

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

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Recession's macroeconomic Impact on Indonesia was small

- Taking account of indirect effects a 15% decline in GDP seemed in the cards.**
- Recession had a big negative impact on exports.**
- But there were offsetting benefits, especially a decline in the cost of imports**
- Plus the benefits of a Government stimulus program**
- Need a checklist like Table 1 to take account of all factors**

Table 1: Direct Impact of the world economic recession on Indonesia- Summary

(\$ Billion - rounded)

			Gross	Net
	Actual 2008	Forecas t 2009	Decline	Decline
<u>A. Goods Exports</u>	137	106	-31.0	
Of which 50% is due to decline in quantity			(15.5)	
Decline in imported inputs at 18% of decline in quantity exported (0.18*15.5)			2.8	
Imported inputs into exports at 18% of total exports			(19.1)	
Effect of 17% decline in prices of imported inputs into exports (0.17*19.1)			3.2	
Net decline in goods exports				<u>-25.0</u>
<u>B. Exports of Services- Total of items below</u>				<u>0.5</u>
Migrant remittances			-1.30	
Tourism			-0.6	
Shipping			2.0	
Interest on private debt			0.3	
Others (including profit repatriation, investment income, other transfers etc.			-0.5	
<u>C. Private Investment</u>				
a. Domestic private investment	100	103	3.0	
Minus imported inputs at 18%	18	18.5	0.5	2.5
b. Foreign direct investment (net)	2.8	3.2	0.4	
Minus imported inputs at 18%	1.3	1.4	0.1	0.0.3
<u>D. Government deficit.</u>	0.4	12	11.6	
Shortfall on expenditures @ 1 % of GDP		4.0	7.6	
Spent outside Indonesia at 15%	0.06	1.14	1.1	6.5
<u>F. Total impact of crisis</u>				<u>-15.0</u>

Taking account of indirect effects: the multiplier

- As the \$ 15 billion loss works its way through the economy it causes further indirect losses
- Need a model as in Table 2 to estimate all the indirect effects through multiple rounds of both losses and gains

Table 2: First Attempt at an Aggregate Open Economy Income Generation Model for Indonesia: The Impact of the World Economic Crisis 2008-09. by Daniel M. Schydrowsky

Multiplier formula:	$dY/d[(1-mx)X + REM + (1-mpfi)FPI] = 1/[1 - (1-m)(1-t)c]$		
mx	0.18		
m	0.226	0.18758	Import intensity before & after price decline for imports
t	0.15		
c	0.7	propensity to consume	
mpfi	0.3		
$\Delta Pm/Pm$	-0.17		
Evaluate Right Hand:	$1/[1 - (1-m)(1-t)c]$		
With m=	0.226	1.85	before price effect
With m=	0.18758	1.94	after price declines
Impact Calculation:	$Y1 - Y0 = EXOG1\lambda1 - EXOG0\lambda0 = (EXOG0 + \Delta EXOG) \lambda1 - EXOG0\lambda0 = EXOG0(\lambda1 - \lambda0) + \Delta EXOG\lambda1 =$ $(\Delta\lambda/\lambda0) (\lambda0) EXOG0 + \Delta EXOG\lambda1 (\Delta\lambda/\lambda0) Y0 + [\Delta X(1-mx) + \dots + \dots]\lambda1$ Change in VA x multiplier		
ΔVA in X + other chnges	-15	Evaluate line 24	
VA in X 2008	112	$(\Delta\lambda/\lambda0)$	0.04
Y0 2008	450	$(\Delta\lambda/\lambda0) Y0$	19.91 Additional Y due to reduction of import prices
M non X 2008	103	$[\Delta X(1-mx) + \dots + \dots]\lambda$	-29.04 Reduction of Y due to fall in export VA + others
		$(\Delta\lambda/\lambda0) Y0 + [\Delta X(1-m$	-9.12 Total reduction of Y
		% of Y0	-0.020
Change in Imports:	$M1 - M0 = m1Y1 - m0Y0 =$ $m1(Y0 + \Delta Y) - m0Y0 = (m1 - m0)Y0 + m1\Delta Y$ $(\Delta m/m0) m0Y0 + m1\Delta Y = (\Delta m/m0) M0 + m1\Delta Y$		
Evaluate: $(\Delta m/m0) M0$	-17.51	this is what prices would have saved if no income reduction	
Evaluate: $m1\Delta Y$	-1.71	reduction of imports due to lower Y	
Evaluate Total	-19.22	total reducion of Ms due to price and Y effects	

References: "A Short Macro-Economic Model of the Indonesian Economy," Daniel M. Schydrowsky, in The Indonesian Economy, Gustav F. Papanek, ed., Praeger, 1980.

"The Vulnerability of Small Semi-Industrialized Economies to Export Shocks: A Simulation Analysis Based on Peruvian Data," Daniel M. Schydrowsky and Martha Rodriguez, Trade, Stability, Technology, and Equity in Latin America, M. Syrquin and S. Teitel, ed

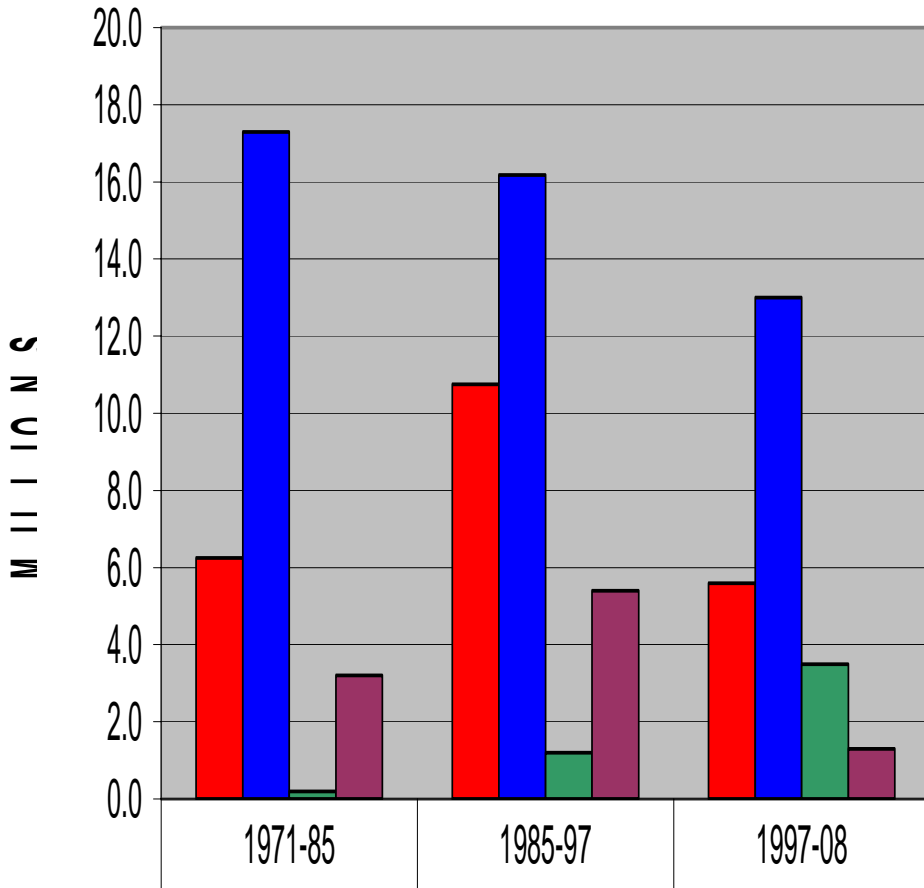
Indonesia was not hard hit by the Recession

- The net impact was a loss of only 2% of National Income
- So instead of growing 6% it is forecast to grow 4% in 2009
- But unlike most countries Indonesia will still grow.
- These good results however ignore a serious problem

Aggravating a serious problem: Unemployment & Underemployment

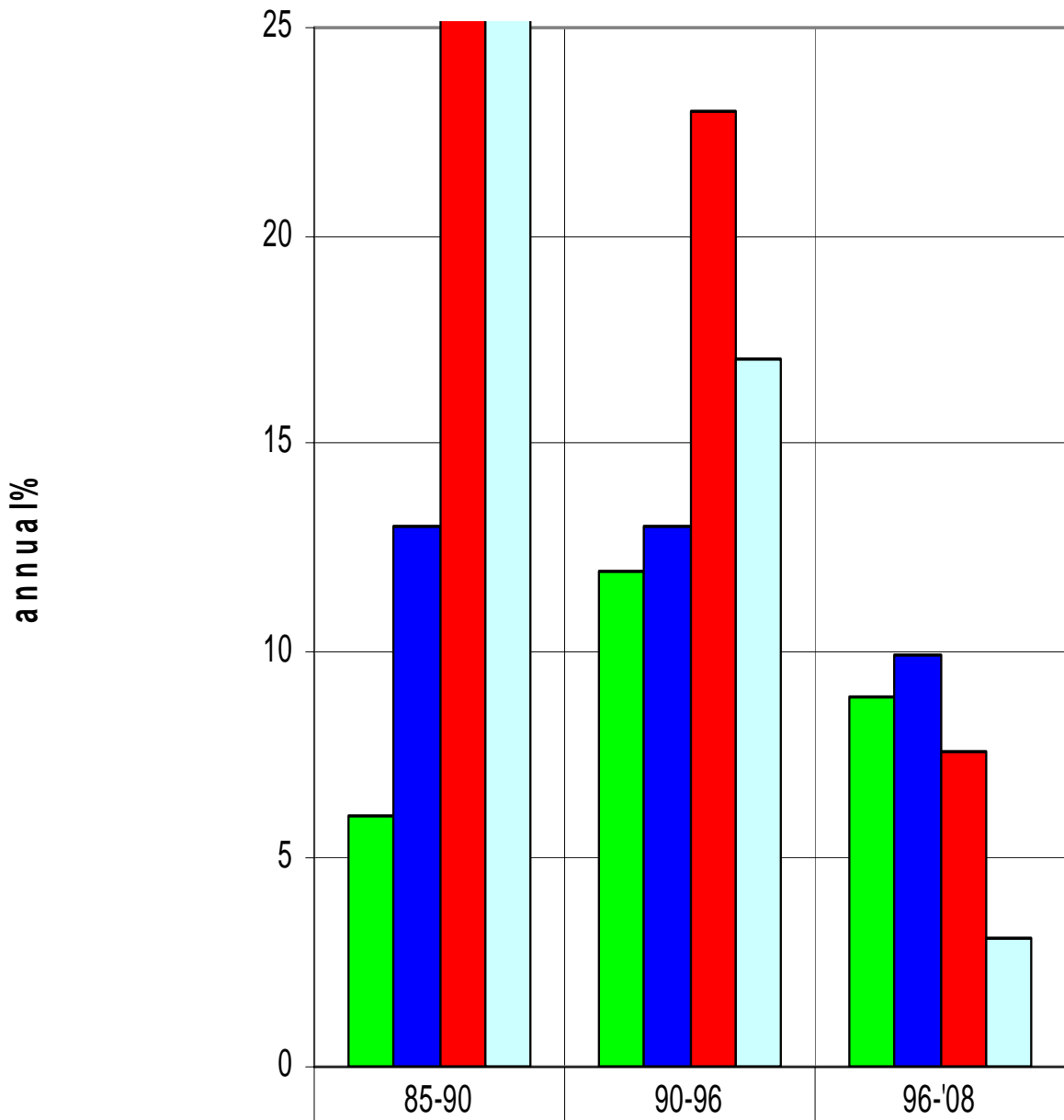
- 22 million added to the labor force since 1997 but only 5.5 million “real” jobs created, jobs resulting from increased demand for labor.**
- The Recession: an estimated 1/2 million lost their jobs and 2 million more joined the labor force but have no work**
- The “job-less” growth primarily due to stagnation in the export of labor-intensive manufactures**

Graph 1: EMPLOYMENT BY SECTORS IN MILLIONS



Real Jobs- added in Indonesia	6.2	10.8	5.6
"Crowding-in" or "Job & income-sharing" jobs + unemployed	17.3	16.2	13.0
Added to migrants	0.2	1.2	3.5
Note: Workers added in manufacturing	3.2	5.4	1.3

Chart 1-Exports - Annual percent change in Current US\$ Billions



■ Total exports	6	12	9
■ Commodity exports	13	13	10
■ Manufactured	39	23	8
■ Labor-intensive manufactures	45	17	3

- **The major reason: Indonesia is no longer competitive because labor is no longer incredibly cheap: wages tripled in real \$.**
 - * **Rupiah wages have been pushed up by minimum wage rules**
 - * **And it suffered from “Dutch disease” – high commodity prices has pushed up the value of the Rupiah**
 - * **Unlike all other countries in Asia it has had a “strong Rupiah” policy**
- **The end of low cost labor was devastating for manufactured exports: growth declined from 30% a year to 3%**

Dealing with Recession and slow growth: “Expand Domestic Demand” is the latest magic bullet

**In most countries it soon runs
up against a Balance of
Payments constraint as
demand spills over into
imports**

- Concerted stimulus by major
Asian economies can reduce
the Balance of Payments
constraint; permit higher
levels of stimulus and higher
rates of growth in all**

For Indonesia expanded commodity exports and stimulus are not enough to absorb the backlog of underemployed.

It also needs to regain competitiveness in labor-intensive manufactures by reducing the cost of:

- Infrastructure**
- Corruption**
- Regulation**
- Labor**

Easier said than done

Application to other countries

- The approach we used provides a rapid, simple and understandable method to estimate the impact of world changes on an economy
- Key elements:
 - [i] systematic estimation of benefits as well as cost
 - [ii] use of a simple macro-model to estimate the multiplier, the indirect effect

Diagnosis and Policy

Prescription will differ among countries

- Differences in importance of exports: 20% of GDP in Bangladesh, 117% in Malaysia
- Differences in ability to expand domestic demand: China's foreign reserves & surplus on current account enough to pay for 26 months of imports; Sri Lanka for 2 months

Structural differences

[continued]

- Differences in the seriousness of the unemployment and underemployment problem: Indonesia needs jobs for a backlog of 15 million additional underemployed since 1997 and to export labor; Malaysia needs to import labor.
- One size does not fit all.