SUMMING UP

The outlook for the next year is clouded by 3 risks:

i. The continued rise in world rice prices as the result of Thai policies;

ii. A slowdown in world growth could result in declining commodity prices and export income, slowing growth in Indonesia significantly;

iii. A reversal of the inflow of short-term funds could reduce the value of the rupiah making Indonesia's producers more competitive but increasing inflation.

All will hurt the poor in the short term. Their impact can be reduced by strengthening the social and economic safety net.

2011 has been a year of below-average inflation, at less than one-third the normal rate. The increase in inflation during Ramadhan/ Lebaran in 2011, as in the previous 23 years, has been only 0.7 higher than in the rest of the year. It is not a serious problem.

The "headline CPI" for urban consumers, is an unsatisfactory measure of the impact of price increases on the poor, especially on the rural poor. From 2007 to 2010 annual "headline" inflation was 7%, but 11% for the rural poor; in 2011 the annual rate of inflation was 4% for the urban CPI, 3.4% for the urban poor, 2.8% for the rural poor.

The incomes and expenditures of the poor have increased very slowly, or not at all, as a result of rapid economic growth in the last 5 years, fueled by the commodity boom:

i. The real consumption of the poorest 40% has grown only 1.2% a year while that of the non-poor increased four times as fast, 4.8% a year.

ii. Real wages rates [adjusted for inflation] of unskilled and semi-skilled workers in agriculture and manufacturing have fallen 10-15% especially in resource poor areas.

iii. While the percent below the poverty line has decreased from 16.6% in 2005 to 12.5% in 2011, the average income of those who remain below the poverty line has probably stagnated or fallen.

Over the longer term the improvement in the welfare of the poor in Indonesia has been great. Subsequent Poverty Policy Briefs will provide information and quantitative analysis why the commodity boom of the last 5 years has not greatly benefited the poor and what policies can make growth more pro-poor.

The Outlook for the Next Year

The Indonesian Economy is vulnerable to likely changes in the world economy.

a. Sharply increased rice prices. The new Thai government has set a floor price for rice that is substantially above the prevailing price. This has pushed international rice prices in September up by 31-36% compared to July-September a year ago. International prices are likely to rise further as Thai policy runs its course. Thailand may not be able to afford this policy for very long, but it was a major promise in the election and therefore will probably push prices up for some time. Indonesian rice prices have generally fallen or risen with world prices. This increase will therefore raise rice prices in Indonesia and hurt the poor.

b. A fall in prices of commodity exports as a result of continuing recession. The decline in government expenditures in the US and Europe on top of reduced private demand is slowing growth. Growth in China and India is also slowing and is expected to slow further in China. The assumption that Indonesia is decoupled from the developed world is overly optimistic: when growth in consumption for the world slowed to 0% in 2009 Indonesian export earnings fell by $20 billion, primarily because commodity exports declined $16.5 billion. Growth of the economy slowed from 6% to 4.5%.

A 20% decline in 2011 commodity prices, would bring prices back to where they were in 2010, and could well happen again as a result of another slowdown in world demand. It would reduce National Income about $25 billion, if one takes account of indirect effects [the "multiplier"][1] and of compensating benefits of a recession: lower costs of many of Indonesia's imports and lower cost of services, like shipping. A decline in National Income of $25 million might slow growth

[1] In 2011 commodity exports were at the rate of $150 billion a year during the first 4 months. A 20% decline in prices would reduce earnings by $30 billion. To produce exports in Indonesia on average required imported inputs at the rate of 18%. Therefore the decline in net exports would be $24 billion. Some of this decline in income will result in lower profits for foreign owners, reducing the net impact on Indonesia. A 20% decline in prices, however, is bound to reduce the quantity of exports, even if by a small amount. (see Papanek, Basri & Schydlowsky for details on the calculation). A rough estimate of the net decline in export earning is $22 billion. The multiplier in Indonesia is estimated to be almost 2; therefore direct and indirect effects of a net decline in export earnings of $22 million would reduce the national income by $45 billion. There would be some major offset [see Ibid; notably a decline in the price of many imports and a decline in shipping costs for exports and imports]. Taking those into account a rough estimate of the decline in national income might be $25 billion or 3.5%. Much better estimates are in process.

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by 3%. The poor in resource-rich areas, whose income is heavily dependent on commodity exports, will be negatively affected.

c. The flight of short-term capital. Pressure for short-term capital outflow can result from a credit squeeze in other areas of the world. Also as the export surplus shrinks the risk of a depreciation of the Rupiah makes it more risky to hold Indonesian bonds and stocks. As the flow of short-term capital to Indonesia slows and reverses the risk increases and capital flight feeds on itself. In 2011 Indonesia lost $10 billion in reserves because of short-term capital flows even though exports boomed, as Bank Indonesia tried to slow the depreciation. If export earnings begin to decline investing in Indonesian bonds and stocks will be seen as more risky; the outflow of short-term money could be much greater, with the Rupiah depreciating significantly as a result.

Increasing the Macro-stabilization resources and the Social Safety nets would reduce these risks. It will be the subject of a Special Report.

Inflation

Both urban and rural inflation in th first 9 months of 2011 has been far lower than in the past. This has been largely due to lower inflation for food, which has especially benefited the poor.

An inflation measure or CPI for the poor differs from published inflation measures. Because the pattern of consumption for the poor is different than for the lower middle class, whose consumption is reflected in the CPI, inflation often has a different impact on the poor than is shown by the CPI. Above all food is a much higher proportion of total consumption for the poor. And food is especially important in rural consumption where housing costs are small.

Table 1: Consumer Price Index (CPI) and CPI for the Poor (The annual % Increase)

	2007 to 2010	Decem 2010 to Septem 2011
Urban CPI- "Headline Inflation"	6.6%	4.0%
Urban CPI for the Poor	7.5%	3.4%
Rural CPI	10.1%	3.4%
Rural CPI for the Poor	10.7%	2.8%

From 2007 to 2010 the urban or headline CPI increased at 6.6% annually but for the rural poor, prices of the goods they bought increased by 10.7% annually, almost double the published CPI. On the other hand in 2011 so far the rural poor had a lower increase in their CPI (2.8% at an annual rate) than shown by the "headline" urban CPI (4%). Conclusion: the "headline CPI" is an inaccurate measure of the impact of inflation on the poor and especially the rural poor. The Poverty Policy Brief will therefore provide every month a CPI for the urban poor and another for the rural poor.

Preliminary estimates

The effect of Ramadhan and Lebaran on inflation is minor (Special report). Inflation is generally higher in the Lebaran month than in the rest of the year. But the increase was rarely a serious matter because the additional inflation was small. For the urban CPI the increase for Lebaran averaged only 0.7% in 2011 and over the past years. For the rural CPI the additional inflation in Lebaran was only 0.4% higher in 2011 and averaged 1.1% in past years.

The impact of inflation for Lebaran 2011 has been larger for the poor than for the population as a whole because food prices rose more than non-food prices. But this was balanced by a smaller increase in food prices the rest of the year so far, so the CPI for the poor increased less in 2011 than for the whole population,

Lebaran also has some compensating benefits for the poor which could more than offset any costs from increased inflation: additional work in food preparation and additional gift income.

Growth in National Income and in Exports

Growth of the economy [GDP] accelerated in 2011 to 6.5%, in part driven by higher exports.

Exports and Imports: The increase in net exports is due primarily to world commodity prices. The strong commodity boom continued to benefit Indonesia as exports in January to June 2011 increased to a rate of $135 billion from less than $100 billion in 2010. The surplus of exports over imports [positive trade balance] rose from $11 billion to $20 billion. The increase in the value of exports was primarily due to the increase in commodity prices: In the last 15 years 80% of the increase in exports was due to the increase in the value of commodity exports; and 70% of that increase was due to increased prices of such commodities as rubber, palm oil, copper and coal.[2] In 2011 the dependence on commodities and especially on the increase in their prices became even stronger.

While the increase in net exports was directly only one factor in higher growth its indirect effects were also important. Notably it contributed to the increase in consumer demand, both by increasing income and by funding increased imports. About 20% of increased consumption spills over into imports. Therefore a 7% increases in income, equal to about $30 billion, will mean that demand for imports will increase $6 billion. A rise in export earnings finances that increase.

The benefits to most of the poor have been small as a result of the more rapid growth that occurred with the commodity

[2]These prices increased between 25% and 80% from January-April 2010 to January-April 2011. Details on exports in 2011 are based on the first four months only. Of course the 17% increase in the quantity of commodity exports would surely have been less without the price increase

boom. The main measure of what happens to the poor has been the poverty incidence, the percent of the population below the poverty line. Using this measure the percent of poor has declined continuously from 16% in 2005 to 12.5% in 2011. But the flaws of this measure are well known, especially:

i. A slight adjustment in the way the poverty line is calculated can result in a very large change in the percent and number of poor;[3]

ii. It ignores the near-poor, the 100 million persons whose average income is just Rp 20,000 ($2.20) a day. It deals only with the 30 million poorest. Therefore the Poverty Policy Briefs will supplement it with other measures of poverty. These follow.

Changes in the Real Consumption of the Poorest 40% of the Population

The poorest 40% of the population, nearly 100 million persons, include not only the poorest but the near-poor as well. Their income is a broad indication of the welfare of the poor which does not change very much with slight adjustments in the calculations. It will be reported four times a year.

of near-poor. The poverty incidence data hide the fact that the poor have benefited little from the higher rate of growth resulting from the commodity boom and that they are falling substantially behind the non-poor in consumption-growth during the boom.

Graph 1: Consumption of the Poorest 40% and Percent below the Poverty Line

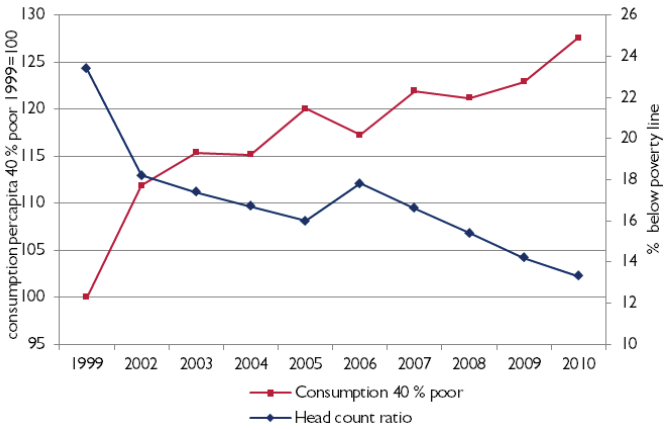


Table 2: Growth in Consumption of the Poorest 40% and the Non-poor 60%		
	1999-2005	2005-2010
Real annual rate of growth of per capita consumption of the poorest 40%	3.1%	1.2%
Real annual rate of growth of per capita consumption of the non- poor 60%	1.6%	4.9%

The consumption of the poorest 40%, adjusted for inflation,[4] increased only 1.2% a year on average during the commodity boom years. The consumption of the non-poor increased four times as fast. During the recovery from the Asian Monetary Crisis [KrisMon] the situation was reversed: income of the poor increased twice as rapidly as that of the non-poor. But as growth of the economy [GDP] speeded up during the boom years, growth for the poor slowed down. The reasons will be analyzed in a special report.

Summing-up: Rapid growth in the last 5 years, driven in substantial part by the commodity boom, was less pro-poor than earlier growth.

The consumption of the poorest 40% and the percent below the poverty line, are broadly consistent. But the data on the percent of the poor provides no information on what happened to their consumption and that of the larger groups

Real Wages of Unskilled Workers and the Income of the Poor

A Special Report will provide evidence that the wage rate for unskilled workers is a good indication of the income of the poor. While many poor do not receive a wage they still get much of their income from their labor. They do not have enough land or other assets to get most of their income from asset ownership. If they did they would not be poor.[5] And the income of urban and rural informal sector workers move up and down with the wages of agricultural laborers and unskilled manufacturing workers. Changes in wages of agricultural laborers tell us a lot about the income of unskilled workers, that is most of the poor.[6]

Real wages—the purchasing power—of unskilled and semiskilled workers, are less per day in 2010/2011 than they were at the beginning of the commodity boom. For real agricultural wages, wages adjusted for rural inflation, the high point was reached in 2007. From 2007 to September 2011

[3]The BPS paper by Mohd. Ikhsan calculates two poverty lines for 1998, both of them legitimate, that differ by roughly10%. One has 13 million more poor than the other; the poverty incidence is 18% and 24%.

[4]Deflated by the CPI for the Poor. We did not use the official CPI to take account of inflation since it is a poor measure of the impact of inflation on the poor. Instead we used a first approximation of the CPI for the Poor: adjusting for a higher share of food in their consumption. In the future the Poverty Policy Brief will use a weighted average of the Rural CPI for the Poor and the Urban CPI for the Poor and both will be more accurate by taking account of other differences in the consumption basket.

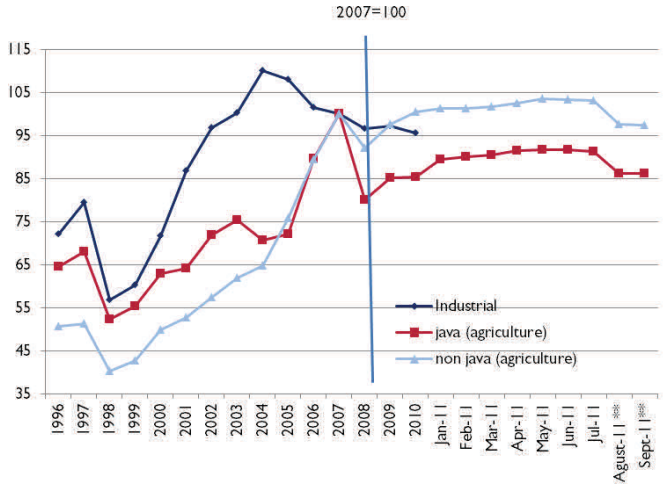
[5]Changes in the agricultural wage rate is closely correlated with labor income in agriculture; a coefficient of 0.89

[6]The street peddler who buys a carton of cigarettes and sells individual cigarettes [by "the stick] is paid mostly for his time waiting for customers.

these wages declined 14% for Java and 3% for non-Java. Wages for production workers in manufacturing have declined even more from their high point in 2005 by almost 15% to 2010 [Graph 2 and Table 3].

Since per capita national income and consumption increased substantially in the five years from 2005 to 2010—by 3% on average a year or by 19% for the period—it is surprising that real wages, that is the purchasing power, of both agricultural and manufacturing workers declined. A special report will analyze the reasons.

Graph 2. Real Wage for Unskilled Workers



Note: August and September 2011 are preliminary.
Sources: Industrial workers wages are from BPS quarterly series for workers below the level of foreman or technician deflated by the urban CPI. Agricultural wages and prices are from NTP or the Farmers' Terms of Trade for 14 provinces.

Table 3: The Commodity Boom and Real Income and Real wages of the Poor					
		2005	2007	2010	2011
Commodity exports ($ billions)		54	76	112	153
Per capita consumption of Poorest 40% (Annual % increase since 1999)		3.10%	2.40%	2.20%	
Real agricultural wages (Rp per day; in 2007 prices)					
	Java	12,015	16,687	14,233	14,334
	Non-Java	19,058	25,177	25,313	25,354
	National	14,217	19,247	17,414	17,487
Real manufacturing wage production workers, Rp per week		154	139	132	

Industrial workers are located mostly in resources-poor Java where real wages fell. What increase in labor demand occurred as a result of the commodity boom occurred outside Java. The slow growth of the manufacturing sector created few jobs in Java and there were few benefits for unskilled and semiskilled workers in Java from the spillover effects of increased income for resources-rich areas. Indonesia suffered a case of the Dutch disease.

Other measures of poverty

During the commodity boom the real income of the remaining poor appears to have stagnated or declined. The average income of those below the poverty line rose in the years of recovery from the Monetary Crisis, from 1999 to 2002/03, but appears to have fallen 7% in the rural area and 14% in the urban area since then.[7]

Appendix. Increase in Exports and Composition of the Increase, 1996–2011

	1996–Estimated 2011		Jan–Apr 2010 to Jan–Apr 2011	
	Billion $	% of total	Billion$	% total
Increase in total exports	157	100	14	100
Increase in commodity exports	122	78	11.5	82
Because of increased quantity	37	30	2	17
Because of increased prices	85	70	9	78
Increase in labor-intensive manufactures	10	6	1	7

Note: Data for 2011 are for January-April but have been projected for the year as a whole in the comparison with 1996.

[7]"Appears" is necessary because these are not strictly comparable groups. In 2002/03 about 16.3% of the population was below the poverty line and in 2010 13.3% were poor. Those 3% who escaped from poverty may have been among the wealthier poor in 2002/03 and their departure from the group would have lowered the average income of the group as a whole. We do not know the average income in 2002/03 of the 13.3% who remained below the poverty line in 2010.

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