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Macroeconomic Aspects of Inclusive Growth in Indonesia

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The views expressed in this presentation do not necessarily reflect the views and policies of the Asian Development Bank, its Board of Governors or the governments they represent.



Why label growth as “inclusive”?

- Unhappiness with the *status quo*
- Governments claim that countries grow fast but workers do not feel it in their pockets
- Yet people see that small group is doing very well
- Jobs are created but ‘not good’, that is, they do not pay decent wages

Presentation

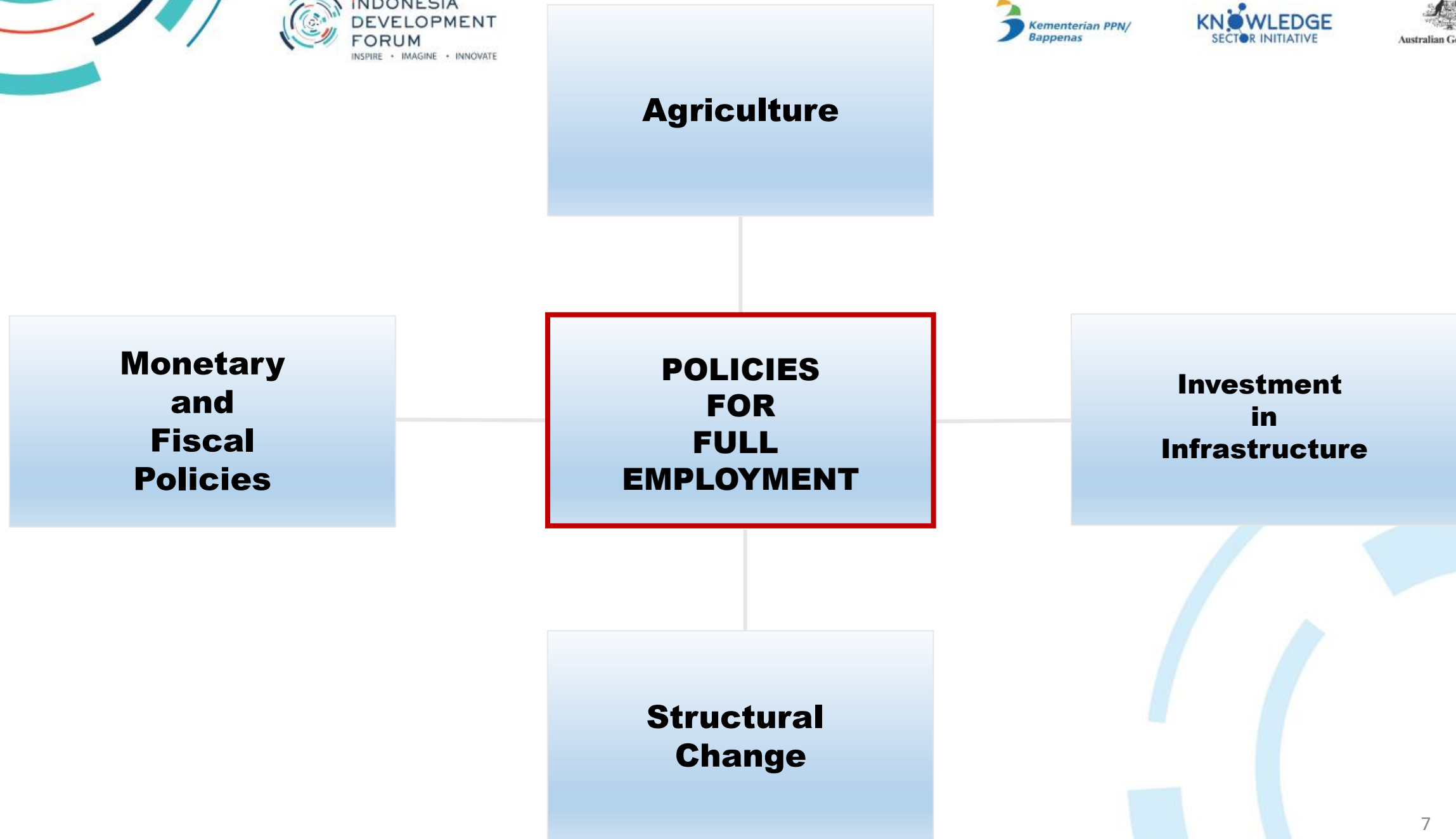
- What is inclusive growth and why it is necessary for Indonesia to embrace this idea?
- Proposal to interpret and operationalize the idea of inclusive growth: a package of policies for full employment
- *“Why does not Indonesia grow faster, like China?”*
 - The need to increase potential and actual growth
 - Coherence between macroeconomic and development objectives

What is Inclusive Growth? *A fuzzy concept*

- *IG is growth that allows all members of society to participate and contribute to the growth process*
- Proposal: How to participate? Through a productive and decent job
- Significant Unemployment and **Underemployment** are not due to skills mismatch or lack of human capital. It is a systemic failure of the economy to create enough jobs
- For this reason, **Full Employment** must be brought to the top of the policy agenda (do not assume it)
- “Inclusive” is an adjective that applies ex-post and in the medium term to evaluate whether a government has achieved or not certain objectives that are valued by society (dichotomous: Yes or No)

Why employment and Full employment?

- (-) Waste of resources: the biggest inefficiency
- (+) High overall purchasing power
- (+) Great individual and social benefits
- (+) A right
- (+) Development Goal
- (+) Political Stability



Policies: The Full Employment Imperative

Modernization of Agriculture

- Largest employer (>30% of total employment)
- Lowest productivity

To do:

- (i) Shift workers to other sectors
- (ii) Use latest techniques
- (iii) Link to markets

Policies: The Full Employment Imperative

Investment in Infrastructure

- Creates employment
- Provides basic public services (water, sanitation)
- Relaxes key bottlenecks that create inflationary pressures
- Facilitates industrialization (ports, roads)

Policies: The Full Employment Imperative

Induce Structural Change

- Transfer of resources
- Sophistication and Diversification
- Development of new sectors
- Public-Private collaboration to solve market failures that difficult private investment

Policies: The Full Employment Imperative

Fiscal and Monetary Policies

- The need for coordination
- *Deficit fetishism and myths.* Countries cannot nation-build without the national government running deficits
- Should Full Employment be a mandate of the Central Bank?

Operationally....when can Indonesia say that growth was inclusive?

When, over the medium term:

- Workers are seen to shift to more productive sectors; the structure of the economy upgrades; and wages increase across the board (working conditions improve then)
- The share of wages in GDP does not decline significantly
- Unemployment and underemployment decline and the economy approaches full employment
- Inequalities decline

Take Away...If we are serious about Employment and Inclusive Growth

- Growth is *inclusive* when it allows all members of a society to participate in the growth process
- The most obvious way to participate is through a job
- Full Employment should be the primary objective of economic policy in Indonesia
- IG should be the medium-term objective of economic policy: *growth was inclusive or not*
- Needed: A set of policies that lead to Full Employment in the context of the challenges posed by structural change: (i) Agriculture; (ii) Investment; (iii) Structural Change; (iv) Fiscal and Monetary.

“Why does not Indonesia grow faster, like China?”

- The need to increase potential and actual growth
- Coherence between macroeconomic and development objectives

Important aspects of growth in Indonesia

- Indonesia's actual growth is lower than China's because the latter's potential is higher
- China's potential is higher than Indonesia's because the former's productivity growth is higher
- Growth (actual) requires spending

The above means that:

- Indonesia needs to make efforts to increase its *potential* growth rate (productivity growth rate) –Macro & Micro issues
- Then increase *actual* growth as *potential* increases
- Actual growth is about spending (injection): no spending, no growth

Achieving Coherence between Macroeconomic and Development Objectives

- For some time now, fiscal policy has been seen with distrust by some (deficit fetishism), with the consequence that the onus of the recovery from the GFC 2008-09 was placed on monetary policy
- Nevertheless....Lessons from the GFC 2008-09 in advanced economies (Blanchard): Under both Ben Bernanke and Janet Yellen, the US Fed shifted from inflation targeting to employment targeting as inflation was in check while the jobs crisis became patent
- Challenge in both advanced and developing economies (*followers*): Central banks need to adopt multiple instruments and targets

Monetary Policy Framework in Indonesia

- To implement monetary policy, since 2005 BI has opted for a working framework known as Inflation Targeting (IT).
- BI aims at maintaining a stable rupiah, which affects inflation
- In the IT framework, **inflation is the ultimate** policy objective
- In the IT framework, central banks set a policy rate
- BI uses the 7-day reverse repo rate (currently at 4.75%) -Reverse repo rate is the rate of interest offered by BI, when banks deposit their surplus funds (no lending or investment options) with the BI for short periods

"Bank Indonesia has one single overarching objective: to establish and maintain rupiah stability...inflation as the final objective"

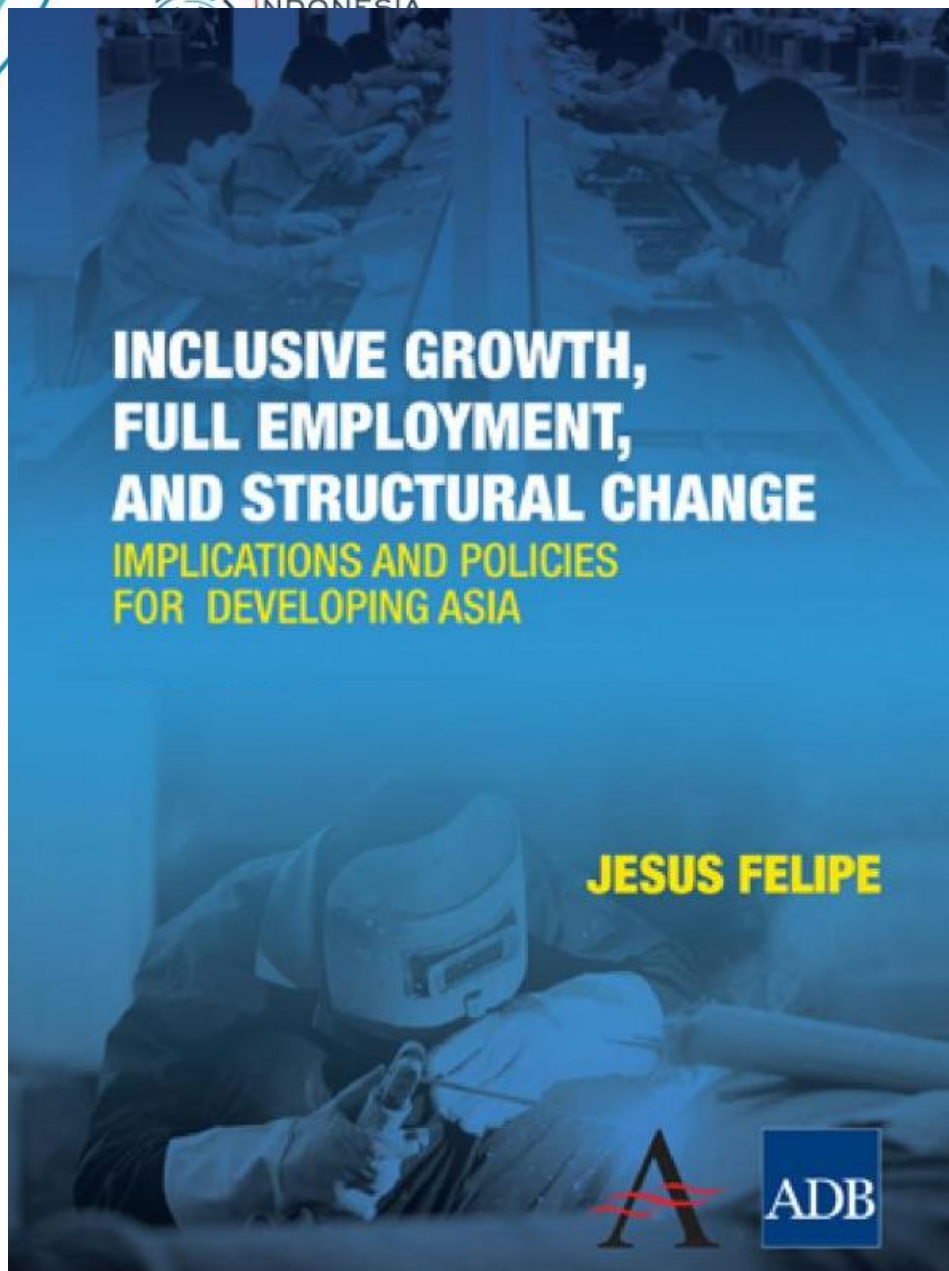
- BI can play a large role in meeting the challenges of development and transformation if it identifies the key developmental and transformational challenges that Indonesia faces and broadens its goals and instruments to help meet those challenges

Coordination of monetary and fiscal policies for development

- Key: The broader government and fiscal authorities must do their share to develop and expand the economy, i.e., there must be monetary and fiscal cooperation, and an attempt thereby to achieve coherence between macroeconomic and development objectives by both the monetary and fiscal authorities
- An increasing number of central banks around the world are finding that they must adopt much more direct development targets in order to achieve key social and economic objectives (e.g., Bangladesh, Argentina, South Africa)

Summing Up

- Indonesia needs to increase its potential growth rate by increasing productivity growth
- As potential increases, then increase actual through, e.g., fiscal policy
- **Inclusive Growth** should not be confused with the standard growth concepts, **actual** and **potential** growth
- Inclusive Growth is a different idea, closer to welfare. Proposal:
Achieve full employment
 - Interventions: Agriculture, Infrastructure, Structural Change, Monetary and Fiscal – Planning (BAPPENAS) but jobs are created by the private sector
 - To be tracked over the medium term
 - Was growth inclusive? Yes, or Not



THANK YOU