



REGIONAL DISPARITY
AND CENTRE-REGIONAL CONFLICTS
IN INDONESIA

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Abstract

This study examines data on regional inequality in Indonesia to help explain regional unrest. Analysis indicates that the New Order regime's equalisation policies produced low levels of welfare inequality by transferring wealth from resource-rich provinces to poor communities on the one hand and to Jakarta on the other. Many in the subsidising provinces resent this strategy which has held back their regions' development. They therefore exhibit an aspiration to inequality as they seek to stop such wealth transfer and to acquire greater control over their own resources. Yet policy emphasis on the economy over development of political institutions has left the political system with no effective means to address regional grievances, which are now manifest in vertical conflicts between the centre and the regions. We therefore propose a new philosophy for equalisation policies. Rather than using a development fund to distribute wealth evenly across the regions, policy should aim to equalise people's opportunities and guarantee a minimum standard of basic services for all Indonesians, without impeding the growth potential of regions.

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REGIONAL DISPARITY AND CENTRE-REGIONAL CONFLICTS IN INDONESIA¹

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I. Introduction and Background

In recent years, Indonesia has faced the possibility of national disintegration as social conflict in the regions has intensified. In this article we explore regional equality and inequality to help explain why. The disintegration threat does not stem primarily from dissatisfaction in the poorer regions but from vertical conflict between the centre and several richer provinces whose people are angered by the centre's use of their region's wealth to subsidise poor regions.² Provinces rich in natural resources see greater autonomy from the central government –or for some, separation from the Indonesian republic– as the only way to break free from what they perceive as the central government's unfair and authoritarian policies.

Indonesia is a diverse island nation with various administrative regions. Inter-regional differences are the consequence of considerable variation in some characteristics that are crucial to securing national stability: geophysical and economic circumstance, distribution of natural resources, and the social and cultural attributes of the communities of people who live there. Unifying culturally disparate and geographically separate peoples was therefore at the forefront of nation building when Soekarno took power postwar in the newly independent nation. Since national unity is a prerequisite to nationhood, unification is still an overriding concern of Indonesia's national policies.

To promote political unity, an early step was to establish a unitary state. To promote economic unity, the central government sought to establish relative

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nationwide economic equality and to maintain Indonesia's historically low levels of economic inequality. However in pursuing policies to promote inter-regional equality in economic development, the government clearly recognised the economic consequences of inter-regional inequality as a threat to national unity but failed to recognise the socio-political consequences of redistributing wealth from rich to poor regions.

Soeharto's New Order regime that took power from Soekarno in 1968 implemented a centralised economic system. This included a raft of equalisation policies subsidising regional governments to help overcome inter-regional and inter-household economic inequalities. These policies resulted in high rates of national economic growth and sustained relatively low levels of income disparity. They helped to make Indonesia one of the East Asian 'miracle' economies that achieved economic growth with equality (World Bank 1993). Until the 1997 economic crisis, significant improvement of the per capita income level translated into relatively equal development in the quality of life of communities across the regions.³ These achievements by the New Order ought to have been key factors in unifying the nation and providing social stability as the basis for continued high economic growth.⁴

However, economic equality thus achieved is continually challenged by an economic underlay of unequal natural endowment between the regions. The unequal distribution of natural resources, especially oil and natural gas, and the uneven development of trade and industrial centres that are concentrated in a few regions, have created growth enclaves. Together these factors worsen the inter-regional disparity in economic output. Indeed, the inclusion of oil and natural gas production and enclave regions in the national dataset significantly increases inter-regional disparity on the per capita production level.⁵

² Throughout this paper 'vertical conflict' refers to centre-regional conflict, and 'horizontal conflict' refers to conflict between socio-economic and ethnic groups.

³ World Bank (1996) stated that per capita GRDP and consumption during the period 1983–1993 increased in all provinces, as did social indicators, and the poverty level decreased.

⁴ Hill (1994) claims that economic centralisation and infrastructure development during the New Order created economic integration evident even from the early 1970s.

⁵ This phenomenon appeared in Esmara's (1975) analysis, which discovered that the CV's Williamson index in 1972 was 0.945 with the inclusion of oil and gas. It became 0.522 when oil and gas were excluded from the equation and became 0.262 after the exclusion of Riau, East and Central Kalimantan.

Thus national economic development has come at a socio-political price: regional resentment by the rich regions that they are subsidising the poor through the national government's highly centralised distribution system. Soeharto's New Order regime enforced suppression of political grievances, effectively muzzling this resentment. Following Soeharto's forced resignation in 1998, however, and the freer climate for political expression that this delivered, public expressions of anger have broken out in rich regions across the country. For more than 30 years the New Order regime pursued economic development while largely ignoring political development.⁶ Today political instability is rife – in horizontal conflicts between the people and in vertical conflicts between the regions and the central government.

Vertical conflict, defined as conflict between central and regional government, is strongest in the four provinces rich in natural resources: Aceh, Papua (Irian Jaya), Riau and East Kalimantan. The re-emergence of the Movement for a Free Aceh (*Gerakan Aceh Merdeka*, GAM) appealing for an independent Aceh, the increasingly intense separatist action by the organisation for Free Papua (*Organisasi Papua Merdeka*, OPM), and the strong pressure for either separation from Indonesia or increased support for federalism in Riau and East Kalimantan, all reflect these regions' dissatisfaction with the present system. The result of the 1999 East Timor referendum favouring separation from the Republic of Indonesia has been a major trigger to action.⁷ These public expressions of dissatisfaction are recognised as a 'disintegration threat' to the nation – an integral part of Indonesia's multi-dimensional crisis that is economic, political, social and cultural and is expressed in falling public confidence.

The long-standing problem of inequality between eastern and western Indonesia cannot explain this increase in vertical conflict.⁸ Political economy analyses offer explanations in military and political repression and concentration of authority in the central government, especially in the economic sector and development

⁶ Huntington (1996: 4–5) has observed that political instability and disorder following the fall of authoritarian regimes in post Cold War Europe is because these regimes slowed the development of political institutions and organisation.

⁷ In 2001 East Timor is under the supervision of the United Nations Transitional Administration for East Timor (UNTAET) while in transition to independent nationhood. A majority of the East Timorese population endorsed independence in a UN supervised referendum agreed to by the Habibi government in 1999.

⁸ For analysis of the inequality between Eastern and Western Indonesia see Sondakh (1994) and Sjafrizal (1997). This inequality is still considered a national problem and its resolution is one of the concerns stated in the 1999 GBHN, which is the state policy guidelines issued by the parliament and followed by the executive arm of government when designing and implementing policies.

planning.⁹ In this study we seek clearer understanding of these vertical conflicts by examining how regional dissatisfaction relates to various measures of regional disparity.

We consider several dimensions of inter-regional disparity and analyse the correlation between regional prosperity and community welfare. We then consider the aspirations of the regions that give rise to the present conflict – the so-called ‘aspiration to inequality’ – in the context of the New Order’s equalisation policies. In concluding we propose ideas for using the current decentralisation momentum to reconstruct equalisation policies for fairer development across the nation.

II. Community Welfare and Regional Prosperity: Evidence of Correlation?

Regional prosperity may or may not result in community welfare. To explain Indonesia’s regional tensions it is thus appropriate to question the nature of correlation between regional prosperity and community welfare. First we consider dimensions of regional disparity using various measures in order to address the primary question ‘*inequality of what?*’

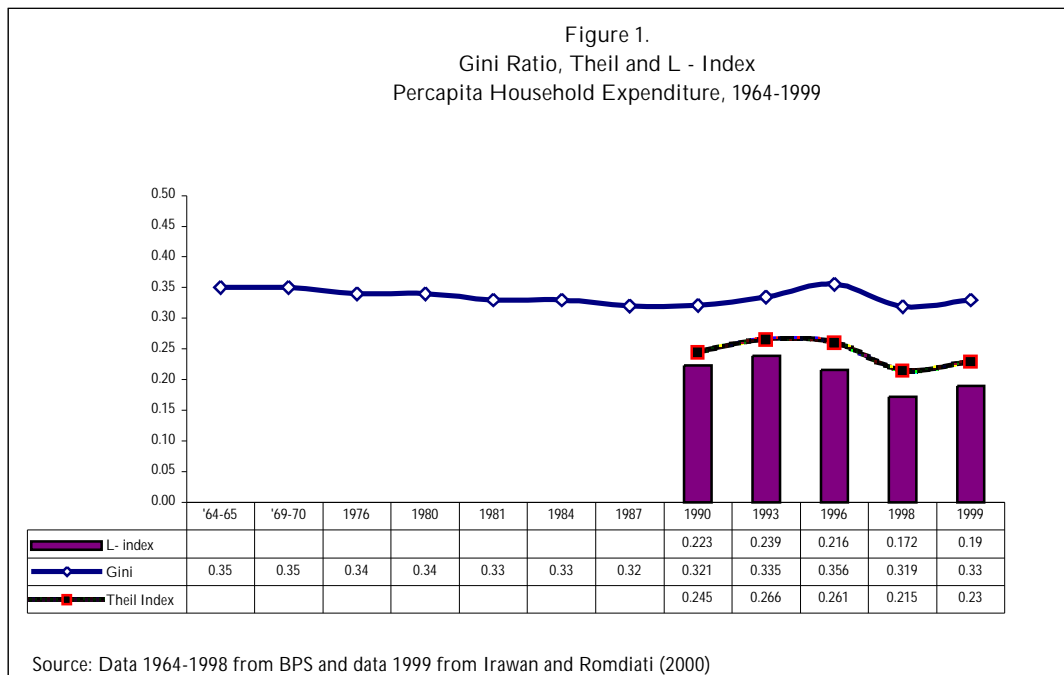
Welfare Inequality

A number of indicators are used to analyse community welfare: household expenditure (based on consumption approach), education, health, and the composite Index of Human Development (HDI). The most common index of inequality is the Gini Coefficient. The Gini Coefficient of individual expenditure in Indonesia during the period 1964–99 was 0.31–0.35, which is relatively low by international standards (Table 1) and did not show any sign of widening during the last three decades (Figure 1). During this period, the Indonesian economy had an impressive growth rate of 7 per cent on average, before the onset of the monetary crisis towards the end of 1997.

⁹ See political analysis by Harris (1999), Nur et al. (1999), and the works on regional development analysis by Hill (1994) and Madjidi (1997) that highlight ignorance of regional difference as the major weakness of the centralised program.

The experiences of Indonesia and other East Asian countries have disproved the ‘conventional wisdom’ positioning growth in opposition to equality (the Kuznets U-shape hypothesis).¹⁰ Arief’s econometric study (1998) proved the Kuznets hypothesis invalid for Indonesia.

Although inequality in Indonesia was considered low by international standards, the regional decomposition analysis shows that inequality *within* provinces contributed to approximately 80 per cent of total inequality. The remaining 20 per cent derived from inequality *between* provinces (based on Theil and L-index measurement presented in Table 2).¹¹ Inequality within provinces reflects inequalities among expenditure groups, between the wealthy and the poor, between natives and immigrants, and all forms of expenditure inequalities among individuals within a province.



¹⁰ Birdsall *et. al.* (1995) argued that to learn from East Asian growth we must move from the conventional wisdom of growth versus distribution (Kuznets, 1955) to a view that does not place growth and distribution as a dichotomy. Their study concluded that low inequalities had a positive impact on economic growth and are factors that contributed independently to rapid economic growth in East Asia.

Different sets of welfare parameters such as education, health, and the composite index of HDI, show that the inequality in regional welfare was significantly lower than the inequality in regional output (Figure 2). Using district level data, the L-index demonstrates that inequality in regional output was 92 times greater than the inequality in the regional average of the HDI. Measuring regional inequality using social indicators like education, health, and HDI based on regency level data is a new exercise for Indonesia. Earlier analyses of regional inequalities in this country have focused on per capita output inequality (GRDP) or household expenditure inequality, using provincial level data.¹²

There is by now considerable evidence to show that attainment of a low level of regional inequality in community welfare was assisted by equalisation policies implemented by the New Order government, mainly through fiscal policy instruments such as central government transfer, inter-regional transfer and other initiatives within the *Inpres* scheme for provincial governments (*Inpres Dati I*). These policies were applied primarily through centralised financing. The central government pooled the largest part of tax revenue and natural resource contributions from the exploitation of oil, gas, mining and forestry, which are concentrated in a small number of districts. The pooled funds were allocated to the provinces throughout Indonesia via centralised budgets to finance public expenditure, especially for the provision of basic services.

¹¹ By applying regional decomposition analysis, Theil and L-measurement can be broken down, where *total inequality* = *within region inequality* + *intra-region inequality* ($I = I_W + I_B$).

¹² Esmara (1975) pioneered the study of regional disparity in Indonesia followed by Uppal and Handoko (1986), Akita and Lukman (1995), Takeda and Nakata (1998) and Garcia and Soelistyaningsih (1998). These studies focused on per capita (GRDP) analysis at the regional level. Most other studies are based on household consumption by Gini Coefficient. No earlier analyses of regional inequalities used broader social welfare indicators.

Table 1
Income or Consumption Inequality Around the World
1970s – 1990s

Sub-region and country	Gini Coefficient		
	1970s	1980s	1990s
Newly Industrialised Economies			
Hong Kong, China	0.41	0.37	0.45
Korea, Rep. Of	0.33	0.39	0.34
Singapore	0.41	0.41	0.39
Taiwan, Rep. of China	0.28	0.28	0.31
China	n.a.	0.32	0.38
Southeast Asia			
Indonesia	0.31	0.36	0.32
Malaysia	0.50	0.51	0.48
Philippines	0.49	0.46	0.45
Thailand	0.43	0.43	0.52
South Asia			
Bangladesh	0.36	0.39	0.28
India	0.30	0.31	0.30
Pakistan	0.30	0.32	0.31
Sri Lanka	0.38	0.42	0.30
Eastern Europe		0.25	0.29
High Income Countries		0.33	0.34
Middle East and North Africa		0.41	0.38
Sub-Saharan Africa		0.44	0.47
Latin America and the Caribbean		0.50	0.49

Source: Deininger and Squire (1996),
<http://www.worldbank.org/research/growth/dddeisqu.htm>

Table 2
***Theil and L - Index* of Per capita Household Expenditure (SUSENAS)**
Applying Regional Decomposition Analysis by Provinces, 1990–1999

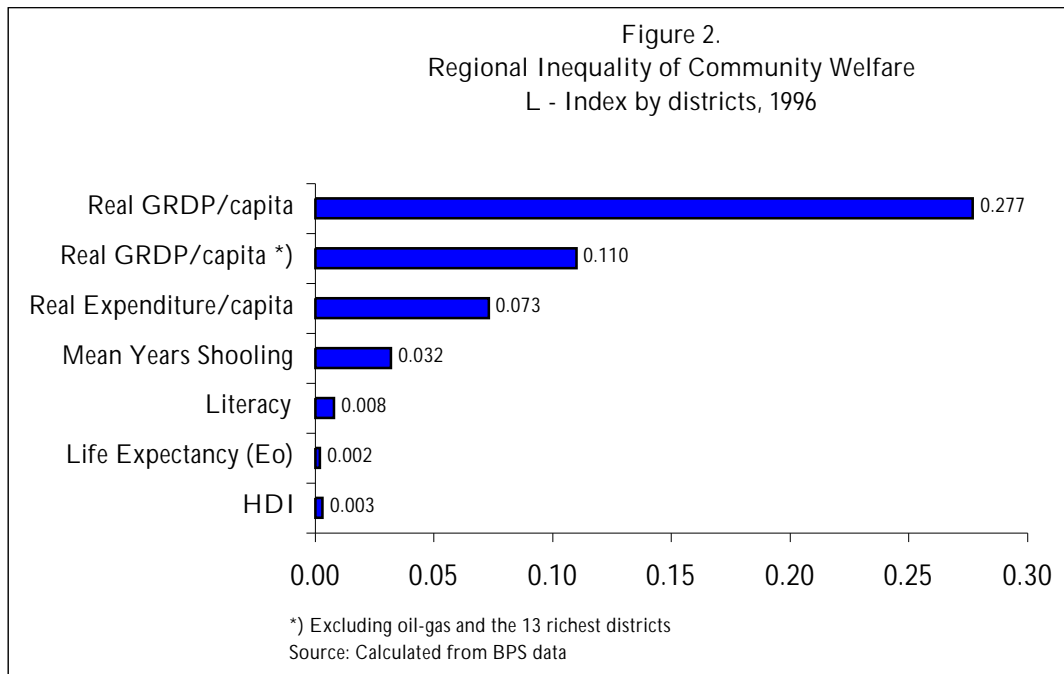
Theil Index	1990	1993	1996	1998	1999
Total	0.245	0.266	0.261	0.215	0.230
Between Provinces	0.041	0.050	0.053	0.043	0.050
Within Provinces	0.204	0.216	0.208	0.172	0.180

Share (%) Between Provinces	17	19	20	20	22
Share (%) Within Provinces	83	81	80	80	78

L-Index	1990	1993	1996	1998	1999
Total	0.223	0.239	0.216	0.172	0.190
Between Provinces	0.030	0.036	0.045	0.038	0.040
Within Provinces	0.193	0.203	0.171	0.134	0.150

Share (%) Between Provinces	13	15	21	22	21
Share (%) Within Provinces	87	85	79	78	79

Sources: Calculated from BPS (Indonesian Central Bureau of Statistics, *Badan Pusat Statistik*) for 1990–1998 and from Irawan and Romdiati (2000) for 1999.



Output Inequality

Only a few of Indonesia's 291 districts¹³ have a very high per capita output and can be considered as enclave regions. Their endowment is mainly oil, gas, or other natural resources. From the distribution of per capita output, these enclave regions can be seen as outliers. We analysed outliers and their contribution to the overall pattern of regional inequality through data screening. First, we eliminated the oil and gas values from the GRDP of all districts and the mining value from the GRDP of the district of Fak-Fak. Per capita GRDP of respective districts was ranked in ascending order, revealing that the top 13 districts – categorised as industry, trade and service enclaves – have very high per capita GRDP values.¹⁴ We excluded these 13 enclave districts from the analysis.

Oil and gas production is mainly concentrated in seven districts located in the four natural resource rich provinces of Aceh, Riau, East Kalimantan and Papua, where public expression of dissent is strongest.¹⁵ These four regions contribute around 72 per cent to the national GDP from oil and gas. By adding these seven districts to the top 13 districts with the highest per capita output mentioned earlier, the number of enclave districts increases to 19, since Kutai regency is included on both lists. Kutai regency produces oil and gas and its per capita output is high even after subtracting the oil and gas contribution to its GRDP. These 19 regencies contribute 33 per cent to the national GDP yet they have merely 9 per cent of the national population. These districts are extremely rich in natural endowment.¹⁶

Regional output inequality is significantly lower when outliers are excluded from the analysis (Table 3 and Figure 3). Based on per capita GRDP, excluding oil and gas, and the 13 wealthiest districts which are the industrial, service and trade enclaves, the Gini Coefficient value of per capita GRDP per district was 0.24-0.27 in 1993–98. When the 13 districts were included, the Gini Coefficient value increased to

¹³ There were 291 districts in Indonesia in 1996, consisting of 231 regencies and 60 towns.

¹⁴ The districts are Batam (fast growing industrial area), Jakarta (capital and largest metropolis), Kudus (centre of the tobacco industry), Surabaya (second largest metropolis), Kediri (where Gudang Garam, the country's largest cigarette maker, operates), Kutai (oil, gas, forestry and mining), Berau (forestry and mining), Balikpapan (oil refineries), and Samarinda (capital of East Kalimantan).

¹⁵ North Aceh (Aceh), the islands of Riau and Bengkalis (Riau), Kutai, Bulungan, and Balikpapan (East Kalimantan), and Fak-Fak (Papua).

0.36–0.38, while the inclusion of oil and gas value further increased the Gini Coefficient to 0.41. The Theil and L-index measurements of inequality also revealed a similar trend. Excluding oil and gas and the top 13 enclave districts significantly decreased the inequality level from 0.33–0.34 to 0.10–0.12 (Theil index) and from 0.26–0.27 to 0.09–0.11 (L-index). The exclusion of oil and gas decreased the Theil index only to 0.26–0.28 and the L-index to 0.21–0.23 (Table 3). Therefore, based on both Theil and L-index measurements, the contribution of the enclave districts was about 60–70 per cent of the overall inequality level with regard to regional output (Table 4). In other words, if the outliers were excluded from the computation, the regional inequality level in terms of output per capita would be trivial.

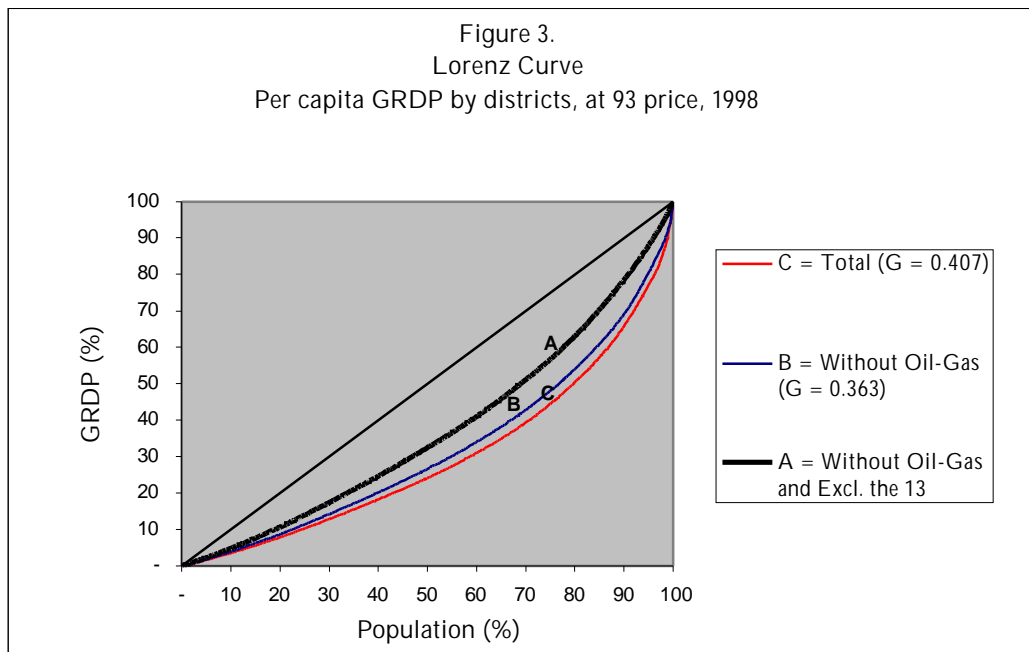
In sum, two factors affect the formation and development of the enclave districts. One is the endowment of natural resources such as oil, gas, minerals and forestry which attract investors who exploit these resources and hence have tremendous output capacity. The districts in this category are North Aceh in Aceh province, Bengkalis and Riau islands in Riau, Kutai, Berau, Bulungan, Balikpapan and Samarinda in East Kalimantan, and Fak-Fak in Papua. The second factor affecting enclave formation is policy driven, based on comparative advantages deriving from such factors as strategic location and infrastructure. Examples are Batam City, Jakarta and Surabaya.

¹⁶ See Table 5 for the economic characteristics of the 19 enclave districts.

Table 3
Several Measures of Regional Output Inequality
Based on Per capita GRDP by districts, 1993 Price, 1993–1998

	1993	1994	1995	1996	1997	1998
<u>Gini</u>						
Total	0.412	0.411	0.411	0.415	0.415	0.407
Without oil–gas	0.363	0.366	0.371	0.378	0.381	0.363
Without oil–gas, minus the richest 13 districts)	0.248	0.251	0.256	0.267	0.271	0.257
<u>Theil</u>						
Total	0.342	0.339	0.336	0.338	0.339	0.345
Without oil–gas	0.263	0.268	0.275	0.282	0.288	0.266
Without oil–gas, minus the richest 13 districts)	0.102	0.104	0.108	0.119	0.122	0.109
<u>L-Index</u>						
Total	0.274	0.273	0.270	0.277	0.277	0.268
Without oil–gas	0.213	0.217	0.222	0.230	0.234	0.212
Without oil–gas, minus the richest 13 districts)	0.096	0.098	0.102	0.110	0.114	0.103
<u>CVw</u>						
Total	1.076	1.067	1.070	1.073	1.080	1.165
Without oil–gas	0.923	0.938	0.962	0.966	0.982	0.965
Without oil–gas, minus the richest 13 districts)	0.483	0.489	0.511	0.526	0.534	0.501

Note: The 13 richest districts are development enclaves in terms of industry, trade and services
Source: Calculated from BPS data



Sources: Calculated from BPS data

Table 4
Percentage Decline in Regional Output Inequality
After Taking Out Oil and Gas Sector and the 13 ‘Enclave’ Districts, 1993–1998
(Per capita GRDP by districts, 1993 Price)

	1993	1994	1995	1996	1997	1998
<u>Gini</u>	40	39	38	36	35	37
<u>Theil</u>	70	69	68	65	64	68
<u>L-Index</u>	65	64	62	60	59	62
<u>CVw</u>	55	54	52	51	51	57

Source: Calculated from table 3

Regional Output and Community Welfare: Is there Correlation?

Data indicate that despite relatively high regional output inequality, inter-regional community welfare is relatively equal as a result of the government’s equalisation policies. Figure 2 indicates the L-index measurements among districts, with regional output inequality almost four times higher than regional expenditure inequality. This is much lower than in Thailand where the L-index figure of regional output inequality is 0.43, and expenditure inequality is 0.40.¹⁷ Compared to the distribution of regional output, Figure 2 also shows the relatively even distribution of education, health and HDI.

Figure 4 shows more clearly the lack of correlation between regional output by district and the various community welfare indicators of respective regions. The correlation test proves no strong correlation between regional output and community welfare. The coefficient of correlation between per capita output and the HDI, as well as other welfare indicators, is relatively small. Even though the enclave districts have very high per capita GDRP and can be clearly distinguished as outliers, their levels of community welfare are almost the same as other districts’ levels.

¹⁷ Based on provincial data from Thailand (1995), extracted from the *Human Development Report of Thailand 1999*.

Table 6 indicates in more detail the comparison between regional output and community welfare of the 19 enclave districts. Indicators such as consumption, education, health and HDI are more or less similar to those of the national average, regardless of these districts' high level of per capita output. The most classic case is Fak-Fak (Papua) where the US-based mining company Freeport McMoran Copper and Gold Inc. has been engaged in copper, gold and silver mining since the late 1960s. This area has a per capita output 16 times higher than the national mining average but its HDI is 5 per cent below the national average and real consumption or expenditure is 18 per cent lower than the national average. Clearly the province of Papua does not receive the benefit from a fair share of the province's natural resources. Its per capita output is almost twice the national level, yet all community welfare statistics show the region's welfare is lower than the national average, with poverty two times higher than the national average.

At least two conclusions can be drawn from this analysis of the correlation between regional output and community welfare. First, by region, correlation between output level and community welfare is very low. In the enclave areas and the four natural resource rich regions, national policy does not transform local natural wealth into increases in local community welfare. This is a source of vertical conflict because the people of the local communities, especially the indigenous people, believe that they are the primary inheritors of all resources available in their region.

Second, indigenous people are largely denied benefit from the prosperity of their region. This is clearly reflected in the data on Fak-Fak. It is widely known that poorly developed local communities live within or near the enclave development areas where intensive exploitation of natural resources generates huge profit.¹⁸ Nevertheless national welfare distribution has left the indigenous people as both spectators and victims of the central government's development and equalisation policies.

¹⁸ For the case of Riau, see Harris *et. al.* (1999: 54–5).

Figure 4.
Per Capita GRDP and Other Welfare Indicators by Kabupaten/Kota, 1996

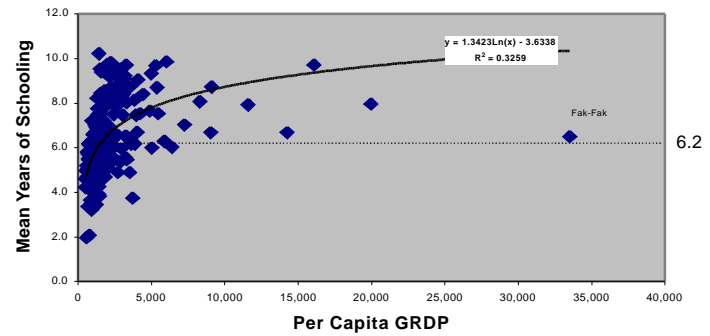
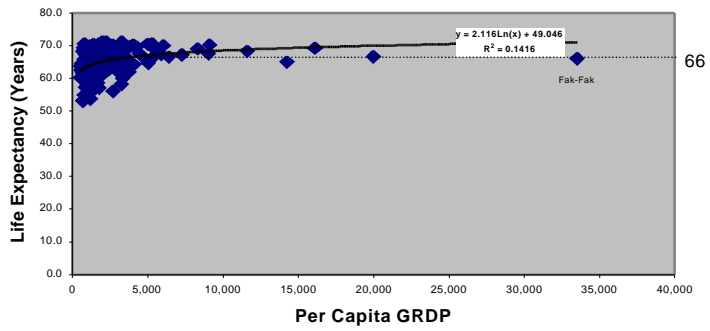
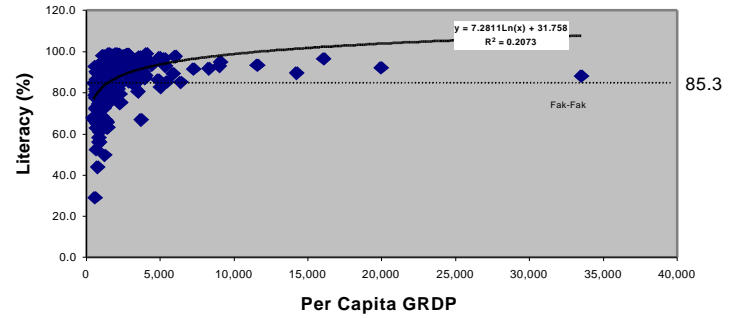
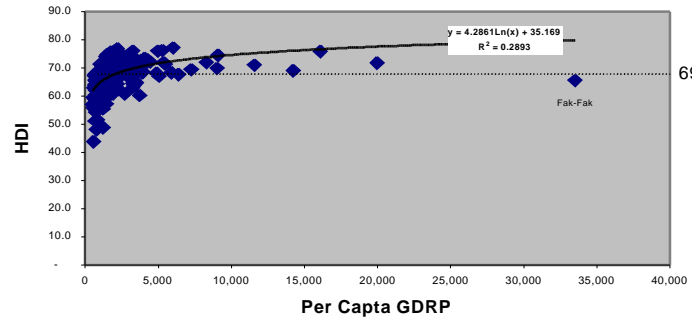


Table 5
Economic Characteristics of the 19 ‘Enclave’ Districts

Province	District	Characteristics
Aceh	1. North Aceh	Oil–gas
Riau	2. The Riau Islands 3. Bengkalis 4. Kota Batam *	Oil–gas Oil–gas Rapid industry area
Jakarta	5. Jakarta Pusat * 6. Jakarta Utara * 7. Jakarta Timur * 8. Jakarta Selatan * 9. Jakarta Barat *	Jakarta is the capital and biggest metropolitan city in Indonesia for industry, trade and services
Central Java	10. Kudus *	Centre of cigarette manufacturing
East Java	11. Kota Surabaya * 12. Kota Kediri *	Capital city, 2 nd metropolitan PT Gudang Garam (the largest cigarette manufacturing)
Bali	13. Badung *	Centre of the tourism industry
East Kalimantan	14. Kutai * 15. Berau * 16. Bulungan 17. Kota Samarinda * 18. Kota Balikpapan	Oil–gas + forest + other mining Forest + other mining Oil–gas + forest + other mining Benefited from oil–gas industries Oil–gas manufacturing
Papua	19. Fak-Fak	PT. Freeport Indonesia (Copper and silver mining)

* The 13 districts with highest GRDP/per capita without oil–gas. The other six districts are oil–gas producing areas (including Fak-Fak with PT. Freeport).

Table 6
Social and Economic Indicators of the 19 'Enclave' Districts, 1996
(Indonesia = 100)

Province	District	Region Prosperity	Community Welfare					
		GRDP/capita, Real	Exp/cap ² Real	E ₀ ³	Lit ⁴	MYS ⁵	HDI ⁶	Poverty ⁷ 1999
Aceh¹		139	82	103	111	132	102	59
	1. Aceh Utara	347	85	102	112	132	103	
Riau¹		239	117	104	115	130	104	52
	2. The Riau Islands	281	113	102	110	119	99	
	3. Bengkalis	432	100	103	114	126	101	
	4. Kota Batam	555	191	104	115	149	103	
Jakarta		341	230	110	119	179	112	44
	5. Jakarta Selatan	288	274	106	120	187	112	
	6. Jakarta Timur	253	222	107	119	183	111	
	7. Jakarta Pusat	770	241	105	119	183	110	
	8. Jakarta Barat	238	219	107	119	175	110	
	9. Jakarta Utara	435	195	107	117	164	108	
C. Java		66	80	106	100	104	101	119
	10. Kudus	241	81	98	102	113	97	
E. Java		83	83	97	95	104	95	119
	11. Kota Kediri	956	108	101	113	151	104	
	12. Kota Surabaya	256	137	101	114	166	104	
Bali		118	123	106	97	119	103	47
	13. Badung	261	159	105	105	142	104	
E. Kalimantan¹		392	130	102	111	136	103	100
	14. Kutai	681	123	99	110	126	100	
	15. Berau	306	146	101	105	113	98	
	16. Bulungan	193	184	106	109	126	103	
	17. Kota Balikpapan	397	135	105	113	153	104	
	18. Kota Samarinda	212	144	102	115	158	105	
Papua¹		165	91	98	83	94	89	176
	19. Fak Fak	1,604	82	100	108	123	95	
Indonesia		100	100	100	100	100	100	100

¹ The four resource rich provinces where vertical conflict has occurred

² Per capita Household Expenditure/month (real consumption)

³ E₀ is life expectancy at birth

⁴ Lit: adult literacy rate

⁵ MYS: mean years schooling

⁶ HDI: Human Development Index

⁷ Based on poverty head count from Susenas 1999 in Irawan and Romdiati (2000)

Source: Calculated from BPS data

'Aspirations to Inequality': The Challenge for Equalisation Policy

The data considered above indicate the economic outcomes of New Order policies that aimed to improve the aggregate level of community welfare while increasing the nation's economic growth. Undeniably these policies have achieved a constant low level of inequality with respect to aggregate welfare of the population. But this has come at the expense of some regions, as we see in the low correlation between regional prosperity and community welfare. This outcome has generated a collective awareness in the rich regions, particularly among indigenous people, that they do not receive what they see as their fair share of wealth generated from 'their' land. The aspirations of these people to the share of wealth produced by their region reflect not so much a desire for equality as, in the Indonesian context, an "aspiration to inequality". The aspirations are a response to the people's first-hand experience of their community welfare being reduced to, or even lowered below, the national average, even though their regions are rich in natural resources.¹⁹ These people are rising up against more than 30 years of political and economic repression under the New Order. They are disrupting the artificial stability achieved under the New Order's equalisation policies.

Studies attempting to analyse the correlation between economic inequalities and economic growth rates frequently convey the common assumption that low inequality reflects low potential for social conflict.²⁰ In the Indonesian data, the level of inter-regional inequality, which is relatively low by international standards, does not of itself reflect potential for social conflict. This is because the indexes examined illustrate only general economic/welfare differences between regions. However, vertical conflict in Indonesia is not the product of the magnitude of these differences, but of the position of particular regions within the overall distribution, and the correlation between regions' prosperity and their community welfare level. This means that even though welfare inequality is low nationwide, for people living in rich

¹⁹ On Riau's 43rd anniversary, *Kompas* daily newspaper wrote that 20 per cent of the 4.2 million population were living below the poverty line, and almost 70 per cent of the workforce lacked education. See '43 years of Riau: rich in resources, but people are still in poverty', *Kompas*, 10 August 2000.

²⁰ See Atinc and Walton (1998), Ravallion (1997), Rodrik (1994), and Barro (1999).

areas whose welfare status is not above or is even below the national average, the sense of injustice can become a trigger for conflict.

Our analysis of the correlation between regional prosperity and community welfare confirms this reason for the sense of injustice felt by people in the rich regions. Correlation is very low between per capita GRDP at the district level and several indicators of community welfare.²¹ The level of community welfare in rich regions is not higher than the national average, and for Papua it is in fact lower. Inevitably the people of the rich regions ask why they do not benefit from their region's wealth. Other factors have also fed into the vertical conflicts and many of these are derivative of the regional 'inequality' problem. One obvious example is the violation of human rights in the Military Operation Zones that were established to handle separatist movements in Aceh and Papua. Hence it is clear that effective moves to reduce vertical conflict must take into account the aspirations and sense of injustice felt by people living in the resource rich regions. These people are economically disadvantaged through national equalisation policies. The philosophy behind the New Regime's equalisation policy as a means for national unity is clearly unsustainable.

Revisiting Equalisation Policy

The present period of transition towards decentralisation and democracy is an ideal time to revisit the principles of the national government's equalisation policies, since the strategy has delivered both economic success and political failure. These policies directly affect inter-governmental fiscal relationships. Most important for equalisation are policies used to manage regional development, including policies on centralising finance and regional redistribution of development funds. Some policies designed primarily for other purposes also have an indirect impact on equalisation. For example, policies on the exchange rate and on distribution channels have negative implications for some regions. Studies on regional development in Indonesia by Sondakh (1994), Majidi (1997), and Hill (2000) point to how, particularly after the oil

²¹ The GRDP used for the calculation is the total GRDP, including gas and oil, although other studies would exclude them amid central government takeover. The intention to use the total GRDP acknowledges the belief of the indigenous people that they are the inheritors of the land.

boom era, government policies tended to disadvantage the primary sectors and indirectly produced a negative impact on production regions located mainly in the outer islands. This is especially true for some areas outside Java after the oil boom era. Yet distribution policies were the main ingredients of regional development policy and will be instrumental in achieving continued national economic development without stifling opportunity in rich regions.

Policies on Centralised Finance and Distribution

At the core of New Order equalisation policies was a system of tight fiscal centralisation and distribution of development grants to the regions. Fiscally, Indonesia is highly centralised with regional revenue completely consolidated by, and dependent on, the central government. In 1968, only around 7 per cent of national revenue was redistributed to the regions (Arndt 1970) with no major changes for the next 20 years. In the 1990s the central government still consolidated approximately 90 per cent of national revenue, leaving the regional governments with only about 10 per cent of total expenditure. Such a highly centralised fiscal system has left Indonesia with the worst financial inequalities in the world, as indicated by the deep vertical inequality in inter-governmental fiscal relations.²²

Grants from the central government come under three categories. One is grants from the central government to be spent by the regional governments that are incorporated into the regional budgets and registered into regional government's accounts. This includes the Subsidy for Autonomous Regions (SDO) and the *Inpres* (Presidential Instruction) scheme to fund development projects (*Inpres Dati I*). The second is grants from the central government to be spent by the regional governments, but which are not incorporated into the regional budgets and are not registered in regional governments' accounts, such as *Inpres* schemes for schools and health development as well as *Inpres* schemes for the *kabupaten* (regencies). The third is funds allocated by sectoral ministries to finance development activities in the regions and is channelled through each ministerial representative office in the region. These are known as sectoral funds and are much larger than funds granted under the other

²² For inequality in various countries see Shah and Qureshi in Basri (1997).

two categories.²³ This means the vast bulk of development funds is still controlled by the central government.

In principle, the government's aim of centralising revenue and redistributing it to the regions was to equalise development throughout the regions without taking into account regional prosperity and production capacity.²⁴ Distribution was to create regional uniformity as reflected in – per head of population – equal budget allocation, equal number of social facilities such as hospitals and schools, and even detailed specifications for delivering public services. This practice of economic homogenising denies not only the uneven endowment of resources but also the diversity of the Indonesian people. Geertz (1971:19) was prescient in his claim that “[A]rchipalegic in geography, eclectic in civilization, and heterogeneous in culture, [Indonesia] flourishes when it accepts and capitalizes on its diversity and disintegrates when it denies and suppresses it.”

The rich regions' 'aspiration to inequality' is therefore more than resentment at losing their economic advantage. It is also a popular reaction against the centre's moves to reduce cultural diversity. However, national economic development demands flexibility on the part of the rich regions in using their prosperity for the welfare of local communities. To achieve a policy outcome that accommodates these aspirations without hindering national economic development, the New Order philosophy of economic equalisation through centrally collected taxes and centrally distributed development funds will need to be replaced with a system that is more regionally sensitive. We argue for a new philosophy that aims to equalise people's opportunities rather than equalising the nation's distributed wealth, and aims to guarantee the provision of a minimum standard of basic services for all Indonesians without impeding the growth potential of any region.

²³ Suharyo (2000) who presented comparisons for 10 regions clearly illustrated measurements of sector funding proportions to total funding.

²⁴ In 1967–69 the government implemented a program of Automated Foreign Currency Allocation, in which regions received 10 per cent of the value of the exports they generated. The scheme was revoked in 1970 due to weaknesses of this program. See Arndt (1970).

Proposal for a New Philosophy on Equalisation

A new national policy based on the philosophy we refer to above proceeds from the recognition of considerable variation between the regions in their material and human resources. The philosophy we propose has two main prerequisites. First, this policy must provide opportunities for regions with abundant natural resources to achieve a higher level of welfare than they have hitherto. Second, the policy must assure that all regions will be able to provide at least a minimum level of basic services as a national standard. These moves are crucial to ensuring both fuller scope for the rich regions to develop and equal opportunities to all Indonesian citizens in a way that is likely to foster greater achievement.

In principal, the equalisation policy should not aim to centralise tax collection for national fiscal supply, nor distribute wealth evenly, by head of population, through a national development fund. Instead it should seek to build a national commitment toward social development to be implemented by all regions at that level,²⁵ as the basis for providing equal opportunities for all citizens in accordance with their own potential. This philosophy advocates a fair and just equalisation, and so does *not* seek homogeneity of the regions. It is fair and just in providing a platform for achieving minimum levels of output, the cost of which is shared by regions according to their financial ability to contribute.

A view common among observers of Indonesia is that offering a minimum level of basic services for all regions is unattainable, especially with the now very restrained government budget. However as we saw earlier in this study, inequality in social welfare across the regions is very low. This relatively equalised welfare level among regions (Table 7) provides a sufficient basis on which to implement the policy philosophy we propose above. Only a few regions like Aceh, Nusa Tenggara, and Papua would require special treatment.

²⁵ Islam (1999) discussed the need for a form of 'social accord'.

Table 7
Estimated Time Needed to Reach the 1996 National Average (Years)

Provinces	Social Welfare Indicators					
	Adjusted Real Consumption	Human Development Index	Human Poverty Index	Life Expectancy at Birth	Literacy Rate	Mean Years of Schooling
Aceh	1.0	a.n.a.	<u>23.0</u>	a.n.a.	a.n.a.	a.n.a.
N. Sumatra	3.4	a.n.a.	a.n.a.	2.8	a.n.a.	a.n.a.
W. Sumatra	a.n.a.	a.n.a.	a.n.a.	a.n.a.	a.n.a.	a.n.a.
Riau	3.2	a.n.a.	7.3	a.n.a.	a.n.a.	a.n.a.
Jambi	2.8	a.n.a.	a.n.a.	a.n.a.	a.n.a.	a.n.a.
S. Sumatra	1.0	a.n.a.	1.6	a.n.a.	a.n.a.	0.9
Bengkulu	2.4	a.n.a.	a.n.a.	a.n.a.	a.n.a.	a.n.a.
Lampung	1.0	a.n.a.	a.n.a.	a.n.a.	a.n.a.	2.0
Jakarta	a.n.a.	a.n.a.	a.n.a.	a.n.a.	a.n.a.	a.n.a.
W. Java	a.n.a.	a.n.a.	1.5	0.8	a.n.a.	a.n.a.
C. Java	a.n.a.	a.n.a.	a.n.a.	4.4	7.3	6.0
Yogyakarta	a.n.a.	a.n.a.	a.n.a.	a.n.a.	<u>12.2</u>	a.n.a.
E. Java	a.n.a.	4.2	a.n.a.	a.n.a.	<u>13.0</u>	5.3
Bali	a.n.a.	a.n.a.	a.n.a.	a.n.a.	5.6	a.n.a.
W. Nusa Tenggara	1.4	9.3	8.0	8.2	<u>28.1</u>	<u>19.2</u>
E. Nusa Tenggara	2.0	3.2	<u>10.2</u>	3.2	9.4	7.5
W. Kalimantan	1.1	2.5	7.0	2.8	4.5	6.0
C. Kalimantan	0.7	a.n.a.	7.6	a.n.a.	a.n.a.	a.n.a.
S. Kalimantan	0.1	1.2	0.2	4.0	a.n.a.	0.9
E. Kalimantan	0.2	1.4	a.n.a.	a.n.a.	a.n.a.	a.n.a.
N. Sulawesi	4.1	a.n.a.	a.n.a.	a.n.a.	a.n.a.	a.n.a.
C. Sulawesi	1.1	a.n.a.	a.n.a.	5.8	a.n.a.	a.n.a.
S. Sulawesi	2.3	1.4	6.2	a.n.a.	6.7	0.5
S.E. Sulawesi	1.1	0.1	a.n.a.	a.n.a.	a.n.a.	a.n.a.
Maluku	2.4	a.n.a.	1.8	1.3	a.n.a.	a.n.a.
Papua	1.0	4.1	<u>13.3</u>	5.0	<u>41.3</u>	<u>12.0</u>

Note:

- a.n.a : above national average

- Estimated time needed to reach the national average of 1996. Calculation based on comparing 1990 and 1996 data that show provincial speed of improvement in terms of social welfare indicators. These estimations are made by assuming that future policies will be similar to past policies. The estimations could be changed by arranging new policy scenarios.

Source: Calculated from BPS and UNDP (1997).

III. Concluding Remarks: Taking Advantage of the Decentralisation Momentum

Politically, Indonesia is undergoing a profound transition from a centralised, authoritarian government to a more decentralised, democratic government. This transition involves major dislocating shifts. As a response to political pressure from regions demanding decentralisation, the central government issued new laws on regional autonomy that came into effect on 1 January 2001. It is believed that these policy changes toward decentralisation will save the Indonesian nation from break-up.

Decentralisation also presents opportunities to move forward with a new philosophy on equalisation, which serves political as well as economic objectives. The philosophy we propose above advocates the pursuit of equality of opportunity undergirded by a guaranteed minimum level of basic services for all Indonesians. These conceptual changes in the equalisation policy paradigm accommodating the rich regions' 'aspirations to inequality' are crucial for Indonesian policy today, considering that demands for regional autonomy were triggered primarily by the rich regions' push for opportunities to improve regional welfare.

Under more than 30 years of Soeharto's New Order regime, the structure of a unitary state, reinforced by suppression of citizens' political rights, ensured that institutional glue would hold the regions of Indonesian together as a nation. Centralised economic planning directed impressive national economic growth accompanied by relative economic equality. Ironically, however, the equalisation policy that was to ensure national unity has instead motivated the 'aspirations to inequality', regional separatist movements and demands for greater regional autonomy that today threaten national disintegration. Regional disparity and vertical conflict will continue to mark the Indonesian political economy as long as equalisation policies fail to liberate the regions and their citizens from the grip of centralised tax collection and welfare distribution.

Appendix

Regional Output and Community Welfare: Clarifying Differences

To represent regional income, our study used regional output parameters that relate closely to a specific geographic area. Regency (*kabupaten*) and city (*kota*) are used as the smallest units. Data is for the GRDP (Gross Domestic Regional Product) at the district (regency and city) level. In this case, GRDP illustrates total value-added produced by the whole economy of a district in one year. Our data source is the regional account of the respective district as published regularly by the Indonesian Central Bureau of Statistics (*Badan Pusat Statistik*, BPS) since 1993. We use per capita GRDP to represent the output value per head of population in the region. Higher per capita GRDP results in a higher level of prosperity for the region. In other words, per capita GRDP reflects regional prosperity.

Welfare is represented by a number of parameters attached to an individual. In this study we used three major indicators: expenditure (consumption), education and health. Our use of these three categories is guided by the Human Development Index developed by the UNDP. Expenditure data uses per capita household expenditure, whereas education is measured by adult literacy rate and mean years of schooling. Health is represented by life expectancy at birth. All data are from *Survei Sosial Ekonomi Nasional*, SUSENAS (a household-based survey), carried out once every three years by BPS, covering 65,000 households across the country. The approach used in the SUSENAS survey is considered reliable for reflecting the individual welfare level within a given region.

Here we need to differentiate clearly between output level and welfare level. Output indicates regional prosperity and uses an area approach for calculation. Welfare is based more on the level of welfare within an area and uses a household approach. In one respect welfare is attached broadly to individuals or households, whereas in another it is attached to a specific area unit, which in this case is the district. However, we need to note that individuals or households refers to those who reside in an area with a certain level of output. Hence, it is relevant to try to find the correlation between output and welfare, as the two constitute different concepts.

In principle, regional output is the sum of all individual outputs in a specific area, as in the GDP national concept (Y). A number of factors can be subtracted from or added to Y to indicate disposable income (Y_d). Consumed Y_d is C , and unconsumed (saved) Y_d is S , where $Y_d = C+S$. Parts of consumed income are for education and health expenditure. In turn, education and health factors increase long-term human capability to generate disposable income. This is a very small cycle connecting regional output and community welfare.

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