

POVERTY REDUCTION IN INDONESIA: A CHALLENGE FACING ASEAN ECONOMIC COMMUNITY

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ABSTRACT

Poverty reduction is an important agenda of Indonesian government. Endeavors to reduce poverty require identification of its main influencing factors. This research was conducted to show the role of economic growth and entrepreneurship in alleviating poverty in Indonesia. Descriptive analysis was done using secondary data and several empirical findings. This study shows that poverty in Indonesia decreased as the economy grew continuously in the long period of time. During the Asia financial crisis poverty jumped up, but then reduced again as the crisis ended and the economic growth did persist. This conclusion is in line with findings of various empirical studies. Two empirical studies in North Sulawesi indicate that entrepreneurship influence household income positively. These findings state that entrepreneurship or entrepreneurship spirit enable households to perform well in economic activities result in higher household income. As household income increases, poverty reduces. It means that entrepreneurship has positive influence on poverty reduction. In macroeconomic view, increased income of households causes increased economic growth. This study concludes that economic growth reduces poverty and that entrepreneurship has positive influence on economic growth as well as poverty reduction. It is recommended that, the endeavor to reduce poverty should always be one of the government priorities and that the government should keep on struggling to foster economic growth as an important way to reduce poverty. Poverty reduction as a result of economic growth supported by strong entrepreneurship enables this country to be better prepared facing Asean Economic Community.

Key words: economic growth, entrepreneurship, poverty reduction

INTRODUCTION

World leaders in the United Nations Millenium Summit of 2000 saw how important is to work together to reduce poverty in order to realize a more peaceful, prosperous, and fair world (Bates-Eamer *et al.*, 2012: 4). Poverty, therefore, is a multi-dimension problem of mankind, and poverty reduction is a multi-purpose program approved by world leaders to be implemented across nations.



In Indonesia, the government and the people have been struggling with poverty for long time, since the beginning of independence in 1945. Almost every Indonesian suffered with poverty in the early history of Indonesia as a new independent nation. But, the proud of being independent Indonesia and the struggle to defend the country from the colonialist caused the people to ignore their miseries of poverty (Zanden and Marks, 2012). In the mid of 1960s, Indonesia was a very poor country, as one of the poorest countries in the world. Benjamin Higgins in 1968 characterized Indonesian economy of the 1960s as *a chronic economic dropout* (Hill, 2000).

New-order government began the development of Indonesia with its first Five-Year Development Plan in 1969. Poverty reduction during this era is considered as very successful. Asian Financial Crisis that hit Indonesia in 1997 caused the poverty rate to jump high, but then after the crisis, especially in the decentralization era, continue to decrease.

Balisacan *et al.*, (2002) begin their report by stating that by international standards, Indonesia has done remarkably well in both economic growth and poverty reduction. For two decades prior to the Asian financial crisis in the late 1990s, economic growth averaged 7 percent per annum, substantially higher than the average growth rate of 3.7 percent for all developing countries. At the same time, Indonesia's poverty incidence fell from 28 percent in the mid-1980s to about 8 percent in the mid-1990s, compared with the poverty reduction from 29 to 27 percent for all developing countries excluding China.

The preceding description encourages us to conduct this study on poverty reduction in Indonesia. The objective of this study is to know the progress of poverty reduction in Indonesia and to comprehend it in line with the progress of economic growth. Then, this study is intended also to show the connection of entrepreneurship and economic growth by reviewing previous empirical studies.

METHOD OF RESEARCH

This report is the result of a review of empirical findings as well as analysis of secondary data on poverty and economic growth in Indonesia. Secondary data were obtained from Statistical Center Board (Badan Pusat Statistik) and various reports of empirical studies. Secondary data were descriptively analyzed to achieve the objective of this study. Various empirical findings were used in comprehending poverty reduction in Indonesia from various perspectives. Hence, this research



is a descriptive analysis based on secondary data and review encompassing various reports of empirical studies.

RESULT AND DISCUSSION

Economic Growth and Poverty Reduction in the New-Order Government.

Poverty in Indonesia reduced significantly during the era of new-order government of Soeharto. The incidence of absolute poverty, the percentage of population below the poverty line declined from 40.08 percent in 1976 to 11.34 percent in 1996. The benefit of growth seems to have been distributed fairly widely, and all provinces have increased income, consumption, and employment (Islam, 1998).

Development of Indonesia from 1969 to 1997 has been successful as shown by the rate of economic growth. During this period of 28 years, the economic growth rate is very impressive. Hal Hill estimates that Indonesia's real GDP per capita that in 1965 was only US \$ 190, increased to US \$ 610 in 1991. That increase of per capita GDP is a result of an average economic growth rate of 4.6 percent annually. In the period of 1984 to 1996, the economy's annual growth rate is 6.83 percent in average (Suryahadi *et al.*, 2012). The main contribution to the economic growth comes from the average annual growth of manufacturing industry sector (7.25 percent), servis sector (7.18 percent), and agriculture sector (4.65 percent).

High economic growth during the new-order government can be associated, among other, to the rapid pace of development, starting from quick process of decision making that is essential in inducing economic development. The phase of democracy in the period of time allows quick decision making as well as pace of development due to the strong leadership and authority of Soeharto. As Boediono (2009) expresses, inducing economic development basically requires quick steps as well as rational, consistent, and long-term-oriented -- *short term pain for long-term gain*.

Table 1. GDP and Population Growth (percent), Indonesia

Growth (annual rate)	1960-1967	1968-1982	1983-1996	1997-1999	2000-2010
Real GDP	2.0	7.5	7.2	-6.4	5.2
Real GDP per capita	-0.5	4.9	5.3	-7.7	4.0
Population	2.5	2.4	1.7	1.3	1.2

Source: See Elias and Noon (2011)



Table 1 shows that the real GDP growth rate is very low in 1960s and then increases significantly to 7.2 percent and 7.5 percent annually in the periods of 1968-1982 and of 1983-1996 before it drops to negative growth as the Asia Financial Crisis struck Indonesia in 1997 --the severity of the crisis reached the peak in 1998 when Suharto fell down. The annual growth rate of real GDP per capita is higher compared to the estimate of Hill in 1983-1996. The table also shows the reducing population growth rate as a result of the family planning program of Indonesian government which is considered very successful, especially in the period of 1980s to 1990s. The decreasing population growthrate contributed to the success of economic development of Indonesia.

The impresive economic growth in the period of 1968-1996 changed the structure of Indonesian economy as shown in the Table 2. Agriculture share decreases substantially from more than half of the economy in 1967 to only 16 percent in 2009 or less than one-third of the initial share.This is a common economic phenomena, when an economy is developing, the share of agriculture is decreasing.The share of manufacturing-industry sector increases significantly to 26 percent in 1996, almost 3.3 times of the share in 1967.This remarkable change of the share of manufacturing-industry sector is a result of a significant growth rate of the sector during a long period of time.

Table 2. Share of Indonesia's GDP by Sector(percent)

Sectors	1967	1982	1996	1999	2009
Agriculture	51	23	17	20	16
Construction	Na	10	10	8	11
Manufacturing	8	13	26	26	27
Mining and utilities	Na	17	8	9	11
Services	36	37	40	37	35

Source: See Elias and Noone (2011)

The growth of manufacturing-industry sector contribute to the growth of the whole economy. Riedel (1992) concludes that industrialization guarantee economic growth in almost all countries (Kindangen, 2001). Many developed as well as developing countries prove that industrialization allow them at least in the long run to reach remarkable economic performance. Rahardjo (1995) supports Riedel conclusion by emphasizing that based on historical precedents, industrialization to developing countries is a precondition and key to prosperity and as one way to help people reduce poverty (Kindangen, 2001).



As the economy grows continuously for 28 years there is always employment opportunity available to those looking for job, especially for those with skills or experience matched to the required ones. Economic growth with employment opportunity increases income and standard of living, providing chances for the poor to reach income above the poverty line. Sustained economic growth in the long run results in continuous poverty reduction that in 1996 reaches as low as 11.34 percent before it jumps up during the crisis reaching 24.2 percent in 1998.

Various studies reveal the same success story of Indonesia by associating poverty reduction to economic growth. But in order to get the more comprehensive picture of poverty reduction, we need to look at the secondary data on poverty across regions. Table 3 indicates poverty reduction in 11 out of 34 provinces, to get a general comparative picture.

Table 3. Poverty in Indonesia by Province (%)

Province	1990	1996	1999
Nangro Aceh Darusalam	15.9	10.8	14.8
South Sumatra	16.8	10.7	26.6
D I Yogyakarta	15.5	10.4	28.5
East Java	14.8	11.9	26.1
Bali	11.2	4.3	8.5
NTT	24.1	20.6	46.7
West Kalimantan	21.2	14.3	14.4
North Sulawesi	14.9	10.6	18.2
South Sulawesi	10.8	8.0	18.3
Maluku	-	19.5	46.1
Papua	-	24.2	54.8

Source: Tambunan (2012) & BPS

The data show that poverty reduction varies clearly across provinces and that the crisis in 1997-1998 gives diverse impact on poverty in different regions showing varied resistance among regions. The data also indicate that poverty in eastern Indonesia, especially NTT, Maluku, and Papua is more severe than that in the other parts of the country and that these provinces are more vulnerable to crisis. Bali is the province with the lowest poverty rate and the least in vulnerability. If we include the data of Jakarta, Bali is actually the second after Jakarta. Data of West Kalimantan also show that this province, in terms of poverty, is not affected by the crisis.

Poverty Reduction in The Decentralization Era

The economic crisis, known as Asia Financial Crisis, later turned to multidimensional crisis that caused the downfall of the new-order regime in 1998, brought Indonesian economy to negative



growth and resulted in sudden increase of the number of poor people. In two-year crisis, many people who were previously not poor, especially those who were before the crisis in the condition of near poor suddenly turn poor, increasing the number of people living in poverty. As a result, in 2000, around 38.7 million people (19.14%) live in misery of poverty.

The economy started to grow positively after the crisis; in 2001 the economy grows at the rate of 3.64 percent. Euforia of reform spread over across regions of Nusantara, the large archipelagic country, and the strong reform spirit pushed Indonesia to change substantialy after the big crisis.

Started in 2001, decentralization of this country involves a major transfer of administrative, political, and financial authority primarily to the district and municipality level of government (Hill, 2014). District is the local government below provincial government, called as *kabupaten* and *kota*.The decentralization laws gave large effect as the laws being applied in 2001. The data of the central statistical agency (Badan Pusat Statistik, BPS) as quoted by Hill, show that during the period 1998-2012, the number of provinces rose from 27 to 34, the number of district (*kabupaten*) from 249 to 399, the number of municipalities (*kota*) from 65 to 98, the number of subdistricts (*kecamatan*) from 4,028 to 6,793, and the number of villages including *kelurahan*, village level in a municipal, from 67,925 to 79,075.

Ilenna and Wai-Poi (2014) states that Indonesia implemented in a short period of the largest-scale decentralization ever seen, to transfer substantial power and resources to the districts (including cities). Since then, the economy has recovered and continuous to perform strongly, with GDP annual growth rate of 5.6 percent in average and continued reduction of poverty.

Economic growth as shown in table 4 continuous to exist during 12 years since the beginning of decentralization and during this period the percentage of poor people shows



Table 4. GDP Growth and Poverty in Indonesia, 2001-2014

Year	GDP Growth (%)	Poor People (%)**
2001	3.64	18.41
2002	4.50	18.20
2003	4.78	17.42
2004	5.03	16.66
2006	5.50	17.75
2007	6.35	16.53
2008	6.01	15.42
2009	4.63	14.15
2011	6.49	11.36
2012	6.26	11.66
2013*	5.73	11.47
2014*	5.06	11.96

Source: Central Board of Statistics (BPS, 2015); * Temporary figure.

decreasing trend from 18.41 percent to 11.96 percent. Just like the experience in the period of new-order government, the poverty reduction after the crisis, especially in the period since the change to decentralization, seems to relate positively to economic growth though the reduction tends to be slower compared to that of the previous period. There is a hypothesis that has been proposed (Suryahadi *et al.*, 2012) to explain the slower poverty reduction during the post-crisis period that Indonesia has experienced a declining growth elasticity of poverty - the reduction in the poverty rate resulting from 1 percent economic growth. The argument is that the drivers of economic growth in Indonesia in this era are capital intensive sectors such as mining and telecommunication.

Studies on the experience of decentralization in 19 countries give conclusion (Sumarto *et al.*, 2014) that decentralization is more likely to have a positive impact on poverty reduction if there is an adequate commitment of the central government to the decentralization process, if the actors involved have the necessary (financial and technical) capacity, and if checks and balances are established at the local level to prevent rent seeking and corruption. Lack of commitment of central government, lack of capacity of the actors, and lack of checks and balances make the decentralization ineffective in reducing poverty.

Sumarto *et al.* (2014) in their analysis of Indonesia's district level panel data of 2005-2010 find support for the argument that heterogeneity in poverty levels across districts is associated with heterogeneity in local governments' resources and capacity. Poverty appears to decrease more in



districts with: (1) an established local office for the coordination of poverty reduction initiatives (TKPKD); (2) a higher share of total fiscal revenues, both locally generated and the transfers from the central government; (3) a higher average level of educational attainment; (4) a larger share of local leaders with secondary education; and (5) a higher share of urban population.

In order to increase the capacity and efforts of district governments for poverty reduction, the government issued a presidential regulation (Peraturan Presiden No. 54, 2005: Tim Koordinasi Penanggulangan Kemiskinan). The regulation encourage the establishment of teams to oversee and coordinate the design and implementation of local poverty reduction strategies. The main responsibilities of this team are to develop and manage local poverty indicators and poverty information systems, and to establish early warning systems on various aspects of poverty. Some data show that districts with longer-established team have been more successful in reducing poverty with a number of intertwined factors (Sumarto, 2014): (1) the support of local elites, especially district heads and members of parliament, in fostering the role of the team; (2) the funding of the team's operations; and (3) local government's and team's capacity to undertake program planning and budgeting.

Empirical Studies on The Role of Entrepreneurship In North Sulawesi

Empirical studies on the role of entrepreneurship in alleviating poverty in Tomohon City and Southeast Minahasa District, North Sulawesi Province (Kindangen and Tumiwa, 2012) analyzed the influence of entrepreneurship on household income. In this study, two independent variables, *commitment and perseverance* as well as *initiative and action* that represent entrepreneurship, both show significant-positive influence on household income. Another empirical study was conducted in Kotamobagu City and Bolaang Mongondow District of North Sulawesi Province (Kindangen and Tumiwa, 2013) found that three independent variables representing entrepreneurship -*commitment and perseverance (KK), initiative and action (IT), and adaptative ability (KA)* – all show significant and positive influence on household income.

Positive and significant influence of entrepreneurship on household income in both studies indicate that entrepreneurship has important role in improving standard of living of households. Increasing income means improving standard of living and, hence, reducing poverty. In both studies, households with higher income are in general those with higher spending for labor. Thus,



they have not only better chance to increase consumption as a result of higher income but also better ability to create job for productive activities.

Empirical study in urban areas of North Sulawesi (Kindangen *et al.*, 2014) supports that entrepreneurship as well as education have significant influence on household income. In this study, years in school is the proxy of education while variables of *commitment and perseverance, initiative and action, and adaptative ability* are the proxies of entrepreneurship. The analysis of the primary data of 340 households again confirm that entrepreneurship has important role in improving income and, hence, reducing poverty in North Sulawesi. In this study, it was found also that the household with higher income – those with better entrepreneurship spirit and better education - are in general those with more spending on labor or more ability to create job. Being able to provide jobs indicates the existence of capacity to produce and hence increase income. For households with better entrepreneurship spirit, the higher the income, the higher the ability to provide job and, thus, the better the chance to keep increasing production as well as income and, of course, to alleviate poverty.

In macroeconomic level, increase production and income means the existence of economic growth. This results remind us to the findings of various studies and theoretical reasonings that economic growth give positive impact on poverty reduction. As Rodrik (1999) affirms, the comparative experience with economic growth taught us a number of important lessons. One of the more important of these is the importance of private initiative and incentives. Rodrik states that all instances of successful development are ultimately the collective result of individual decisions by entrepreneurs to invest in risky new ventures and try out new things. Citing Parente and Prescott, Boediono (2009) reminds that economic growth is required to be broad-based and to be entrepreneurial-activity-based in a healthy-competitive atmosphere. Broad-based economic growth tend to create and increase middle class as the revitalizing class giving positive influence on development, especially economic development that results in, among other, economic growth and poverty reduction.

Poverty In The Coastal Area

Despite the success of poverty reduction In Indonesia in general, it is still a major problem for this country to alleviate poverty in coastal area, the residential area of fishermen. Indonesian government acknowledged that coastal area is a poverty zone (Kementerian PPN, 2015). Marine



sector in Indonesia is often mentioned as the future of Indonesia due to the richness in various kinds, among others: fish, sea grass, mining, stream and wave , as well as access of transportation. Despite the enormous wealth in the sea, vast majority of fishermen live in poverty. Wekke and Cahaya (2015) cited Orisini, Kahane, Nono-Womdin, and Gianquinto that 60 percent of fishermen in villages still have average income below the minimum requirement for living, or still live in absolute poverty. This fact might have been one of the reasons for the government to raise development intervention program such as CO-Fisch of The Ministry of Maritime and Fisheries especially for coastal communities.

As a matter of fact, the majority (63.47 percent) of poor people in Indonesia live in coastal and rural areas. With the large marine potential resources, fishermen's welfare is very low. Statistical data shows the average daily real wages of a farmer, including labor fishermen, is only Rp 30.449,- per day; much lower compared to the daily nominal wage as construction worker foreman of Rp 48.301,- per day. This fact should raise a serious concern considering the close linkage between poverty and the management of coastal areas.

Poverty often triggers a vicious circle because poor people are often the cause of damage to the coastal environment, but also bear the brunt of environmental degradation. Under these conditions, it is not surprising that destructive fishing practices are still common in coastal areas. Their income from bombing activities and reef fishing with cyanide is still far greater than their income as fishermen. With the huge income disparities mentioned above, it is difficult to overcome the problem of damage to coastal ecosystems without solving the problem of poverty that occurs in the coastal region itself.

Management of coastal areas, particularly on fisheries and marine, agricultural, and livestock face the common problem of low skills and knowledge required for improvement in the field; limited facilities and infrastructure; limited genetic engineering through the development of seeds. Furthermore, problems in the field of food security is low business efficiency and quality of economic actors, limited facilities and infrastructure as well as capital economic actors in these sectors which resulted in limited development of product processing and application of technology to improve productivity, quality and value-added in order to enhance the product. Meanwhile, the problems encountered in the field is the tendency of declining quality of natural resources and environment, as well as lack of knowledge and awareness of coastal communities on the importance of preservation. These facts hinder the endeavor to alleviate poverty in the area.



Lessons Learned

Poverty reduction is a very important agenda to all governments especially those of the developing countries. Reducing poverty means increasing welfare of those people being enabled or empowered, but it also means increasing the welfare of the whole society. As the economic integration of ASEAN, namely The Asean Economic Community, approaches the commencement at the end of 2015, it is often mentioned in discussion that Indonesia is still have to work hard to improve the quality of human resources. Keep reducing poverty is one important endeavor and strategy to improve human resource quality in the long run since poverty reduction means people empowerment. Increasing income of the poor people enables them to improve their quality of life, among other, through better education that increase knowledge, skill, and hence, competitiveness.

The experience of Indonesia during the main period of the new-order government and of the ‘reform-order’ government in the decentralizing era give lessons that is worth to be learned. Began as a very poor nation in 1945, the year of independence declaration, the country experienced very long period of misery due to poverty. After twenty years since the independence, Indonesia in the mid of 1960s, was one of the poorest countries in the world, being characterized as *a chronic economic dropout* by Benjamin Higgins. The severe economic backwardness in mid-1960s might be one of the factors that worsen the political disaster of 1965.

Indonesia’s overall growth and poverty reduction experience appears to be consistent with the findings of studies using cross-country regressions. Dollar and Kraay show that the incomes of the poor move one-for-one with overall average incomes, suggesting that poverty reduction requires nothing much more than promoting rapid economic growth (Balisacan *et al.*, 2002). But this, of course, not all the story of Indonesia’s growth-poverty nexus. Balisacan, et al quotes from several sources such as Hill and Booth writes that growth and poverty reduction vary enormously across the groups of islands, the provinces, and districts of Indonesia. They acknowledged that the difference in poverty pictures is due to the fact that this country is highly diverse geographically as well as the difference in institutional attributes and economic performance.

The findings on the differences in growth and poverty evidents across regions is understandable due to the enormous diversity in many aspects across regions. The facts of poverty and the problems associated in coastal areas, for example, indicate more variety of conditions and problems that require different approaches and measures to be implemented. The evidents of



divergence in growth and poverty should encourage the government and academicians as well as businessmen to know collaborate to identify and understand the various problems and ways to solve them.

Reducing poverty requires economic growth, but in order to have growth with quality, it is necessary to foster wide participation of people in various economic activities. Encouraging entrepreneurship is one of the strategic ways to foster wide participation. Entrepreneurship gives us ability to see and grasp opportunities and then take advantage from the opportunities by taking actions to accomplish an objective.

Three empirical studies on the influence of entrepreneurship on household income show findings that entrepreneurship with *commitment and perseverance, initiative and action, and adaptative ability* being the proxies influence household income positively. When someone has the quality or the spirit of entrepreneurship, he or she tends to perform better in his work or endeavor to achieve objective, in this case to achieve higher production or income. Someone with the quality or spirit of entrepreneurship tends to have activities that requires involvement of others as workers and, hence, gives contribution to the creation or widening of employment.

David McClelland emphasized long time ago the requirement of at least two percent of population as entrepreneurs as a required condition for a country to reach prosperity.

As poverty reduction will always be one of the agenda to be done, entrepreneurship should always be encouraged to grow in order to help people reach better life, improve living standard. Encouraging growth of entrepreneurship requires the government to create and offer incentives. One of the incentives is the provision of infrastructure - hard infrastructure and soft infrastructure. The effort to encourage entrepreneurship, however, should also be conducted through education by embracing entrepreneurship education started from primary school to university.

Infrastructure is one of the weaknesses in Indonesia, especially in eastern Indonesia. Providing good infrastructure across provinces and districts is one of the main and urgent agenda that should be fulfilled by the government. Infrastructure is the necessary condition for the people to play their role optimally in various economic activities and, hence, contribute to the better performance of economy and poverty reduction. Developing infrastructure, encouraging entrepreneurship, improvement of economic performance, and poverty reduction enable this country to be better prepared facing the Asean Economic Community.



Conclusion and Recommendation

Four conclusions can be formulated. First, poverty in Indonesia decreases in the long run; the poverty figure suddenly jumps up due to the financial crisis in 1997-1998, then shows again the decreasing trend until 2014. Second, rural and coastal areas have higher poverty rate compared to urban area. Third, economic growth gives positive impact on poverty reduction in Indonesia. Fourth, entrepreneurship has positive influence on economic growth and poverty reduction.

Based on the conclusions, five recommendations can be asserted. First, the endeavor to reduce poverty should always be one of the government priorities in improving welfare. Second, the government needs to keep on struggling to foster economic growth as an important way to reduce poverty. Third, though economic growth is very important to be driven, it is imperative to ensure that the growth is of good quality, a result of active and far-reaching participation of all people, especially those in the rural and coastal areas. Fourth, to reduce poverty, it is a strategic way to encourage entrepreneurship to grow; entrepreneurship increases competitiveness. Fifth, one of the essential endeavor to drive entrepreneurship is by providing better infrastructure and incorporating entrepreneurship education in school and university curriculums.

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