Policy International
Centre for Inclusive Growth

The International Policy Centre for Inclusive Growth is jointly supported by the Poverty Practice, Bureau for Development Policy, UNDP and the Government of Brazil.

One pager No. 86

June, 2009

The Indonesian Response to the Financial and Economic Crisis: **Is the Developmental State Back?**

by Degol Hailu, International Policy Centre for Inclusive Growth (IPC-IG)

The current economic slowdown is jeopardising efforts to achieve the Millennium Development Goals. Poverty is worsening and jobs have been lost. The Asian Development Bank estimates that by 2010, about 100 million people in Asia will fall into poverty.

The slump is affecting Indonesia mainly through declines in its exports and capital flows. The prices of its major export commodities are falling. The stock market has plummeted in the last six months. The markets for Indonesian Government Securities and Indonesian Certificates (SBIs) showed a deficit of US$2.2 billion in the first four months of 2009. Added to the crisis is food-driven inflationary pressure. In 2008 the consumer price index (CPI) reached 12 per cent, up from 6.6 per cent in 2007. Food prices account for 49 per cent of the rise in inflation. The CPI weight for food is 36 per cent. How is the Indonesian government responding to the financial and economic crisis?

In the first quarter of 2009, rubber exports fell by 32 per cent. Farmers have suffered most. In some provinces tapping has completely ceased. The policy response was to cut shipments of rubber exports by 700,000 tons, a cartelist measure that was taken in concert with Thailand and Malaysia. The hope is to keep prices high and maintain constant income levels, just as the Organisation of Petroleum Exporting Countries (OPEC) does.

The price of tin, another major Indonesian export, fell from US$23,595 per ton in July 2008 to US$12,355 in April 2009. The government suspended the quota system that set minimum limits on tin exports. When prices were high, provinces such as Bangka Belitung and the Riau Islands were required to export at least 90,000 and 15,000 tons of tin, respectively. By suspending the minimum quota, the government is encouraging producers to cut their output and keep prices stable in the face of slow global demand. As a result, tin production fell from an average of 120,000 tons between 2005 and 2007 to 80,000 tons in 2008.

The footwear and textile sector is also suffering from sluggish global demand. Currently, 60 per cent of production is exported, while 40 per cent is consumed locally. Like other Asian countries, notably China, the government is openly discussing the shift in its development strategy. The new focus is on expanding domestic markets. In fact, the target for the footwear and textile industry is to switch the above percentages: 60 per cent for domestic consumption and 40 per cent for exports. As part of its stimulus package, the government is providing direct subsidies for the purchase of machinery under the Machinery Revitalisation Programme. Recently, the footwear industry received a cash subsidy of US$5.17 billion, and US$22.1 billion was provided to the textile industry.

The drive to boost domestic consumption is also accompanied by an import-substitution strategy. For instance, Indonesia produces about 24,000 tons of cotton annually. But estimates suggest that domestic cotton production satisfies only 4 per cent of demand. The balance is imported, mainly from Egypt and the United States. Again, the government stepped in and launched a scheme to increase cotton output to 48,000 tons in the next few years, and to double the area under cultivation to 40,000 hectares. The provision of subsidised seeds and farm inputs has already started in Gunung Kidul, Yogyakarta, Pati, Kudus, Blora, East Java, and South Sulawesi provinces.

The government's response to the crisis has also included macroeconomic policy changes. The interest rate was cut to 7.8 per cent in 2009 from 9.5 per cent in 2008. A fiscal stimulus of US$7 billion, or 1.4 per cent of GDP, has also been announced. The stimulus comes in the form of tax cuts (76.5 per cent of it), infrastructure expenditure (16.8 per cent) and direct subsidies (6.7 per cent). Fortunately, 2009 started with a fiscal deficit of 1.2 per cent of GDP, which gave the government room for deficit financing.

Cartelist stances in the supply of commodity exports, direct industrial subsidies, import-substitution measures and a Keynesian fiscal stimulus have been the hallmark of the Indonesian response to the crisis. Until now these heterodox measures have been anathema to the neoliberal consensus. We are witnessing the resurgence of the developmental state, given the crisis of legitimacy faced by that consensus.

Note: This article is based on consultations held during the author's recent visit to Indonesia under a UNDP research project. Sincere thanks go to the many people who generously provided their insights.

Click and comment

International Policy Centre for Inclusive Growth (IPC - IG)
Poverty Practice, Bureau for Development Policy, UNDP
Esplanada dos Ministérios, Bloco O, 7º andar
70052-900 Brasilia, DF - Brazil

E-mail: ipc@ipc-undp.org ▪ URL: www.ipc-undp.org
Telephone: +55 61 2105 5000