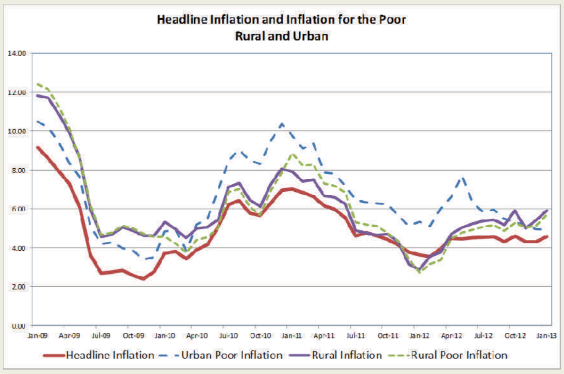
Poverty and the Economy February 2013



INFLATION

Inflation in January

Inflation for January 2013 was 1.03%, relatively higher than January 2012 (0.76%) and January 2011 (0.89%). The food inflation (3.39%) was the highest contributor for this month inflation which is triggered by an increase in chicken, fresh fish and red chilies.

In the rural area, inflation in January 2012 was 1.02, much higher than December 2012 of 0.43%. Similar to the urban area, the highest contributor was the food inflation (1.99%) compared to 0.59% in December 2012.

World food prices

World prices in January were relatively unchanged compared to December. The prices of cereals, meat and sugar were lower while the prices of oil and dairy were slightly higher. Stable food prices have a positive impact on the poor in Indonesia because it should reduce pressure on domestic food inflation.

DEVELOPMENT

World Growth is expected to increase gradually

The global growth in 2013 is expected to increase but downside risks remain significant. The latest IMF's World Economic Output (January 2013) predicted that global growth will strengthen gradually in 2013 reaching 3.5% on annual basis. An increase in growth during the third-quarter was partly due to temporary factors such as increased inventory accumulation (mainly in the US). Activity in the euro area periphery was softer than expected. Japan's output continued to contract further in the third quarter.

Policy action is needed to secure the world's fragile growth. Action is needed the most in advanced countries. Many advanced countries face two challenges; first there is a need for steady and sustained fiscal consolidation, and second there is a need for continued need for continued financial sector reform to decrease risks in the financial systems. Meanwhile, emerging market and developing countries need to rebuild macroeconomic policy space to balance external downside risks and risks of rising domestic imbalances.

The Indonesian economy

Indonesia's economy grew by 6.23% in calendar year 2012, slightly below the government's target of 6.5%. However, it was still the second fastest-growing country in the G-20 after China. The highest rate of growth were recorded in the transportation and communication sector (9.98%), followed by the trade, hotel and restaurant sector (8.11%). However, the largest contributors to growth were the manufacturing sector and trade, hotel and restaurant sectors (1.47% and 1.44% out of 6.23% respectively). The contribution of services sector was 4.09% relatively high compared to other sectors (agriculture, mining, manufacture and utilities). The share of services sector in the GDP in 2012 was higher than in 2011 (49.05% compared to 48.35%).

On the expenditure side, the largest contributor of growth was private consumption (2.93%) and investment (2.40%), while the highest growth was in investment (9.81%) and imports (6.65%).

The slower growth in 2012 resulted in fewer jobs being created. This had a negative impact on the poverty alleviation program especially with the low level of growth in the agriculture sector that is so important for the rural poor, which account for the majority of the poor in Indonesia.

Indonesia experiences the first annual trade deficit in 2012

Continuing weak global demand in the last month of 2012 resulted in Indonesia's first trade deficit (US$1.65 billion) for a full year. Exports dropped to $109.04 billion, or 6.61% lower than the previous year, while imports increased by 8.2% to $191.67 billion. Declines in commodity prices of raw materials such as palm oil, rubber, coal and other mineral commodities contributed to the plunge of export in 2012. The trade deficit was mainly caused by the oil trade (deficit of $5.6 billion), while the non-oil trade still experienced a surplus of around $4 billion. The oil and gas deficit was in part caused by high demand of subsidized fuel. Meanwhile, imports of intermediary and capital goods dominated non-oil imports in 2012.

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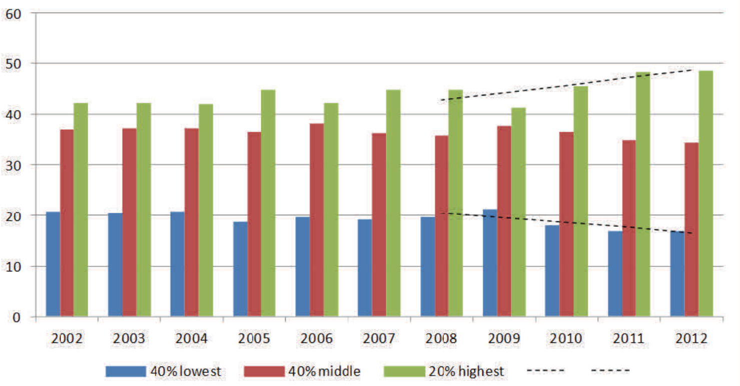
SPECIAL REPORT

International Commodity Prices and Inequality in Indonesia

Indonesia has traditionally had a good track record on income equality. Decades of poverty reduction, interrupted temporarily by the Asian financial crisis, had meant that inequality, as measured by economists, had been falling to stable for many years. This changed over the past few years. Income inequality, as measured by Gini coefficient, has increased from 0.37 to 0.41 from 2009 to 2011. This was particularly surprising as Indonesia's Gini coefficient has never moved so quickly in the past and is now at its highest level ever.

Figure 1: Income Distribution of Three Household Groups, 2002-2013 (Source: BPS)



Some analysts looking for the cause of this change in income distribution point to the fact that during the same time that incomes were becoming more skewed, the world price of many Indonesian export commodities rose sharply. Those sectors, particularly mining, are highly capital intensive and skilled -labor intensive. An increase in the price of mining commodities will increase the returns to factors more intensively used in those sectors, and thus has a tendency to increase inequality.

SEADI commissioned a study on the impact of the international commodity prices increases on inequality in Indonesia by Dr. Arief Anshory Yusuf and his colleagues. They use a computable general equilibrium model (INDONESIA-E3) to investigate the extent to which increases in Indonesia's main export commodities (estate crops and mining) could have contributed to the increase in inequality in Indonesia.

The model estimated the impact on inequality of increases of the magnitude observed during the period of 2009-2011 in the prices of eight main Indonesian export commodities. The results suggest that export price increases indeed increase inequality, yet with a magnitude of only a quarter of the increase in Gini coefficient observed during the period of 2009 to 2011.

The model indicates that the increases in the world price of mining commodities have a much larger impact on inequality than increases in prices of estate crops. The effect of increases in the world prices of rubber, palm oil, coffee, and tea on inequality is negligible and poverty-reducing in rural areas. On the other hand, the effect of the increase in the world price of coal, oil, gas, and metal increase inequality significantly. These findings suggest that, from the perspective of equality, restricting export of estate crops commodities can be counter-productive in the midst of the commodity booms, but taxing revenue from mining sectors for use in poverty reduction programs could be a sensible policy response.

Gini Coefficient

The Gini coefficient measures the level of inequality in the distribution of income. A Gini coefficient of zero expresses perfect equality, where all households have the same income. A Gini coefficient of one (100 on the percentile scale) would mean that one household receives all of the income in the economy. Thus changes in the share of total household income received by the poor vs. the rich result in changes in the Gini. Indonesia's Gini coefficient has been around 0.30.

Over the past three years, Indonesia's Gini coefficient has increased from 0.37 to 0.41. During the same period, the income share of the richest 20% increased from 41.2% to 48.6% while the income share of the lowest 40% fell from 21.2% to only 16.9%.

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