

The Rise of Inequality in Indonesia: The effects of Globalization in the Labor Markets

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Abstract

Permasalahan nomor satu yang sangat mendesak di dunia saat ini adalah ketimpangan pendapatan yang semakin memburuk dan berdampak luas. Globalisasi telah menghasilkan dampak signifikan terhadap pasar tenaga kerja yang disebabkan karena adanya keputusan perusahaan-perusahaan global untuk merelokasi aktivitas yang berpusat pada tenaga fisik manusia dan kurang mengandalkan keahlian ke luar negeri. Disaat yang sama, perusahaan-perusahaan global tetap melakukan aktivitas yang mengandalkan keahlian kerja dalam negeri. Hal ini telah mengakibatkan meningkatnya permintaan tenaga kerja yang memiliki keahlian dan pendidikan tinggi di berbagai sektor, disaat yang sama menurunnya permintaan tenaga kerja yang kurang memiliki keahlian dan ketrampilan khusus. Isu global ini juga terjadi di Indonesia yang menyebabkan terjadinya ketimpangan pendapatan antar tenaga kerja. Tulisan ini mengelaborasi teori tentang ketimpangan ekonomi serta isu ketimpangan pendapatan di Indonesia sesuai studi terakhir Bank Dunia. Penulis sampai pada kesimpulan bahwa ketimpangan pendapatan tenaga kerja yang terus berlangsung memerlukan solusi berbagai aktor seperti pemerintah, sektor swasta, aktor/lembaga non pemerintah serta akademisi.

Kata kunci: *Globalisasi, Ketimpangan, Bank Dunia, Tenaga Kerja, Kemiskinan.*

Introduction

The increased of globalization in the last twenty years or so has brought many challenges as well as significant transformation to the way the world operates. There are several dimensions of globalization in particular that have impacted our world significantly, such as political, cultural, ecological, and economic. Each of these dimensions has its own important aspects of discussion. This paper in particular addresses the economic dimension of globalization which covers the topics of labor market and international trade, specifically on the matters of inequality in employment and labor income.

As globalization is both inevitable and a necessary condition for many global corporations to embrace in order to survive in the increasingly competitive world, there are several disadvantages of globalization that is easily to be overlooked. The negative aspects of economic globalization that will be discussed in particular related with its effects on the labor market especially in the developing or

emerging economies such as in Indonesia. This paper will examine more thoroughly the recent findings from the latest World Bank's report in November 2015 about Indonesia's rising inequality in the labor market. As the paper concludes, there will be several recommendations provided about what should be done in order to tackle this pressing issue of inequality in Indonesia.

Globalization have not reduced inequality in emerging economies: Eric Maskin's Theory

One simple definition of globalization according to Lechner and Boli which was stated in their book "The Globalization Reader" is the set of processes by which more people become more connected in more and different ways across ever greater distances

¹. This understanding of globalization is closely connected to the more specific definition of economic globalization proposed by Manfred B. Steger as the intensification and stretching of economic interrelations across the globe². The latter definition of globalization has strongly influenced the perspectives of its proponents in promising the benefits of globalization for the developing or poor countries, that it would surely bring prosperity and therefore reduce income inequality in those emerging economies.

While it has been true that the economic prosperity of many developing countries has grown dramatically due to globalization in particular through the international free trade implementation, in reality income inequality (in specific, wage inequality) has actually increased. Professor Eric Maskin, a 2007 Nobel Laureate in economics from Harvard University has proposed an alternative theory for the proponents of globalization in regards to the negative impact of globalization in emerging economies. According to Mr Maskin's theory, looking at the current wave of globalization, while average income has been rising as a result of more trade and global production, so has inequality within countries. This phenomenon is largely emanated from the understanding of how global production cycles sort labors into different jobs³. The industrial relocation system of production which has been widely operated by the majority of global companies has produced the needs for skills matching of workers between the developing and developed country. Mr Maskin's "Skills Matching" theory places workers into four classes: high-skilled workers in rich countries (A); low-skilled workers in rich countries (B); high-skilled workers in poor countries (C); and low-skilled workers in poor countries (D)⁴. The better workers are matched to each other according to their skills, the more productive ones they will become. For example, the low-skilled workers can be more productive

¹ Frank J. Lechner and John Boli, *The Globalization Reader*, 4th ed. (n.p.: Wiley-Blackwell, 2011).

² Manfred Steger, *Globalization: A Very Short Introduction*, 3rd ed. (n.p.: Oxford University Press, 2013).

³ Stephanie Garlock, "How globalization begets inequality," February 17, 2015, accessed June 26, 2016, <http://harvardmagazine.com/2015/03/how-globalization-begets-inequality>.

⁴ E Maskin, "Why Haven't Global Markets Reduced Inequality in Emerging Economies?," *The World Bank Economic Review* 29, no. suppl 1 (January 1, 2015).

when matched with high-skilled ones or when they work together, this is in large due to the knowledge transfer process that has been forged during their times of working together¹. Prior to the current wave of globalization which was started in the 1980s, the skilled and unskilled workers in developing countries—the Cs and Ds—worked together. Maskin points, for example, in a pre-globalization rural India, a rural Indian man who is capable of speaking English fluently might help the local farmers to understand the modern agricultural methods based on the text book he has learned from his previous education background. As a result, due to the interaction with the well-educated rural Indian man (typifies the Cs), the local farmers (the Ds), were able to have their total agricultural production output increased. Consequently, this in turn has made the wages for the Ds workers increased, so the inequality of wage income in the developing countries has been reduced significantly².

However, due to the latest wave of globalization, the high-skilled workers in poor or developing countries (the Cs) are able to access better quality of work opportunities more easily with the low-skilled workers in the developed or rich countries (the Bs), which has the negative effect of leaving their poor neighbors or low-skilled workers (the Ds) left behind. As for example, the customer services type of work in IT call centers across India which is owned by the US-based multinational corporations, has outsourced the majority of high-skilled workers in the country, which according to research from Cornell University most of those Indian workers has a bachelor's degree, even though at the eyes of the rich-world standards, these production process should be commonly handled by the low-skilled or low-educated workers in the developed countries if the jobs were not sent overseas³. Another example from the previous story of rural Indian English speaking man, due to the latest movement of globalization, he could have a better opportunity to work in an US owned export factory in the city where he interacts regularly with his American supervisor, the Bs workers, which has been relocated to India. As a result, the Cs workers which are represented by the rural Indian English speaking man as the high-skilled workers in poor countries, ended up working together side by side with the Bs, or the low-skilled workers in rich countries, and they become more productive. Sadly, the Ds are left by the wayside without having any opportunities to move upward in their career ladder. Therefore, globalization as Mr Maskin's theory concludes, has not reduced inequality in developing countries, but in fact it just the opposite, globalization has increased inequality through the existence

¹ The Economist, "Revisiting Ricardo," August 23, 2014, accessed June 26, 2016, <http://www.economist.com/news/finance-and-economics/21613280-why-globalisation-not-reducing-inequality-within-developing-countries-revisiting>.

² E Maskin, "Why Haven't Global Markets Reduced Inequality in Emerging Economies?," The World Bank Economic Review 29, no. suppl 1 (January 1, 2015).

³ The Economist, "Revisiting Ricardo," August 23, 2014, accessed June 26, 2016, <http://www.economist.com/news/finance-and-economics/21613280-why-globalisation-not-reducing-inequality-within-developing-countries-revisiting>

of unequal wages between the skilled and unskilled workers due to the difference of productivity and unequal opportunities of advancing one's career in their work.

Inequality in Indonesia: A Portrait from the World Bank 2015 Report (“Indonesia’s Rising Divide”)

What is actually inequality? The basic definition of inequality according to the Oxford Advanced Learner's Dictionary is the unfair difference between groups of people in society, when some have more wealth, status or opportunities than others. In a more advanced definition provided by the Department of Economic and Social Affairs of the United Nations, inequality is the state of not being equal, especially in status, rights, and opportunities¹.

In the last couple of years, the issue of inequality has become an increasingly significant topic in the global debate, so much so that it has been chosen as the number one challenging issue facing the world's regions in the 2015 Outlook on the Global Agenda by the World Economic Forum². In addition, The United Nations through its Post-2015 Development Agenda or the new Sustainable Development Agenda, has stated inequality as one of the 17 (seventeen) global goals that needs to be addressed and reduced by 2030³.

In Indonesia, according to the latest report from the World Bank in November 2015, the level of income inequality is considered to be significantly high and rising faster than most of its neighboring countries in East Asia⁴. In 2002, the top 10 percent richest Indonesian has consumed as much as the 42 percent of the poorest population in the country combined, while in 2014, they have consumed as much as the 54 percent of the poorest population in the country combined⁵. Inequality is also measured by using the Gini coefficient, where 0 represents complete equality and 100 represents complete inequality. The level of Gini coefficient in Indonesia has increased from 0.30 in

¹ Development Strategy and Policy Analysis Unit of the United Nations, "Concept Of Inequality", Development Issues No.1, accessed June 21, 2016

<http://www.un.org/en/development/desa/policy/wess/wess_dev_issues/dsp_policy_01.pdf>

² REUTERS and Carlos Jasso, "1. Deepening income inequality," 2014, accessed June 26, 2016,

<http://reports.weforum.org/outlook-global-agenda-2015/top-10-trends-of-2015/1-deepening-income-inequality/>

³ Florencia Soto Nino, "Reduce inequality within and among countries - United Nations sustainable development," July 2, 2016, accessed June 26, 2016, <http://www.un.org/sustainabledevelopment/inequality/>.

⁴ The World Bank, 'Indonesia's Rising Divide', Executive Summary, November 30, 2015, accessed June 21, 2016.

⁵ The national poverty level in Indonesia is defined by the Central Bureau of Statistics (Biro Pusat Statistik/BPS) from the consumption perspective, which is measured according to the economic ability of each households to fulfill their basic needs (basic needs approach), such as food and non-food, which can be seen from the household's monthly consumption level or expenses. The threshold to classify the poor is called the poverty line. Thus, for households whose average of their monthly consumption expenses falls below the poverty line will be classified as the poor. In 2015 the Indonesian government stated the poverty line at a monthly per capita of 334,809 rupiah per person per month. Meanwhile, the World Bank measured the poverty line based on the income perspective, which classified poor people as people living on less than USD \$1.25 a day as poor.

2000 to 0.41 in 2014, at the highest level ever recorded (Appendix - Figure 1). All of these numbers have shown that income inequality is indeed rising rapidly in Indonesia.

Another important measurement that can be added is using the Human Development Index (HDI) achievement in each provinces, and thus compare the index numbers between the west and the east region of the country to see the stark differences. HDI is a global measurement created by the United Nations Development Programme to assess the human development achievement in each country, which mainly consisted of 3 (three) particular dimensions, i.e.: a long and healthy life, access to knowledge, and a decent standard of living¹. In terms of the achievement in Indonesia, the HDI in west provinces of the country such as in West Java and Jakarta is way higher than the east provinces area such as in Papua and West Papua. In 2015, the HDI in Jakarta is the highest one compared to all regions in the country, 78,99, as compared to Papua's, which is 57,25 (Appendix - Figure 2).

When it comes to the main causes of inequality in Indonesia, according to the research project conducted by the World Bank in November 2015, there are 4 (four) driving factors of inequality in this country, i.e.: inequality of opportunity, unequal jobs, high wealth of concentration, and low resiliency.

In regards to the first driving factor of inequality, the research results from the Bank has found that inequality of opportunity at birth and during childhood will determine one-third of all income inequality in the later stages of life. Surprisingly, it turned out that most of the factors that have caused the inequality of opportunity are beyond the individual's controls, such as the place of birth, the parent's level of education, and the gender of the head of the household. For the children born and raised in the poorer households, the lack of access to basic yet life-essential services such as quality education, good nutrition, clean water, proper sanitation and quality health services during their critical growing years will be impacting their future tremendously since they would be hindered in developing their life skills such as the cognitive and emotional skills, as well as having a lower educational levels, as compared to the children who grow up healthy and raised in the better-off households. Consequently, these poor children will have difficulties in reaching their full potentials in the future when they have become adults, mainly they would not be able to find a decent job due to their limited skills and educational level, and thus will earn less income as compared to their well-educated and better equipped peers.

The second driving factor of inequality in Indonesia is the increasing need in the modern industry and economy, in particular in the higher productivity sectors, to find and employ higher skilled labors which in turn will increase the wages of the skilled labors as compared to the unskilled

¹ Human Development Report Office, "2015 human development report", 2015, accessed October 3, 2016, <http://report.hdr.undp.org/>.

labors. This specific rising phenomenon of inequality in the Indonesia's labor market will be discussed more thoroughly in the latter part of this paper.

The third driving factor of inequality in Indonesia is the increasing concentration of wealth in the hands of the minority or a few of Indonesians only. The income generated from owning financial and other physical assets has benefited fewer households in Indonesia than in many other countries. It is estimated that the richest 10 percent of Indonesians own 77 percent of all the country's wealth¹.

The last driving factor of inequality in Indonesia is the low resiliency of the poor households in facing the sudden and unexpected shocks that would reduce their incomes and resources drastically. In Indonesia, the nature of poverty is quite transitory, which is shown by the high number of people considered to be situated in the near-poor living condition. There is approximately around 70 million or 26,9 percent vulnerable people of all the populations who might fall easily into poverty once natural disasters, chronic diseases or loss of employment occurs in their life. These vulnerable ones are sometimes called the 'Transient Poor', which defines the households whose consumption expenditure or income was not always below the poverty line and was sometimes above it, and thus occasionally they can become poor in one period of time, and in another period of time they can move out of poverty².

Inequality in the Indonesia's Labor Market: Globalization Effects

The globalization phenomenon has brought many significant changes to the labor market conditions in developing countries, as what have been shown recently in Indonesia's labor market as well. There is a rising demand of employers in Indonesia, both foreign and domestic corporations, to look for a higher skills as well as higher levels of education attainment in their prospective labors or employees' background.

According to the latest report from the World Bank, there is an increasing volume of employment in Indonesia requiring senior high schools or tertiary education attainment level over the past decade, which is from 22 percent in 2002 to 35 percent in 2013 (Appendix - Figure 3)³. In the mean time, at the present time, there are more than 30 million senior secondary graduates and more than 10 million tertiary education graduates in Indonesia's labor force. From 2010 to 2015, the number

¹ The World Bank, 'Indonesia's Rising Divide', Executive Summary, November 30, 2015, accessed June 21, 2016.

² Teguh Dartanto and Nurkholis, "The Determinants of Poverty Dynamics in Indonesia: Evidence from Panel Data," Bulletin of Indonesian Economic Studies 49, no. 1 (April 2013).

³ The World Bank, 'Indonesia's Rising Divide', Executive Summary, November 30, 2015, accessed June 21, 2016.

of workers with a tertiary education in Indonesia has increased by more than 1 million annually and those with a senior secondary education by more than 2 million annually¹.

Looking from the education level requirement conditions alone, one can easily conclude that there should be no difficulties for employers in Indonesia to find the right candidate for their organizations. In reality, the employees education level does not simply promise that their skills level will satisfy the employer's demand. From the survey held by the World Bank ("Skills for the Labor Market in Indonesia") in 2011, around 40 to 50 percent of employers in services and manufacturing sector in Indonesia has identified skills gap in their staff, which means it turned out that the employees in their respective companies are still lacking of required working skills in their daily job, such as thinking, behavioral, computer, and English skills, despite of their already high education attainment. According to another survey held by the ADB in 2015, it is estimated that 51.5% of the employed population in Indonesia is actually underqualified for their positions, meaning that more than half of the labors employed in various positions in Indonesia is actually lacking of the right skills required to perform well in their daily routines, despite holding post-secondary education qualifications².

Aside from the current trend of employers' higher demands to look for higher skilled workers, the nature of the new jobs that have been created for the past decade in Indonesia is mostly geared towards the need for low skilled, low-productivity and non-skill-intensive jobs³. Out of the total 20 million jobs which have been created from 2001 to 2012, 30 percent of these took place in the community, social and personal services sector, 28 percent in the wholesale, trade, and retail sector, while the manufacturing sector supplied only to 16 percent of the new employment creation. According to the World Bank, the creation of more productive jobs has been stalled due to a variety of factors such as underinvestment in infrastructure, a non-supportive investment climate, and a rigid labor regulations from the government among all other factors.

As a consequence of being employed in low-productivity and often informal type of jobs, most of the these low-skilled labors unfortunately are also trapped in low-wage jobs. Thus, this situation has created more inequality due to the widening wage gap between the increasingly higher wage for the few high-skilled workers as compared to the low wage for the unskilled or low-skilled workers. In addition, according to the recent study conducted by the ADB, the informal economy workers — such as the casual street vendors, scavengers, farm workers, and other type of casual workers — who are mostly considered to be among the low-skilled labors themselves, have much

¹ Emma R Allen and Asian Development Bank, *Analysis of Trends and Challenges in the Indonesian Labor Market* (n.p.: Asian Development Bank, 2016), accessed June 21, 2016, <http://www.adb.org/publications/analysis-trends-and-challenges-indonesian-labor-market>.

² Ibid.

³ The World Bank, 'Indonesia's Rising Divide', Executive Summary, November 30, 2015, accessed June 21, 2016.

lower earnings than the regular or formal economy workers, who are mostly consisted with the high-skilled workers. In 2015, the average monthly wage of casual employees in agriculture was Rp.0.8 million, casual employees not in agriculture was Rp.1.3 million and own account workers was Rp.1.4 million, while regular employees earned Rp.2.1 million on average. To emphasize, the average wage of regular employees was 2.6 times higher than that of casual employees in agriculture¹.

Another sad yet a true fact of labors' inequality in Indonesia is a different treatment the low-skilled workers received due to their insufficient educational background, which has made all the difference in the world. In August 2015, employees with a university degree have the highest average wages, which is at Rp.3.9 million, while employees that have only completed junior high school have an average wage of Rp.1.3 million. Therefore, it can be said that wage gains are increasingly associated with returns to education, while those with limited education are being left behind².

Moreover, another reason for inequality in Indonesia's labor market is a lack of access for the low-skilled and low-educated workers to gain technical skills and vocational training opportunities. Much of the negative effects resulting from not having access to important trainings can be seen mostly in the youth employment sector. According to the study held by the ILO in November 2015 regarding the labor and social trends in Indonesia, almost half of the employed youth in Indonesia are under-qualified for their positions and entered the workforce with unmatched qualifications which needed by their respective employers³. This is happened mostly because these youths leave their schools without finishing their education as well as experiencing poor quality education. Sadly, there is indeed a limited opportunity for these youths to develop the needed work-related skills later in their life. From the recent study held by the World Bank, it is estimated that less than 1 percent of youths aged 19-24 years old have attended training courses in engineering, IT, or languages⁴.

One of the main reasons of why there is such a few opportunities or access to technical training opportunities is due to the high cost needed to provide these kind of trainings from the employers' perspective, and since most of the firms in Indonesia is small-medium sized enterprises (SMEs) thus it is not making enough good sense for these firms to provide trainings to their workers. Compared to the other countries in East Asia, less than 40 percent of firms in Indonesia which employing more than 100 workers offer formal training, while 70 percent of firms in the region does provide formal training for their workers. Consequently, it is becoming more difficult for the low-skilled workers to

¹ Emma R Allen and Asian Development Bank, *Analysis of Trends and Challenges in the Indonesian Labor Market* (n.p.: Asian Development Bank, 2016), accessed June 21, 2016, <http://www.adb.org/publications/analysis-trends-and-challenges-indonesian-labor-market>.

² Ibid

³ International Labour Organization, "Labour and social trends reports," *Asia-Pacific Decent Work Decade*, July 9, 2015, accessed June 22, 2016, http://www.ilo.org/asia/info/research-and-data/WCMS_182359/lang--en/index.htm.

⁴ The World Bank, 'Indonesia's Rising Divide', Executive Summary, November 30, 2015, accessed June 21, 2016.

improve their skills and find better jobs due to the limited access to the "second-chance" skills training opportunities¹.

Solutions to the Inequality Problems in the Labor Market: The Role of Multiple Actors

Having discussed the inequality issues in the labor market and its impact in the long run, we should be thinking of what would be the solutions to these urgent issues. Certainly, the involvement of all respective actors or stakeholders in the labor market is greatly needed to solve these complex and challenging inequality problems in Indonesia.

The first important actor to solve the inequality issues in the labor market is the government. The role of government is very central and crucial in promoting better jobs and skills training for the workforce, particularly by increasing opportunities for the low-skilled workers to access higher productivity and higher-wage jobs. In order to attract more investors to create more productive jobs in the country, the Government of Indonesia should first increase its spending and investment on infrastructure, so that the core infrastructure basics such as road networks, ports, electricity and telecommunication facilities will be available throughout the country and so it will satisfy the demands of the foreign and domestic manufacturing firms to open their businesses in Indonesia². Second, the government should invest more in the social protection and social security systems in order to support the productivity of the labor force as well to provide coping mechanism for the vulnerable workers who work in the informal sector to survive and keep their jobs should the unwanted economic and health shocks happen in their poor households³. Third, the government should improve the dynamic relationship required between the education sector and the employers in the job market, specifically in order to reduce the youth unemployment, skill shortages, and skill mismatches issues in the future. In this way, the quality of the education provided in the educational institutions will be matched with the skills requirement demanded by the employers in today's competitive business world. In addition to these efforts, the local government in all provinces would need to ensure that the human development standards which is measured by the HDI has to be incorporated into their regional development planning activities, specifically in the dimension of access to knowledge, so that the low-skilled workers would be benefited from the education and training access and programs provided by the government. The last yet a very important role for the government to take is to ensure that all companies and employers will provide the essential workforce trainings in their respective workplaces through the Corporate Social Responsibility (CSR) initiatives,

¹ Ibid.

² Ibid.

³ International Labour Organization, "Labour and social trends reports", Asia-Pacific Decent Work Decade, July 9, 2015, accessed June 22, 2016, http://www.ilo.org/asia/info/research-and-data/WCMS_182359/lang--en/index.htm.

in order to guarantee that the skills of the low-skilled workers will be improved, and thus will be matched with the international demands in today's global competitive world. In Indonesia, the enactment of the 40th Constitution (Undang Undang No 40) in 2007 by the government has enforced each corporations in the country to conduct corporate social responsibility programs as part of their regular business operations¹.

The second actor to solve the inequality issues in the labor market is the private sector or companies. As what has been previously discussed, the major role for the private sector in solving inequality issues in the labor market is to provide the necessary workforce trainings and programs in order to improve the competitiveness of their own workers according to the business needs of the company, as well as to provide opportunity for the low-skilled workers to access better quality and more productive type of jobs. Another type of action that might be possible for the companies to do through their CSR initiatives is to create the apprenticeships and internship programs for the youths, specifically for the bright and high achievers youth located in the poor and remote regions of the country such as in Papua or East Nusa Tenggara. These poor yet clever youths living in remote areas of the country are indeed often being marginalized in not being able to access potential employment opportunities due to their disadvantaged locations and poor family economic background.

The third actor needed in solving the inequality issues in Indonesia is the role of the non-state actors, specifically the Non-Governmental Organizations (NGOs) and the Donor Agencies. These important actors are very instrumental in providing the necessary assistance for the companies and government in order to enable them to conduct a quality workforce training programs, such as providing technical or capacity building as well as funding assistance. In Indonesia, there are many NGOs which possess excellent qualifications and experience in providing these kinds of support for the local government in different parts of the country.

The last yet also an important actor needed to contribute in solving the inequality issues in the labor market in the country is the university or academia community. As what has been discussed in greater details previously, the globalization era in our modern economy requires higher skilled labor. Therefore, the university also should be willing to step down in playing a significant part to educate and upgrade the low-skilled labors by assisting the employers in providing technical assistance at their workforce training sessions. In addition, the university and academia can also assist the lower level of educational institutions such as the vocational and regular high schools to ensure that their curriculum meets the technical demands of the employers and thus the youth entering the workforce

¹ *Undang-Undang Nomor 40 Tahun 2007*, accessed July 23, 2016, <http://www.hukumonline.com/pusatdata/detail/26940/node/70/uu-no-40-tahun-2007-perseroan-terbatas>.

once they graduated from these high schools will have the matched and necessary qualifications required by the employers.

In conclusion, having all the necessary actors' involvement in solving the challenging yet rising issues of inequality in the labor market is indeed will offer a better solution and hope for Indonesian workforce to compete and excel in today's increasingly competitive global labor market.

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