the same opportunities without exception'.<sup>86</sup> Oxfam's 2014 paper *Working for the Many* outlines how public services put 'virtual income' (the income that people would otherwise have paid out-of-pocket) into the hands of poor people, especially girls and women, and therefore contribute to reducing social, economic and gender inequality.<sup>87</sup> Furthermore, access to free quality education is a basis for shaping citizens who are informed and can demand accountability and change.

However, in Indonesia total social spending as a percentage of GDP is lower than many other countries in the region, including Malaysia, Vietnam and Thailand, and less than a fifth of social spending in Brazil, which has a comparable economy (Figure 8). A lack of funds prevents public health and education services in Indonesia from playing their full role in tackling inequality.

**Figure 8: Social spending as a percentage of GDP in South-East Asia and Brazil**



Source: Oxfam, Commitment to Reducing Inequality Index (forthcoming, 2017); using most recently available authenticated data; education, health and social protection spending as a % of GDP combined.

Equity in access to, and quality of, education is still a significant concern. Increased investment by the Government of Indonesia in education has led to almost universal enrolment in primary education. However, only 55 percent of children from poor families are enrolled in secondary school.<sup>88</sup> The range of skills that should be acquired from both formal and informal educational institutions is far from optimal, which makes it hard for young people to gain employment. A 2016 survey ranked Indonesia the lowest of 34 OECD member countries and partners in terms of adult literacy and skills.<sup>89</sup> In a 2014 survey conducted by the International NGO Forum on Indonesian Development (INFID), members of the public cited inequality in educational attainment as a major cause of social and economic disparities.<sup>90</sup> Despite an annual increase in spending on education in nominal terms, the education budget as a percentage of GDP is still only 3.4 percent<sup>91</sup> – below UNESCO’s standard for education spending of 4–6 percent of GDP.<sup>92</sup> The lack of government spending on education has led to a proliferation of private schools, which now account for 40 percent of all secondary school enrolments.<sup>93</sup> Private schools are not accessible to the poorest families, and they also tend to exclude girls. Furthermore, there is regional disparity in access to quality education. For instance, schools in rural areas and in eastern Indonesia are less likely to have proper facilities or trained teachers.<sup>94</sup>

*Only 55% of children from poor families are enrolled in secondary school*

*Indonesia is the worst performing country in the OECD for adult literacy and skills*

The current government relies on its Smart Indonesia Card (KIP) scheme as a key instrument for opening up greater access to education for primary and secondary students. Under the scheme, young people aged 6–21 with access to a KIP, or from a household which holds a family welfare card (KPS), gain educational grants when registered in formal or vocational education.<sup>95</sup> The scheme aims to improve enrolment in elementary and secondary schools, reduce drop-outs, and reduce educational inequality between different groups (rich and poor, men and women and urban/rural areas). It aims to improve on the previous Cash Transfers for Students Program (BSM) by increasing eligibility from 11.2 to 20.3 million children, and covering vocational education.<sup>96</sup> Nevertheless, the programme has not been able to address effectively educational issues at the local level, especially in hard-to-reach regions due to geographic inaccessibility.

The picture for healthcare is more positive. Indonesia has made great strides towards achieving universal health coverage (UHC) by introducing a new national health insurance scheme (*Jaminan Kesehatan Nasional*, or JKN) to cover the whole population. The JKN has been launched successfully and is already the biggest single-payer health system<sup>97</sup> in the world. It is also impressive that the scheme aims to enrol all groups in society (rich and poor, formal and informal sector) into one risk pool, which, if successful, will increase the coverage, efficiency and effectiveness of its funding. The new healthcare system has huge potential to reduce the gap between rich and poor, and reduce women's unpaid care. However, despite these powerful strides in the right direction, the system still relies on premiums to be paid, which excludes millions of people from access to healthcare. Health spending is still equivalent to just 1 percent of GDP, which is very low by regional standards; for example, in Vietnam health spending is 1.6 percent of GDP and in Thailand 2.1 percent. In Brazil, health spending is 9.7 percent of GDP.<sup>98</sup> This is partly due to the very low levels of tax revenue collected by the Indonesian government. Private hospitals proliferate when there is a lack of investment in public healthcare, and privatization of facilities has meant that many Indonesians have been priced out of health services altogether. For example, in Kupang the privatization of Yohannes General Hospital has caused costs to skyrocket by up to 600 percent.<sup>99</sup>

## UNEQUAL ACCESS TO INFRASTRUCTURE AND LAND

Access to infrastructure, such as good roads, bridges, telecommunications and electricity supply, can drive economic growth and create employment and is essential to reducing inequality between rural and urban areas, thus reducing overall economic inequality.

Rural roads make up approximately 80 percent of the total road network in Indonesia, yet 57 percent of the rural road network is in poor condition.<sup>100</sup> Oxfam's experience of supporting rural farmers in eastern Indonesia, from Papua to East Nusa Tenggara, has demonstrated that poor road conditions in rural areas lead to the geographical isolation of farmers, meaning that they are unable to access wider markets and/or they receive low prices for their produce because intermediaries have to deduct significant transport costs from their buying price. The difficulty in accessing such places also means higher prices for staple foods (e.g. rice and cooking oil), which are often imported from other parts of Indonesia.<sup>101</sup> A poor-quality road network makes it more difficult for those living in rural areas to access education, employment opportunities and healthcare. Road quality in poor rural areas has been identified as one of the factors behind Indonesia's high maternal mortality rate, as it prevents easy access to health facilities.<sup>102</sup>

*57% of the rural road network is in poor condition*

Access to a reliable power supply is essential to engage in more lucrative economic activities higher up the value chain, and while most Indonesian provinces had electricity coverage of over 86 percent in 2014, some rural areas such as East Nusa Tenggara (74 percent) and Papua (47 percent) had much lower coverage.<sup>103</sup> The private sector often does not invest in areas that lack power supply and have bad roads, which leads to industry and economic activity being concentrated in Java and other urban areas at the expense of rural areas. For example, Freeport Indonesia decided to build a smelter in Gresik, East Java, instead of in Papua, due to the unreliability of Papua's power supply.<sup>104</sup>

*Just 25 large business groups control 51 percent of the country's 5.1m hectares of oil palm plantations*

Lack of access to land is another factor contributing to inequality. On average, a smallholder farmer in Indonesia controls less than a quarter of a hectare of land, which does not produce sufficient crops to sustain their family.<sup>105</sup> In contrast, according to research conducted in 2015 by Indonesian NGO Transformasi untuk Keadilan (TuK) and economic research consultancy Profundo,<sup>106</sup> just 25 large business groups control 51 percent of the country's 5.1m hectares of oil palm plantations; an area equivalent to almost half the size of Java. Five



companies have holdings exceeding 300,000 hectares each. A concentration of land ownership in the hands of big corporations and wealthy individuals means that the benefits of land ownership accrue to those at the top and are not shared equally. Unequal access to land drives wider inequality.<sup>107</sup>

### Box 2: Supporting Indonesia's 'One Map' policy initiative

Sekadau, a newly created district in the province of West Kalimantan, is predominantly inhabited by the indigenous Dayak people. The Dayak control and manage their land and forests as common property, under a customary tenure system. Since their customary use of land and forests is not protected by formal titles, their land is under threat. In the eyes of the government it is considered to be 'idle' and, in the process of spatial planning, it designates their land and forests to commercial activities such as logging, plantations or mining.

A project to improve community participation in spatial planning was set up by the Indonesian Community Mapping Network (JKPP) in Sekadau district, with the support of Oxfam. Participatory mapping of customary land and forest was used as a tool to empower indigenous peoples to claim their access to and control over natural resources. The tool has also been used to influence local spatial planning.

The participatory mapping initiative undertaken by JKPP has resulted in the community having a deeper understanding of their environment and use of natural resources, and has also increased awareness of their rights regarding natural resources and of regional development and spatial planning processes. The district government of Sekadau has accepted the maps, which have been used to resolve boundary conflicts and to fix the official boundaries of villages. The Sekadau District Forest Agency has started collaborating with local communities in Nanga Mahap for the management of village forest (*Hutan Desa*) and community forest (*Hutan Kemasyarakatan*), in an attempt to delegate forest management to local communities.

Source: International Land Coalition<sup>108</sup>

## THE LABOUR MARKET AND UNFAIR WAGES

A key driver of income inequality is the labour market, with large numbers of Indonesians (one-third of regular employees) working in low-skilled, low-earning jobs with a lack of job security.<sup>109</sup> This ratio is higher for women and the trend over the past two decades shows an increasing percentage of female employees receiving low pay, which reflects the increasing number of women shifting out of unpaid family work into part-time contract work.<sup>110</sup>

At the same time, Indonesia is struggling to meet demand for high-skilled and professional workers, with a lack of job-relevant skills across the spectrum of educational attainment, from graduates to the 60 percent of the workforce who have only completed education to lower secondary level.<sup>111</sup> The shortage of high-skilled workers pushes up the wages of those who are able to do the jobs, leading to increasing income inequality between skilled and unskilled workers.<sup>112</sup> This also increases inequality between urban and rural areas (and western and eastern areas), as skilled workers are mostly found in industries in urban and peri-urban areas in the west of the country. A lack of relevant training also means that Indonesia's labour and economic structures are mismatched. Despite the economic structure shifting further away from the informal agrarian sector to the formal industrial and service sectors (and to the civil engineering, building and construction sectors on account of the government's ambitious infrastructure programme), the labour structure still leans more heavily towards the agrarian sector.

### Box 3: The dream of a living wage and the reality of debt

EP, a 31-year-old man, has worked for seven years as a mechanic in a garment factory in Tangerang. His daily task is to check the condition of the sewing machines on three production lines. He receives a monthly salary of 3,021,000 rupees (IDR – around \$300), plus allowances for transport and meals and an insurance premium with a value of IDR 77,300 (around \$7.70). Therefore, his total monthly earnings are the equivalent of around IDR 3,098,300 (\$308).

EP is married with one child. In addition to being the main breadwinner for his small family, he also provides for his parents. Every month, the family's expenditure to meet basic needs is around IDR 4.8m (\$480). To fulfil their family needs, EP and his wife have to work very hard. He works an extra 15–16 hours per week on top of his job, for which he earns IDR 950,000 each month. His wife also has to take on various menial jobs, for which she earns on average IDR 500,000 per month. Despite this, the family's limited expenditure still exceeds their income.

Their coping mechanisms include foregoing some basic needs included on the decent living standard (KHL) index, which is a list of essential expenditure required to cover food, housing and education needs. They also purchase lower quality goods to ensure that their limited money will stretch as far as possible. Nevertheless, to cover essential expenditure EP still needs to take out loans from a local moneylender.

This story is typical of many workers who are forced deep into debt just to cover their basic needs. According to EP, almost 90 percent of workers in the factory where he works have to service debts with interest rates of 20 percent. For factory workers, getting a loan from a moneylender is the easiest solution in the short term because the process is simple and they can get access to funds very quickly. As collateral, however, they have to relinquish important personal documents such as their healthcare insurance (*Jamsostek*) card, school certificate or vehicle certificate. Sometimes moneylenders keep workers' ATM cards with the PIN and deduct the monthly debt repayment after payday (normally on the 10th of every month). The ATM card can be held by the moneylender until the debt has been repaid in full. 'Just see for yourself, at ATM machines around the factory on the 10th of every month, there are a number of people who withdraw money many times. You can bet that they are moneylenders,' said EP.

EP has heard many worrying stories from co-workers who are heavily indebted to moneylenders. Some of them have not had access to their own ATM card for years, as every month they can only cover the interest but not the principal loan. Some workers have taken out loans from multiple moneylenders, but have been unable to pay them back. These workers have eventually had to stop coming to work as the situation had become unbearably embarrassing. For EP and other workers in the factory, the notion of a living wage to cover their essential living costs is just a dream.

For those in low-skilled jobs, there is little chance of progression to higher-skilled, higher-paid work. Oxfam research conducted in the garment industries in four cities in mid-2016 revealed that most workers stay in the same jobs for many years.<sup>113</sup> The inability of workers to develop their skills makes it a challenge for Indonesia to meet the demands of its growing industries and transition from an economy fuelled by the extractive industries and low-technology sectors to one based on high-tech manufacturing and service industries. The lack of training and skills development also has a big impact on the employment prospects of young people; youth unemployment is a major issue in Indonesia, according to the ILO.<sup>114</sup>

The level of wages of those at the bottom is also a key issue as regional minimum wages – even when enforced – do not give workers sufficient income to cover their essential needs.<sup>115</sup> Oxfam's 2016 research revealed that the minimum wage covers only 84.7 percent of real household expenditure in Tangerang, 87.2 percent in Bandung, 60.3 percent in



Semarang and 63.9 percent in Yogyakarta. The minimum wage is calculated on the basis of the needs of 1.5 people, but most workers are the main income earners in families of 4–5 people. Furthermore, in some instances workers receive even less than the regional minimum wage set by the government, due to a lack of enforcement of laws and the weak bargaining power of workers, especially in factories without effective labour unions.<sup>116</sup> Earning a fair wage is even harder for women, given the gender pay gap. In addition, women often have to juggle low-paid long hours with unpaid care work. To cover the gap between their wages and their families' needs, workers often have to work extra hours and other family members (including spouses and older children) are forced to seek income through employment or by setting up micro-businesses. However, for many workers this is still not enough, and they are forced to take out loans from moneylenders, leaving them trapped in low-paid jobs and in debt.

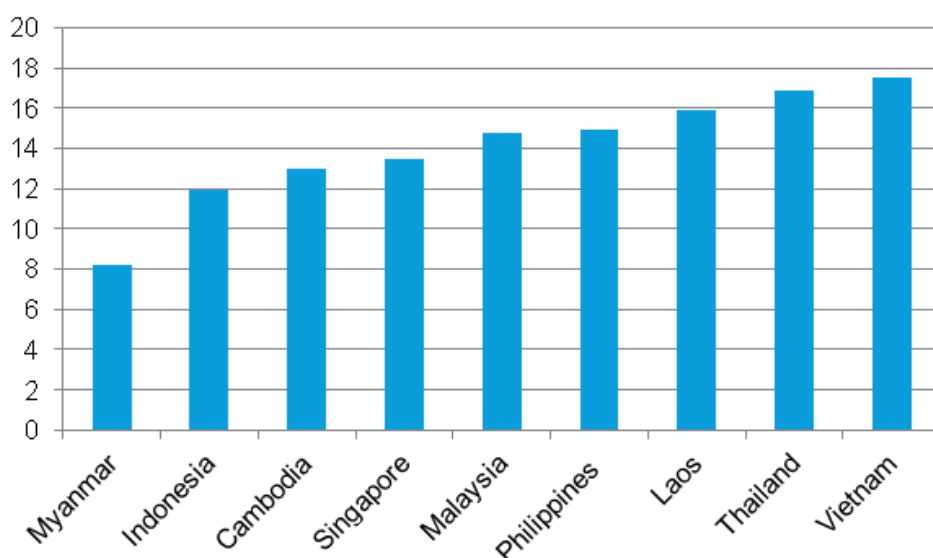
While the situation for employed workers is bad, low earnings are an even bigger issue for the more than 55 percent of the labour force in the informal sector or who are self-employed, especially in agriculture and micro- and small enterprises.<sup>117</sup> Data from the World Bank in 2014 showed that the average earnings of casual workers and the self-employed were 51 percent and 68 percent respectively of the average for regular employees.<sup>118</sup> As well as lower incomes, informal workers without secure employment contracts generally receive weaker protection and less access to career development. Women are more likely to be informally employed than men.<sup>119</sup>

## UNEQUAL TAXATION SYSTEM

As stated by Indonesia's Coordinating Minister for Economic Affairs, taxation is one of the most effective tools to tackle inequality,<sup>120</sup> both through redistributing wealth and income, and raising the necessary revenues to fund vital inequality-busting public services. However, tax collection in Indonesia is poor. The OECD considers Indonesia to have the worst tax administration system of any South-East Asian country<sup>121</sup> and it has the second lowest tax-to-GDP ratio in South-East Asia (see Figure 9). Its targeted tax ratios of 12.9 percent for 2016 and 13–14 percent for 2017 are well below the IMF's estimate of its tax potential of 21.5 percent of GDP.<sup>122</sup> Furthermore, due to weak administration and poor compliance, the government consistently misses its low tax revenue targets.<sup>123</sup>

*Indonesia has the second lowest tax-to-GDP ratio in South-East Asia*

**Figure 9: Tax-to-GDP ratios in South-East Asia**



Source: Oxfam, Commitment to Reducing Inequality Index (forthcoming, 2017); using most recently available authenticated data.

The ability of the taxation system to tackle inequality cannot be measured just by the amount of revenue raised. How it is raised is critical, as progressive taxation systems play a key role in redistributing wealth.<sup>124</sup> There is much scope for improvement in Indonesia in this respect. Indonesia's ratio of direct to indirect taxation is 1.41, lower than other economies in the region such as the Philippines (1.87) and Malaysia (3.07), meaning that a higher proportion of its total tax take is raised through regressive indirect taxation.<sup>125</sup> Data from 2012 shows that 34.6 percent of total tax revenue was generated from value added tax (VAT) and only 10 percent was generated from personal income taxes (PIT).<sup>126</sup> While the share of PIT in the total tax take is not dissimilar to that of other countries in the region, it is well below the OECD average of 23.5 percent.<sup>127</sup>

Indirect taxes such as VAT are regressive because they are flat-rate and so the taxes cost poor people a higher percentage of their incomes. Although Indonesia has some exemptions for essential goods (including rice, corn and soybeans), direct taxation is a far more equitable way to raise revenues. However, the ability of the PIT system to do this is undermined by its design, which does not oblige those at the top of the income scale to contribute according to their means. The top tax band is set far too low, with anyone earning over IDR 500m annually paying a tax rate of 30 percent, which means that those earning IDR 1bn or IDR 100bn pay the same rate. There is also a lack of progressive wealth taxes. While there is a small land and buildings tax, inheritance tax is set at a low flat rate of 5 percent<sup>128</sup> and there is no tax on individual wealth.<sup>129</sup> Furthermore, there are also worrying plans to further reduce the corporate tax rate to a new low of 17 percent,<sup>130</sup> despite a previous cut from 30 percent to 25 percent in the past decade.<sup>131</sup>

Like other countries in the region, Indonesia offers a wide array of tax incentives, enabling corporations to further cut tax payments.<sup>132</sup> This is despite the fact that there is little evidence to suggest that such incentives are economically beneficial. A recent study by Oxfam in Vietnam found that despite the widespread use of tax incentives, there was little evidence that they had contributed to increased investment or to economic growth.<sup>133</sup> Tax incentives are also in danger of fuelling a regional tax competition within South-East Asia. For example in 2014, in competition for investment from Samsung, Indonesia offered a corporate income tax exemption for 10 years, while Vietnam offered 15 years.<sup>134</sup> In a regional race-to-the-bottom, it is corporations and their wealthy shareholders who benefit at the expense of countries' tax bases.

Indonesia is also having its tax base undermined by wealthy individuals and companies who avoid or evade paying their fair share of tax, using tax havens to hide their wealth and assets offshore away from the authorities. It is estimated that at least \$200bn of Indonesian wealth is stashed away in Singapore alone.<sup>135</sup> Data from Global Financial Integrity (GFI) highlights the reality that vast amounts of capital are flowing out of the country. GFI found that from 2004 to 2013 assets worth \$180bn flowed out of Indonesia illicitly; the ninth-highest level of illicit financial flows in the world during this period.<sup>136</sup> New analysis of IMF data by Oxfam shows that in 2014 over \$100bn flowed from Indonesia into tax havens, nearly double the figure in 2009,<sup>137</sup> and equivalent to nearly 10 times the education budget in 2014.<sup>138</sup> The scale of tax dodging was laid bare recently by the Panama Papers, the world's biggest ever leak: nearly 3,000 Indonesian individuals and companies were mentioned in the disclosed papers, including many of the country's most wealthy and powerful people.<sup>139</sup>

*Over \$100bn flowed from Indonesia into tax havens in 2014, equivalent to nearly 10 times the entire education budget*

### 3 INEQUALITY IS NOT INEVITABLE

Despite a rapid increase in the gap between the rich and the rest in Indonesia over the past two decades, extreme inequality is not inevitable. Reversing inequality will require a concerted effort on the part of the Indonesian government, but it has been done in other countries (see Box 4). President Jokowi's government has shown commitment to fighting inequality. On taking office, President Jokowi committed to reduce the country's Gini ratio from 0.41 at the time to 0.36 by 2019. In January of this year, he announced that tackling inequality is the government's top priority for 2017,<sup>140</sup> with a specific commitment in the 2017 budget for the income of the bottom 40 percent of the population to grow much higher.<sup>141</sup>

#### Box 4: Learning lessons from Brazil

Despite a worrying global trend of rising inequality within countries, some have taken action successfully to fight inequality, showing that with political will and the right policy measures, governments can halt the rising tide of inequality. Brazil shares many similarities with Indonesia: for example, both have large natural resource-based economies, both have decentralized political systems and Indonesia is transitioning to become an upper-middle-income country, which Brazil recently became.

Although it started from a high base, between 2001 and 2009 Brazil reduced income inequality by five points on the Gini index, from a Gini coefficient of 58.8 to 53.7.<sup>142</sup> It did this in three ways. The first was an outspoken political focus on reducing poverty and inequality. Second, Brazil began a concerted effort to expand education to poorer households, which led to more workers becoming skilled and therefore receiving higher wages. This also reduced the number of unskilled workers and so pushed up their wages too. In addition, between 2003 and 2016, Brazil increased the minimum wage by 77 percent above inflation, with increasing numbers of formal jobs being created.<sup>143</sup> It is estimated that falling wage differentials between skilled and unskilled workers accounted for around two-thirds of the reduction in inequality.<sup>144</sup>

Third, there was an expansion of inclusive social transfer programmes and universal pension schemes. These include the country's flagship conditional cash transfer programme (Bolsa Família), its non-contributory pension programme for the elderly poor (Benefício de Prestação Continuada) and a milk transfer programme. The equalizing potential of these policies could be multiplied even further if they were combined with others, particularly progressive tax policies. Unfortunately, that is not the case. Moreover, despite clear evidence that social spending has contributed to a fall in inequality in Brazil, recent legislation to freeze social spending for 20 years risks undermining progress in the fight against inequality.<sup>145</sup>

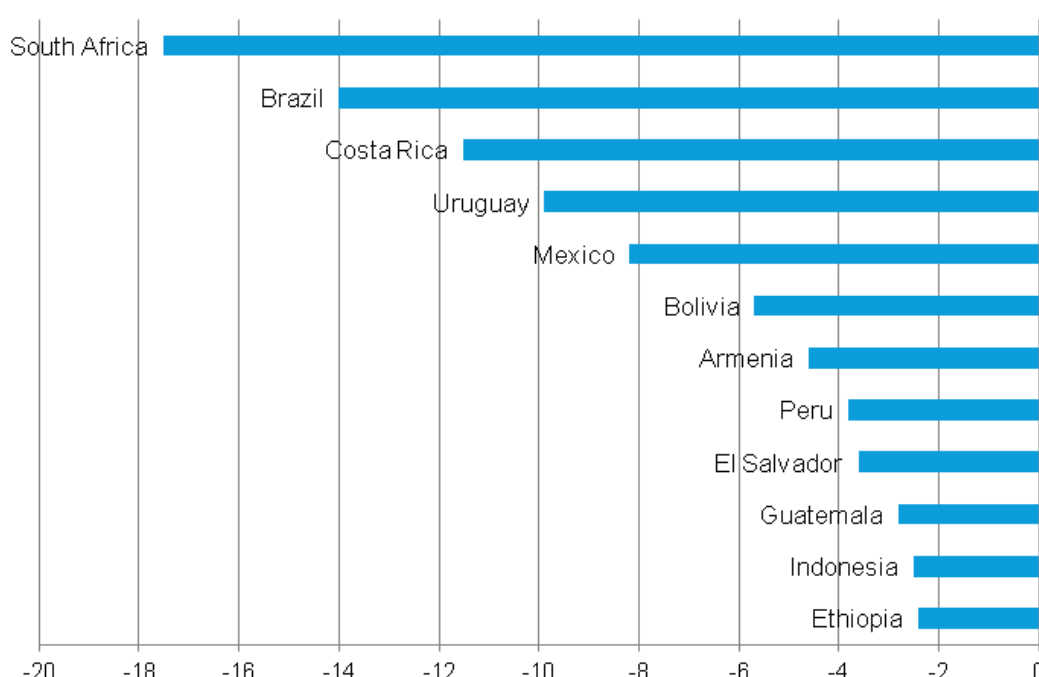
The current government has already taken many positive steps to reduce inequality. The initiation of a gender budgeting process will help to tackle gender inequality by ensuring that women's voices are heard in decision making processes so that budgets more adequately respond to their needs and spending is prioritized to reduce gender inequality; and the government has made huge strides towards UHC through its new JKN national health insurance scheme. Recent falls in income inequality are a promising sign that tide is beginning to turn on extreme inequality in Indonesia, but it is not yet clear whether this a long-term trend. Much more can and must be done to bring inequality in Indonesia down to a sustainable level. While the political context of decentralization adds new challenges to resolving these issues, it also provides opportunities to ensure that policies targeting inequality can be responsive to the local context.

The government recently launched the ‘Economic Justice Policy’ which includes a range of policy measures designed to tackle inequality.<sup>146</sup> The package includes land policies which aim to increase and hasten land redistribution through formalized ownership rights and improved access to credit,<sup>147</sup> improving access to land for poor people in urban and rural areas. It also aims to provide equal access to the labour market and secure jobs by improving vocational education and entrepreneurship opportunities. Access to credit for micro, small and medium-sized enterprises will also be improved. Furthermore, the package includes plans to apply a progressive tax on unused land to help generate extra revenue and deter land speculation.<sup>148</sup> This is combined with plans to impose a capital gains tax on land sales.<sup>149</sup> While it is too early to judge whether these policies will be successful in tackling extreme inequality, they show real promise, and demonstrate the government’s ongoing commitment to tackling inequality.

But the government can and must go further. There is huge scope for fiscal policy (taxation and public spending) to be utilized to close the gap between the rich and the rest. Fiscal policy in Indonesia currently has very little impact on reducing inequality (see Figure 10). Total taxes and transfers reduce inequality by only 2.5 points in Indonesia, whereas in Brazil, for example, the Gini coefficient for final income is 14 points lower than it is for market income (income before taxes and transfers), indicating a very large reduction in inequality due to fiscal policy.<sup>150</sup> Furthermore, with the global economy cooling and concerns about an impending fiscal crisis in Indonesia, now is the time for the government to introduce reforms to raise more tax revenues via progressive means, and ensure that they are spent on ensuring universal access to quality public healthcare and education.

*Fiscal policy reduces inequality in Indonesia by only 2.5 points, compared with 14 points for Brazil*

**Figure 10: Impact of tax and spending on public services on inequality in different countries**



Source: World Bank (2015). *Taxes and Public Spending in Indonesia: Who Pays and Who Benefits?*

The government’s budget for 2017 sets out to reduce inequality by creating job opportunities and increasing workers’ skills, improving access to basic services and guaranteeing protection in the event of shocks and turmoil.<sup>151</sup> The next section outlines recommendations on how the government can do this: by ensuring fair work and wages; raising sufficient revenues through progressive taxation to increase public spending; increasing investment in healthcare to improve health outcomes and therefore productivity and reduce catastrophic

out-of-pocket expenses; and investing in the improvement of formal education and vocational training. The government is already on the right track to reverse alarming levels of inequality. With political will and the right policy choices, the government can deliver on its commitment and ensure a prosperous and more equal future for Indonesia.

## FAIR WORK AND WAGES

### **Increase minimum wage levels to a living wage and ensure that this is enforced, and further explore the proposal for a living wage in all ASEAN states**

Despite pressure from trade unions leading to some big improvements in the national minimum wage,<sup>152</sup> tens of millions of workers still receive a wage that fails to cover their basic living costs. Workers should not have to work long hours and become indebted to cover their living expenses. As minimum wages in Indonesia are set at the sub-national level, there are discrepancies between minimum wages in different regions, and regions at the bottom end of the scale have some of the lowest minimum wages in the ASEAN region.<sup>153</sup>

#### **Box 5: Living wages – a definition**

A living wage, in short, means a wage that a worker and their family can live on. It includes enough for suitable housing, for education, for transport and for food, and it allows the worker to save a little as well. A living wage:

- must be established in consultation with workers
- is sufficient to cover basic needs including food, housing, clothing, medical care, education, social relations, transportation and some savings
- includes enough for some discretionary spending for unforeseen events such as accidents or illness
- supports more people than just the individual worker – it is a family wage
- includes consideration of the number of hours needed to earn a living wage – not more than 48 hours per week
- includes strategies to periodically update rates, so that workers maintain their relative purchasing power.

Workers (both domestic and migrant) in all regions and all sectors, both formal and informal, should be earning at least a living wage. The Indonesian government should follow the lead of other countries in the region and increase minimum wages. In 2016, Malaysia increased its minimum wage in different regions, up to a maximum of a 15 percent increase.<sup>154</sup> The Indonesian government should commit to lifting minimum wages to living wage standards, setting out a roadmap to do this in consultation with workers and unions. Businesses should support this initiative and institute policies and practices to move towards living wages within their operations.

The government should also ensure that minimum wage levels are enforced. The role of strong and effective labour unions is central in setting fair and decent wages closer to a living wage and supporting the enforcement of such wages. Oxfam has been working for over a decade with labour unions and international sportswear companies and their suppliers to ensure workers' right to association; and its experience shows that in companies where there are strong labour unions with collective bargaining agreements (CBAs) workers' rights are better protected.

Indonesia's Vice President, Jusuf Kalla, recently called for ASEAN countries to adopt a standard regional minimum wage to prevent unhealthy competition on wages.<sup>155</sup> This initiative could help to prevent a race-to-the-bottom on wages in the region, where states compete to offer low wages to investors. If a living wage is used as the basis for establishing regional minimum wage standards, this could guarantee an adequate income for millions of people across the region. However, there are questions about the ability of ASEAN to enforce a regional minimum wage, and there would have to be regional consensus between ASEAN leaders, which could be difficult to achieve.<sup>156</sup> Furthermore, given the wide range of minimum wage levels in the region, workers in countries at the upper end of the scale may not benefit. Living wages in all member states should be further explored in consultation with labour unions.

## **Regulate for secure employment**

Secure employment contracts offer multiple benefits to workers. They enable people to claim entitlements from employers and to claim social welfare from the government, and they make workers more visible, which means that they are more likely to be engaged with and supported by trade unions, labour organizations and NGOs. Secure employment contracts can also act as collateral, allowing people to obtain housing and bank accounts: with this they bring the capacity to plan and save, increasing a household's resilience to shocks.<sup>157</sup> Secure contracts also offer many benefits to businesses, including a reduction in worker turnover, less management time spent on recruitment and better productivity and product quality.

The Indonesian government has passed legislation stipulating that all workers who are part of the core activities of a company should be treated as formal workers.<sup>158</sup> However, in reality many workers are contracted as casual workers, leaving them with a lack of job security. The government should strive to ensure that the primary form of employment is permanent, open-ended and direct, and any deviation from this norm should be justifiable, planned, limited and regulated. The government should regulate to deter companies from following discriminatory employment practices and from using high proportions of agency or temporary staff or workers on insecure contracts. It should also require transparency on the proportions of workers employed on secure and permanent contracts. Furthermore, the government should regulate to require companies to ensure that all workers are able to access their rights, especially to freedom of association and collective bargaining. It should put in place independent verification, which will be considered robust enough if the most vulnerable workers trust it and use it. The most vulnerable may include home, agency or temporary workers or those on insecure contracts, such as those with variable hours chosen by the company and not the worker. The private sector should take the initiative to increase the number of workers on secure employment contracts and should ensure that those on insecure contracts are able to access basic labour rights.

## **Close the gender pay gap and remove barriers to women's equal participation in the labour force**

Female workers still experience discrimination at work in terms of pay and fulfilment of other rights. Indonesia's gender pay gap (14.5 percent), although not high by global standards, is far higher than those of both Thailand (2.8 percent) and Malaysia (3.9 percent).<sup>159</sup> Closing the gender pay gap could have multiple benefits for both businesses – including higher staff retention, improved morale and more effective utilization of skills<sup>160</sup> – and society more broadly, by leading to a more equal and cohesive society and improving the economic independence of women.<sup>161</sup> The Indonesian government must commit to closing the gender

*Indonesia's gender pay gap (14.5%) is far higher than those of Thailand (2.8%) and Malaysia (3.9%)*



pay gap, including by implementing legislation aiming to give female and male workers equal access to work and ensure that they receive equal wages. Businesses should publish data on their own pay gaps and take further measures to remove barriers to women's equal participation in the labour force, such as through ensuring access to decent and safe employment opportunities, ensuring non-discrimination in the workplace and promoting women's rights to organize and play an active role in trade unions. Businesses should provide facilities and rights to support women workers, such as spaces for breastfeeding, childcare facilities and paid maternity leave.

Promoting positive social norms and attitudes to women's work is also key. As in many other countries, women in Indonesia perform most of the unpaid domestic and care work,<sup>162</sup> but these roles are often not valued. The extent of unpaid care work limits women's choices and is a strong contributory factor in their lower participation in the labour force and concentration in low-wage, part-time work. The government and civil society should work together with local communities and indigenous and religious leaders to change the belief that women's place is at home, looking after the family. Sensitizing and encouraging men to bear some of the burden of domestic work and childcare could contribute significantly to increasing women's participation in the workforce.

## PROGRESSIVE TAXATION

A progressive taxation system is crucial to fight inequality, both through raising sufficient revenues to invest in essential public services and by directly reducing income and wealth inequality. There is great potential in Indonesia to improve the tax system to increase revenues and redistribute wealth. This will also help to build the vital social contract between citizens and the state.

### Increase the tax-to-GDP ratio

As discussed, Indonesia has a low rate of revenue mobilization compared with other countries in the region. This means that there is a lot of room to expand the fiscal space. This is clearly recognized by the government: upon taking office, President Jokowi stated that a key government initiative would be to expand tax receipts, from below 12 percent to 16 percent of GDP.<sup>163</sup> Finance Minister Sri Mulyani Indrawati recently emphasised the importance of increasing Indonesia's tax-GDP ratio:

*'The numbers show that if we make taxation more effective, then we can take money from those in a better economic situation and distribute it to state spending that favours those below the 40 percent. Education, health, infrastructure and even cash transfers can be distributed to the poor.'*<sup>164</sup>

*If Indonesia had reached its full tax potential in 2015, it could have raised an extra \$63bn to invest in public services, enough to increase public health spending nine times over.*

The government should increase the tax-to-GDP ratio towards Indonesia's maximum tax capacity, to realize Indonesia's full tax-raising potential and raise revenues to fund vital public services. The IMF has suggested that Indonesia's tax capacity is 21.5 percent of GDP.<sup>165</sup> If Indonesia had reached its full tax capacity as outlined by the IMF, in 2015 it could have raised an extra IDR 836 trillion (\$63bn) to invest in inequality-busting public services,<sup>166</sup> enough to increase health spending nine times over.<sup>167</sup>

### Reform the tax system

The current tax system does not do enough to redistribute wealth or ensure that everyone pays according to their means. The tax mix needs to be shifted from regressive indirect

taxation to progressive direct taxation. The government has mooted plans to reduce personal income tax (PIT) rates,<sup>168</sup> but bringing the tax rate down will not necessarily increase tax compliance or increase revenues. Instead, the PIT code needs reform to ensure that the super-rich pay higher tax rates than everyone else, as they can most afford it. The government must also ensure that the PIT system is enforced.

**Table 2: Personal Income Tax Code in Indonesia, proposed changes in red**

Taxable income (IDR)	Rate (%)
Up to 50,000,000	5
50,000,000–250,000,000	15
250,000,000–500,000,000	25
500,000,000 – 10 billion	30
<b>Over 10 billion</b>	<b>45</b>

In the short-term, the government should add an additional tax band with a 45 percent rate to the personal income tax system to ensure that the ‘mega-rich’, defined as those with income over 10 billion IDR, pay according to their means. This would target between 250 and 350 of Indonesia’s wealthiest people, including executives, top management, owners and shareholders of some of the biggest companies. A 45 percent top rate of income tax is used in other G20 countries, such as the United Kingdom, while other advanced economies adopt a higher top tax rate, such as Belgium (50 percent) and Denmark (51.5 percent).<sup>169</sup> In the long term, the government should conduct a review of the personal income tax system with the aim of adding additional tax bands for those at the top, at higher rates. For example, the income range between the rich and the super-rich could be determined and the tax rate for the mega-wealthy could be higher than that for the ‘merely’ rich. The range could be between IDR 500,000 and IDR 5bn yearly for the rich, who would pay a 45 percent tax rate. A 65 percent rate could then be applied to those earning over IDR 10bn on an annual basis. Economists such as Anthony Atkinson have suggested that a 65 percent tax rate for the super-rich is optimal.<sup>170</sup>

## Enforce progressive wealth taxes

Taxes on wealth, including recurrent taxes on wealth and property and inheritance taxes, are an important tool to address inequality as they are highly progressive, targeting only the richest group in society. Moreover, they are vital to prevent excessive concentrations of wealth and power in the hands of a few,<sup>171</sup> and to ensure greater equality of opportunity across generations.

In OECD countries, wealth taxes contribute close to 2 percent of GDP on average. In contrast, they play only a marginal role in Asia and the Pacific. Of all the region’s developing countries, only China manages to collect more than 0.5 percent of its GDP in property taxes, and taxes on inheritance exist in only a few countries.<sup>172</sup> Despite difficulties in collecting wealth taxes,<sup>173</sup> several higher-middle-income developing countries in South-East Asia are taking action to capture the benefits of wealth taxes. For example, Thailand introduced inheritance tax for the first time in 2016; although less ambitious than expected,<sup>174</sup> it still demonstrates an attempt to use wealth taxes to rein in widening inequality. China is also planning to introduce property and inheritance taxes in the coming years.

Currently the only wealth tax in Indonesia is the ‘land and buildings tax’, payable annually on land, buildings and permanent structures, with the top rate typically set at no more than 0.3 percent, although it varies between districts. Indonesia does collect inheritance tax but this is set at a low flat rate of 5 percent. While this is similar to the rate in Thailand, other countries

in Asia have set inheritance taxes at a much higher level: for example, 50 percent in South Korea and 55 percent in Japan.<sup>175</sup> There is a clear case for increasing inheritance tax rates on intergenerational equity grounds, and it is also less economically distortionary than many other tax measures.<sup>176</sup> There is no other tax on accumulated capital or assets, such as a net wealth tax.<sup>177</sup> The Indonesian government is considering a plan to impose a progressive tax on assets, capital and excess profits.<sup>178</sup> It should launch a review of wealth taxation with the aim of increasing land and property taxes for the highest value land and properties, increasing inheritance tax rates and introducing a net wealth tax to address inequality, while also exploring these other measures. This will ensure that a progressive wealth tax system is in place to oblige the wealthiest to contribute according to their means.

## **Ensure that everyone is paying their fair share of tax**

Tax avoidance and evasion by wealthy individuals and companies undercuts Indonesia's tax base. Recent signs that the Indonesian government is committed tackling tax dodging by multinational corporations are welcome. For instance, the government recently announced plans to investigate Google with the aim of claiming five years of back taxes, suggesting that the US tech company could face a bill of over \$400m for 2015 alone if it was found to be avoiding taxes.<sup>179</sup> However, efforts to clamp down on individual tax dodging have focused on a tax amnesty initiated in July 2016. This follows the 'sunset policy' of 2008 under which the previous government waived penalties for one year to permit the registration of previously undeclared taxable income.<sup>180</sup> Effective until March 2017, the amnesty imposes extremely low tax rates of 2–5 percent and 4–10 percent, only one-third of the normal rate, for those declaring previously undeclared assets and bringing them back onshore. The programme has attracted criticism from the OECD<sup>181</sup> and from civil society, which consider the amnesty to be overly generous and a reward for the rich who have hidden their money away, and claim that it hinders the effective implementation of tax regulations. Furthermore, plans have been discussed for the government to establish tax haven jurisdictions within some areas of Indonesia, with the aim of allowing Indonesian and foreign companies to set up shell companies and access other privileges to reduce their effective tax rate.<sup>182</sup> Creating local tax havens contradicts the G20 principle of transparency and will undermine regional cooperation and Indonesia's own tax base.

*Google could face a bill of over \$400m for 2015 alone if it is found to have been avoiding tax*

Indonesia has taken the positive step of signing up to the Common Reporting Standard (CRS) for the automatic exchange of information (AEI), which will come into force in 2018. This means that Indonesia will share information on tax and financial transactions with other tax authorities and will receive it in return, thus making it more difficult for wealthy individuals to hide their assets. However, those taking advantage of the tax amnesty will still be able to move money onshore in advance without facing any penalties.

The government should develop a national action plan to combat tax evasion and tax avoidance. This should be followed by the creation of a new taskforce on multinational companies and the ultra-rich to curtail illicit flows, supervised by the Corruption Eradication Commission (KPK). Furthermore, the government should accelerate the establishment of an integrated administration system that unites all the functions of state ministries, agencies and special taskforces of the KPK, Bank of Indonesia (BI), Financial Services Authority (OJK), Financial Transaction Reports and Analysis Centre (PPATK), the police force and the attorney general's office to curtail illicit flows.

## **Retain current corporate tax rates and review tax incentives**

The government needs to scrap plans under consideration to slash the corporate income tax rate from 25 percent to 17 percent.<sup>183</sup> Corporate tax cuts can be counter-productive, as lower rates do not automatically translate into better tax compliance or significantly increased revenues. There is also a lack of any strong evidence that tax cuts increase foreign direct investment (FDI). Many studies cite factors that are more important in attracting FDI, including skills levels in the local economy, the availability of infrastructure and macroeconomic stability,<sup>184</sup> all of which are facilitated by a well-resourced state that can invest to improve these conditions. A corporate tax cut is likely to further narrow Indonesia's fiscal capacity to finance much-needed health, education and infrastructure programmes. Furthermore, it will encourage other governments in the region to compete by lowering their own tax rates. There are already fears of a 'tax war' in the ASEAN region,<sup>185</sup> as states compete to offer a lower corporate income tax rate and other tax incentives, resulting in a race-to-the-bottom in which all states lose out, benefiting multinational corporations at the expense of everyone else.<sup>186</sup> Recent announcements that the government will not introduce a low tax regime are welcome,<sup>187</sup> but the government must resist the temptation to lower corporate taxes.

Almost all countries in the ASEAN region offer tax incentives. These can play a positive role in attracting investment or helping a country shape its economy, but there is little evidence in many cases that they provide economic benefits. Too often, tax incentives are granted to corporations without parliamentary or public disclosure or scrutiny. As a result, such incentives are often ineffective and have become associated with abuse and corruption.<sup>188</sup> The Indonesian government should subject all current and new tax incentives to rigorous economic and risk assessments (including their contribution to global and regional competition). All incentives should be reviewed regularly to limit private long-term benefits and public harm, and all tax exemptions should be phased out where there is no clear evidence that they are effective.

## **Work at the regional level for tax cooperation**

Increased tax cooperation and coordination at the regional level would benefit all economies in the region, including Indonesia. As one of the largest economies in ASEAN, Indonesia can play a leading role in facilitating regional cooperation in tax matters.

There are opportunities to tackle the pervasive phenomenon of tax dodging at the regional level. Indonesia needs to ensure that tax is part of ASEAN's agenda to tackle illicit financial flows and needs to more actively foster cooperation with other member states to exchange data and information, evaluate tax treaties and to act on breaches of tax treaty obligations. Indonesia could push for ASEAN to agree a regional action plan to tackle tax dodging. Close cooperation is necessary to prevent transfer pricing and other forms of tax avoidance in the region. The Indonesian government should seek to ensure that all ASEAN states follow its lead and comply with the CRS on the automatic exchange of information. Indonesia can also push for the region to establish guidelines and criteria for the circumstances under which tax incentives and exemptions are acceptable, in order to limit competition between states in granting tax incentives.

Another cooperation framework that could be developed by ASEAN countries is the Action Plan on Base Erosion and Profit Shifting (BEPS), which was created in July 2013 by the OECD with the aim of tackling corporate tax avoidance.<sup>189</sup> Adherence to the BEPS Action Plan will go some way to reducing corporate tax avoidance in the region, though the plan does not go far enough to fix the broken international corporate tax system. Indonesia

should join with others in the ASEAN region to go beyond BEPS. Governments should use parts of the BEPS inclusive framework that are beneficial at the national level, while also pushing for a second generation of international tax reforms, to be conducted by a Global Tax Body at the UN.<sup>190</sup>

## PUBLIC SPENDING

### Remove healthcare premiums and move to a tax-funded national health system for all

Public investment in healthcare is a key tool that the Indonesian government can use to close the gap between the rich and the rest and reduce poverty. It is also vital to achieving SDG 3 to ensure healthy lives and promote well-being for all.<sup>191</sup> The impact of public healthcare in reducing inequality is evidenced by other Asian countries.<sup>192</sup> Thailand is globally celebrated for its Universal Coverage Scheme (UCS). Since 2001, the Thai government has funded free healthcare for all those outside the formal economy. Within one year the UCS, along with the other government-funded schemes, achieved near 100 percent coverage, including for 18 million previously uninsured people.<sup>193</sup> The number of households falling into poverty due to healthcare costs fell by five-and-a-half times to just 0.49 percent in 2009. Importantly, the gap between rich and poor in out-of-pocket expenditure for health has been eliminated.<sup>194</sup>

*In just one year  
Thailand's  
Universal Coverage  
Scheme achieved  
near 100%*

President Jokowi achieved significant success while he was governor of Jakarta by initiating the Jakarta Health Card (KJS) scheme. The scheme aimed to increase the capital's health service capacity and provide free healthcare to its 4.7 million poor people. The card entitles holders to free medical treatment at community health centres and local hospitals. Although not without its flaws<sup>195</sup> – including hospitals struggling to cope with increased demand not matched by the required increase in investment – the scheme has meant that thousands more people have been able to access healthcare. And unlike its predecessor, under this scheme residents are not required to prove their income, a lengthy process that often involved bribing officials.<sup>196</sup>

Building on his reforms in Jakarta, President Jokowi has made great strides towards achieving UHC by launching the new JKN national health insurance scheme (*Jaminan Kesehatan Nasional*) to cover the whole population. The scheme aims to make basic healthcare available to everyone by 2019. It has been launched successfully and is already the biggest single-payer health system in the world. By pooling all resources for health, the government has maximized the potential for equity, with maximum subsidization from rich to poor and from healthy to sick, regardless of employment status or income. As part of the UHC scheme healthcare for the poor or near-poor will be fully paid for by the government.<sup>197</sup>

*In The JKN  
national health  
insurance scheme  
is already the  
biggest single-  
payer health  
system in the  
world*

However, despite its potential, current policies and funding levels are severely restricting the performance of this ambitious health reform. Some 90–100 million Indonesians are still not covered after the health reforms, and the government has failed to reduce out-of-pocket payments (OOPs) for health services – the most regressive form of health financing. OOPs still constitute 47 percent of total health spending in Indonesia – the same level as 20 years ago.<sup>198</sup> A key obstacle to progress under the JKN scheme is the requirement of informal workers to pay a regressive premium in order to benefit.<sup>199</sup> Evidence from Indonesia and other countries, including Ghana and Tanzania, demonstrates that charging insurance premiums for the poor and those in informal work raises multiple problems. First, premiums are unaffordable and/or cannot be prioritized for the vast majority of informal workers who

are living on low and precarious incomes, resulting in the large-scale exclusion of those most in need of healthcare and financial protection. Government spending on health then becomes even more inequitable with subsidies skewed towards those who have the income security to join. Second, there are high administration costs for collecting premiums from informal workers. Third, the finance collected is not significant enough to fund quality healthcare, and increasing the premium decreases people's participation in the scheme as many are unable to afford the fees. Indonesia must avoid a two-tier health system, where those who are enrolled can access healthcare, but the remainder – often the majority of poor people and informal sector workers – are excluded and face continued high OOPs. This can become entrenched over time as formal sector workers seek to defend their access to improved care.<sup>200</sup>

#### Box 6: Life made easier with the Jakarta Health Card<sup>201</sup>



Ismayati, a resident of Jakarta, believes that the Jakarta Health Card has made it easier for her to access medical services.

The Jakarta Health Card (*Kartu Jakarta Sehat*, or KJS) was officially launched on 10 November 2012 by Joko Widodo, who was then governor of the Special Capital Region (DKI) of Jakarta. The programme aimed to provide health insurance for residents of Jakarta, especially the poor and underprivileged, through a tiered referral system.

Four years on, citizens, particularly those living on low and precarious incomes, have benefited considerably from the health programme. Ismayati, for example, believes that the health card has made things easier for her when it comes to accessing medical services. 'Normally you would have to pay IDR 15,000 in administrative costs when visiting the *puskesmas* (primary healthcare centre), but not any more. The money can now be used for other necessities,' she said.

Ismayati has been a KJS cardholder since 2014. She gets her medicine for free, and considers the KJS scheme to be well implemented. 'Blood tests, and even tests for cholesterol and sugar levels, are free of charge,' she added. Every other member in her family of five – Imron (husband), Fadli and Rifqi (children) and Munaroh (mother) – holds a health card. She says that the family is now no longer hesitant to visit the *puskesmas* or hospital because the KJS process is both easy and quick. Munaroh is nearly 70 years old, and she frequently visits the clinic for health checks and treatment, including cholesterol and blood glucose tests.

In 2015, a year-end survey of the Jakarta government conducted by the Populi Center found that the KJS is considered to be the provincial government's most beneficial programme for residents.



No country has ever achieved UHC without a significant increase in government spending on health to cover all of those who are unable to make direct contributions. Instead of questioning how to get informal workers to pay premiums, the government should recognize the enormous economic contribution already made by informal workers to Indonesia's growth, as well as the numerous indirect and informal tax payments they make on a daily basis. Premiums should be removed to protect the health of these important economic actors, and the President's promise of universal free healthcare should be funded entirely by an increase in general government spending. Priority should be given to comprehensive primary healthcare to meet majority needs, promote preventative health, and keep costs down. This is feasible but is dependent on political priorities.

Actuarial analysis suggests that scaling up to achieve universal coverage for a comprehensive benefits package, without charging premiums to informal workers, would cost the government a total of 2.2 percent of GDP.<sup>202</sup> That means more than doubling the current dismally low expenditure of just 1 percent of GDP. However, this still falls far short of the investment needed to tackle Indonesia's urgent supply-side constraints that exacerbate inequality, including the desperate shortages of health workers, supplies and infrastructure, especially in rural areas. Indonesia should therefore work towards an interim target of 3 percent of GDP health spending, to match the expenditure of the regional leader on UHC, Thailand. Over the longer term, and as Indonesia enjoys the growing economic returns to its investment in UHC as other countries have experienced,<sup>203</sup> the government should aim to increase health spending to 5–6 percent of GDP in line with WHO recommendations.

## **Increase education spending and ensure equitable access**

Despite a steady increase in the education budget in recent years, there is still insufficient funding to ensure that all Indonesians can access quality education. The 2012 Programme for International Student Assessment (PISA) shows that Indonesian students are performing some three years behind the OECD average. Over 50 percent of Indonesian fifteen-year-olds do not master basic skills in reading or mathematics.<sup>204</sup> This contrasts with Vietnam, which came 12<sup>th</sup> in the 2015 PISA tests. While PISA assessments focus on 'hard' skills over 'soft' skills – which are also essential for quality education – and are not very sensitive to local needs, this does provide an indication of the quality of education in Indonesia. Furthermore, INFID research has shown that students do poorly in problem solving, and lack creativity and innovation.<sup>205</sup> Indonesia is behind UNESCO's target of 4–6 percent of GDP being spent on education.<sup>206</sup> In the short term, the government should mobilize tax revenues to increase education spending by 0.6 percent of GDP to reach the 4 percent target. In the long term, it should aim to increase spending to 6 percent of GDP, to ensure that it has a fully funded education system. Public funding is essential to invest in and strengthen the quality of public schools, ensure school fees and other financial barriers are not excluding children, and that marginalized groups are being targeted with extra funding.

Funding must also be used to extend the length of compulsory education to 12 years of free public education to broaden access of education up to the upper secondary level, and to ensure that Indonesia achieves Goal 4 of the Sustainable Development Goals.<sup>207</sup> Indonesia has 1.9m adolescents out of school at lower secondary age and 4m youth out of school at upper secondary age, giving a total of 5.9m adolescents of secondary school age who are out of school, one of the highest figures in the world.<sup>208</sup> Lengthening the duration would improve access to upper secondary education, reduce inequality in access and reduce school dropout rates. This will significantly quicken the pace at which the quality of Indonesia's human capital can be improved in order to compete better at the regional level.

*Over 50% of Indonesian fifteen year-olds do not master basic skills in reading or mathematics*

*5.9 million adolescents of secondary school age are out of school in Indonesia*

The government must also make a concerted effort to tackle inequality of access to education. The greatest rate of school drop-outs occurs in the transition between school levels and affects the poorest the most. Between primary and junior high school, enrolment rates reduce by 5 percent for the richest quintile, but 17 percent for the poorest quintile.<sup>209</sup> Likewise, from junior to senior secondary school, enrolment for the richest quintile falls from 89 percent to 70 percent, whereas from the poorest quintile it falls from 59 percent to 33 percent – three times as much.<sup>210</sup> Access to education is also gendered – only 39.9 percent of women complete at least some secondary education, compared with 49.2 percent of men.<sup>211</sup> Furthermore, 70 percent of young people with disabilities have no access to education.<sup>212</sup> In announcing his plans to tackle inequality in 2017, the president emphasized improving educational equality. The government should conduct a review, in partnership with teachers and communities, to assess the continuing barriers to poorer students, girls, and young people with disabilities in accessing secondary education, and launch a three year plan to urgently address these barriers to achieve universal completion of secondary education in line with the SDGs.

### **Introduce more and higher quality vocational training**



Domestic workers are able to gain access to education, training and better opportunities for their careers through the National Advocacy Network of the Domestic Workers or Jaringan Advokasi Nasional Pekerja Rumah Tangga. Photo: Andi Cipta Asmawaty/Oxfam

With two million people entering the job market each year,<sup>213</sup> there is an urgent need to give them the skills necessary to compete in the job market and to develop a base of professional, skilled workers in order for Indonesia to become a competitive, skills- and knowledge-based economy. President Jokowi's recent commitment to improve the quality of vocational education is welcome.<sup>214</sup> The government's recently announced 'Economic Justice Policy' package outlines that the Ministry of Industry will support vocational education, competency-based training, apprentice programmes and push people to become adequately certified in their chosen profession. If Indonesia manages to implement this, it will follow countries like Japan and Germany which as a result of investing in vocational training have managed to keep the level of youth unemployment fairly low and enable mobility in the labour market.<sup>215</sup>

Sufficient budget must be made available to fund vocational training centres and courses and to support on-the-job training. The government should use increased tax financing to ensure that 10–20 percent of the education budget is spent on vocational education and training, without undermining the quality, effectiveness or access to formal educational training. It should also remove barriers to those without formal educational qualifications or beyond school age from accessing vocational training. Training programmes should be developed and conducted in collaboration between various ministries – such as the Manpower, Marine and Fishery, Rural Development, Transportation, Industry and Agriculture ministries – and businesses to ensure job-relevant skills. Local training centres should play a role in ensuring that workers' skills match local demand, but they need to be equipped with sufficient funds and be able to adjust their training curricula to suit local needs.

Broadening job training programmes beyond the formal system (in vocational schools) is another important step that Indonesia must undertake. The promotion of on-the-job training and paid internships and facilitating the creation of new job opportunities, such as start-ups, are key initiatives. There should be an obligation for companies to provide training opportunities, such as on-the-job training, paid apprenticeships and placements, with corresponding professional certification and recognition. Companies should commit to offering more training opportunities for current and potential future employees, recognizing that investing in their skills will enable the business to move further up the value chain. Furthermore, businesses should support efforts to improve the quality of local training programmes by providing additional tutors and instructors for job training programmes.

Capacity building should also be extended to workers (especially women) in the agriculture sector so that they can apply good agricultural practices that increase yields, reduce post-harvest losses and adapt to the effects of climate change. Furthermore, there should be increased efforts to empower women in rural areas to move further up the value chain and to engage in processing and marketing. They should be provided with training to develop their skills, along with access to credit and markets.

The increased budget for vocational training should also have an in-built equalizing mechanism to ensure that those from the lowest socio-economic groups, and in particular women and girls, are able to access quality vocational training. A 2012 study found that, of 22 countries where vocational education is a major part of education at age 15, Indonesia had one of the lowest proportions of vocational secondary school students from the lowest socio-economic group.<sup>216</sup> Ensuring equitable access to vocational training will help to reduce labour market inequalities, as it will give all groups the opportunity to increase their skills and to access higher-skilled jobs with higher wages. The government should consider expanding existing support programmes that aim to guarantee access to formal education for those from lower socio-economic backgrounds (such as the Smart Indonesia Card (KIP) scheme<sup>217</sup>) to those accessing vocational training.

### **Box 7: Oxfam's Empower Youth for Work Programme**

Youth unemployment is a particular problem in Indonesia, which has the highest youth unemployment rate of any ASEAN country (at over 20 percent).<sup>218</sup> Oxfam in Indonesia is pioneering a new programme to empower youth for work. The project will cover three provinces – West Java (Indramayu), South Sulawesi (Barru, Maros and Pangkep) and Southeast Sulawesi (Buton and Bau-Bau) – and is expected to reach more than 48,000 direct beneficiaries (young people aged 14–24, 70 percent of them women and girls). The programme will focus on youth who have limited opportunities to develop their life skills and the formal skills required to take up formal employment or to develop micro-enterprises. Many of the women targeted will be constrained by a lack of sexual and reproductive health rights and limited control over their own time.

Oxfam will work with partners to undertake a mixture of activities, engaging with both the private sector and the government. These include working with other stakeholders to introduce and improve the quality of existing technical and soft skills training; encouraging the private sector to provide more on-the job training activities; and setting up local hubs so that young people have a space to improve their skills and a support network to help them find work. The programme will also work with companies to improve wages and working conditions and to hire more young people, especially women. It will aim to create an enabling environment for young people, especially women, to claim their economic, social and reproductive health rights by campaigning for supportive policies and changes in social norms that exclude youth from economic empowerment and perpetuate gender inequality.

Central to the project is a Youth Advisory Board, with representatives drawn from each of the provinces covered by the programme, which will meet biannually to provide ideas for activities to be undertaken, insights on how to engage young people in the programme, feedback on planned activities, and monitoring and evaluating plans.

## 4 CONCLUSION AND RECOMMENDATIONS

There are clear steps the government can take to end extreme inequality in Indonesia. The overwhelming majority of Indonesians believe that the government must take urgent action to close the gap between the rich and the rest. President Jokowi agrees, and the government has made tackling inequality its top priority for 2017. It must go further than the positive measures already introduced, to ensure fair work and wages for all, and deliver a progressive tax system that raises sufficient revenues to invest in vital public healthcare and education services. Recent signs of a small reduction in inequality are welcome, but it is not yet clear whether this will last. In President Jokowi's own words, inequality in Indonesia has reached 'dangerous' levels, but taking the following actions now will help to turn the tide on rising inequality and ensure that recent inequality trends are maintained. This will reduce poverty, ensure sustainable economic growth, build social cohesion and ensure that Indonesia meets its SDG targets. Taking action now is the only way to ensure a prosperous future for Indonesia.

**To close the gap between the rich and the rest, the government should take the following actions.**

### **Inequality**

- Develop a national plan to show clearly how it will meet the inequality reduction target that the President has set, and what contribution will be made by different policies and sectors. The plan should outline how regional inequality, including between urban and rural areas, and east and west, will be tackled.
- Ensure that local governments also commit to reduce inequality by including inequality reduction in local development plans.

### **Fair work and wages**

- Set out a roadmap to increase minimum wage levels to a living wage in consultation with labour unions, and ensure that the minimum wage is enforced. Further explore the idea of a living wage in all ASEAN member states.
- Move towards secure employment by regulating to:
  - deter companies from discriminatory employment practices and from using high proportions of agency or temporary staff or workers on insecure contracts
  - require transparency on the proportions of workers on secure permanent contracts
  - require companies to ensure that all workers are able to access their rights, especially to freedom of association and collective bargaining. Put in place independent verification, which will be considered robust enough if the most vulnerable workers both trust it and use it.
- Close the gender pay gap and remove barriers to women's equal participation in the labour force by legislating to give female and male workers equal access to work and ensure that they receive equal wages. Work with civil society to promote positive social norms and attitudes around women's work.

### **Tax**

- Increase the tax-to-GDP ratio towards Indonesia's maximum tax capacity to realize Indonesia's full tax-raising potential and raise revenues to fund vital public services. The IMF has suggested that Indonesia's maximum tax capacity is 21.5 percent of GDP.
- Reform the personal income tax system. In the short term, the government should add an

additional 45 percent tax band to ensure that the ‘mega-rich’, defined as those with income over 10 billion IDR, pay according to their means. In the long term, the government should conduct a review of the personal income tax system, with the aim of adding additional tax bands for those at the top, at higher rates.

- Launch a review of wealth taxation, with the aim of increasing land and property taxation for the highest value land and properties, increasing inheritance tax rates, and introducing a net wealth tax to address inequality.
- Ensure that all taxpayers are paying their fair share by developing a national action plan to combat tax avoidance and tax evasion, and establishing a new taskforce on multinational companies and the ultra-rich to curb illicit financial flows.
- Refrain from engaging in a ‘race-to-the-bottom’ on corporate taxation by cutting the corporate income tax rate and cease offering discretionary tax incentives. Subject all current and new tax incentives to rigorous economic and risk assessments (including their contribution to global and regional races-to-the-bottom). All incentives should be regularly reviewed to limit private long-term benefits and public harm, and all tax exemptions should be phased out where there is no clear evidence that they are effective.
- Work at the regional level on tax cooperation with other ASEAN states, including ensuring that all states in the region follow its lead and comply with the common reporting standard (CRS) on the automatic exchange of information; developing a regional action plan to tackle tax dodging; and pushing for a second generation of international tax reforms beyond BEPS, to be conducted by a UN Global Tax Body.

### **Public spending**

- Building on the strides made towards universal health coverage through the JKN national health insurance scheme, improve equitable access to healthcare by scrapping all premiums for health services and move to an entirely tax-funded national health system. Do this by doubling health expenditure to at least 2.2 percent of GDP. Work towards increasing this spending to at least 3 percent of GDP on health in the coming years in order to urgently address supply side constraints, especially health workers, and prioritize primary healthcare to meet needs and keep costs down.
- Increase education spending to 4 percent of GDP in the short term, and in the long term aim to reach UNESCO’s recommendation of 6 percent of GDP. Use increased spending to extend the length of compulsory education to 12 years free public education and broaden access up to the upper secondary level.
- Conduct a review, in partnership with teachers and communities, to assess the continuing barriers to poorer students, girls, and young people with disabilities, in accessing secondary education, and launch a three year plan to urgently address these barriers to achieve universal completion of secondary education in line with the SDGs.
- Introduce more and higher quality vocational training, by using increased tax financing to allocate 10–20 percent of the education budget to vocational training – without undermining the quality of the formal education system – ensuring cross-ministry collaboration and partnership with local government in developing training programmes; obligating companies to provide on-the-job training; and implementing mechanisms to ensure that the poorest, women and girls, are able to access vocational training.

### **Gender**

- Systematically analyse proposed policies for their impact on women and girls. Expand current gender budgeting processes and provide support for women’s rights



organizations to engage in decision making processes on public spending, to ensure civil society participation.

- Commit to initiatives that reduce gender inequality across society, including addressing harmful social norms, supporting women's leadership and decision making power and ending violence against women and girls.
- Amend the marriage law to increase the minimum legal age for marriage from 16 to 18, and repeal point 3 of article 31 that states that the husband is the head of the family and the wife is the 'mother' of the household.

**The private sector should play its role in reducing inequality, and businesses should take the following actions.**

- Publish data on their own gender pay gaps.
- Ensure access to decent and safe employment opportunities for women, ensure non-discrimination in the workplace and promote women's rights to organize and play an active role in trade unions.
- Employ workers on secure employment contracts.
- Support government action towards a national living wage and institute policies to move towards a living wage within their operations.
- Invest in the skills of employees to meet the need for higher skilled workers, thus enabling the business to move further up the value chain and increasing wages for workers.
- Provide on-the-job training, paid apprenticeships and placements, with corresponding professional certification and recognition.
- Engage with local government to ensure that local training centres provide training that matches market requirements.

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multiplying the poverty gap figure (the average percentage that people living in extreme poverty are beneath the \$1.90 line) of 1.25% by \$1.90, giving a figure of \$0.02375. The amount of money needed to eradicate extreme poverty was then calculated by multiplying the number of Indonesians living in extreme poverty by the absolute poverty gap value by 365 days, giving a figure of \$181,975,483.6. Multiplying daily earnings of the richest Indonesian's wealth by 365 days gives \$324,000,000 annual earnings. This figure is an underestimate as it does not take into account the cumulative effect of interest.

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For further information on the issues raised in this paper please email [advocacy@oxfaminternational.org](mailto:advocacy@oxfaminternational.org)

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