

SUMMARY

THE IMPACT OF THE WORLD RECESSION ON INDONESIA AND AN APPROPRIATE POLICY RESPONSE: SOME LESSONS FOR ASIA

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A. The Recession had a relatively small macroeconomic impact

1. Negative impact big: Recession reduced export earnings by 7% of GDP. Adding the impact on remittances, tourism, foreign investment and the indirect effects as those worked their way through the economy -- a 15% decline in GDP seemed in the cards.

2. But this ignores the benefits and offsets of recession- The biggest benefit is the decline in the cost of imports – a gain of over 4% of GDP. Decline in shipping costs for both imports and exports and in interest payment on foreign debt. Deliberate offset – Government stimulus or rather size of government deficit.

3. Shows the importance of systematically compiling all costs, benefits and offsets [Table 1]

4. And then calculating the indirect effects – the “multiplier”.

5. The net effect of the Recession is a reduction in expected growth of 2% of GDP leaving 4% growth in 2009.

6. Indonesia weathered the Recession well because:

- [i] it is a large economy with low trade dependence;
- [ii] macro-economic management was good, instilling confidence;
- [iii] a modest stimulus package, contributing to a larger government deficit, helped.

B. But the Recession aggravated a serious problem: Unemployment and Underemployment

1. Indonesia added 22 million to the labor force since 1997 but created only 5.5 million “real” jobs, jobs resulting from increased demand for labor. Because of the Recession an estimated ½ million lost their jobs and 2 million more joined the labor force without work for them -

2. The “job-less” or job-poor growth since 1997 is primarily due to stagnation in the export of labor-intensive manufactures because Indonesia is no longer competitive in the world market for these goods.

a. Indonesia has always been a high cost economy, but compensated by low wages.

b. The big change since 1997 is the end of low cost labor, with a devastating effect on manufactured exports: growth declined from 30% a year to 3%

C. Dealing with the Recession and with Chronic Underemployment – Social Protection and Anti-Poverty Programs- Indonesia lacks a comprehensive program of Social Protection, but has substantially expanded efforts in this direction.

1. Tackling structural poverty–The National Community Empowerment Program [PNPM] is the biggest, most effective program, expected to give off-season employment to 24 million in 2010

a. It is a Community Driven Infrastructure Development Program; self-targeting by setting its wage too low to be attractive to the non-poor;

b. More than half of its benefits are from the structures it builds and therefore result in a long-term increase in income and employment

c. Providing work and income when most needed it can serve as a partial social safety net if it is expanded or contracted in response to need

2. Breaking the inter-generational poverty chain is the objective of 3 programs

a. School Operational Assistance gives funds to schools to enable them to reduce school fees for the poor, but a substantial proportion goes to the non-poor

b. The Jamkesmas health program for the poor suffers from the same problem

c. A household Conditional Cash Transfer (CCT) program is only starting up. It provides grants to poor families that keep children in school and take preventive health measures

3. Dealing with shocks: The Direct Cash Assistance Program (BLT) gave grants, equivalent to 20% of income, to compensate poor families for the reduction of fuel subsidies. It was successful both politically and economically because targeting was good.

IV. Policies Advocated to Deal with Recession and Poverty: Expand Domestic Consumption, Foster Commodity Exports

1. Expanding domestic demand is seen by some as a magic bullet for Asia

a. But it soon runs up against a Balance of Payments constraint as demand spills over into imports

b. The expansion of labor-intensive exports may also be needed to generate productive employment

2. Commodity export led development was also advocated as a strategy for Indonesia

a. But the reality is that Indonesia is not a resource-rich country on a per-capita basis

b. And a commodity-led strategy provides few jobs

V. Regaining Market Share: Enhancing Indonesia's Competitiveness

1. Without regaining a larger share of the world market for labor-intensive manufactured exports it will be difficult to provide productive employment for the underemployed

a. Policies to achieve it will also enable producers to compete more effectively with imports

b. And to increase the growth of agricultural exports and tourism

c. Indonesia needs a growth rate of about 8% to deal with underemployment and can achieve such a rate.

2. To break the major constraint and achieve competitive costs involves

a. Taking advantage of Indonesia's improving reputation for stability and safety and the declining competitiveness of some others

b. Reducing the high cost of infrastructure services by using PNPM to improve the rural infrastructure and using private firms more extensively to build power stations, ports and roads.

c. Continuing efforts to improve the investment climate, reduce corruption and improve governance – all easier said than done

d. Lowering the effective cost of labor can not be avoided

i. That means tackling "Dutch disease": doing what all other Asian countries have done which is to frame exchange rate policy to keep labor-intensive production competitive

ii. Compensating for any increase in inflation in goods consumed by the poor by reducing tariffs and import restrictions

iii. Exploring a "Grand National Bargain" to slow minimum wage increases and reduce the cost of regulation

iv. Fostering on-the-job training by industry, technology transfer and other steps to increase productivity

VI. Lessons for Asia – How Countries Differ in the Impact of the Recession and with Respect to an Appropriate Policy Response

1. The methodology used to analyze the impact of the Recession can be used by other countries to provide quick, understandable results
2. The Recession will have a different impact on other countries and require different policies if they differ in structure from Indonesia
 - a. With respect to the importance of exports, remittances and tourism
 - b. The level of their Foreign currency reserves and the balance on current account determines their ability to fund an expansion of domestic demand.
 - c. However concerted stimulus by major Asian economies can reduce the Balance of Payments constraint and can permit levels of stimulus and higher rates of growth in all of them.
 - d. The magnitude of the problem of underemployment and unemployment influences the rate of growth and the emphasis on labor-intensity each country requires to deal with the problem.