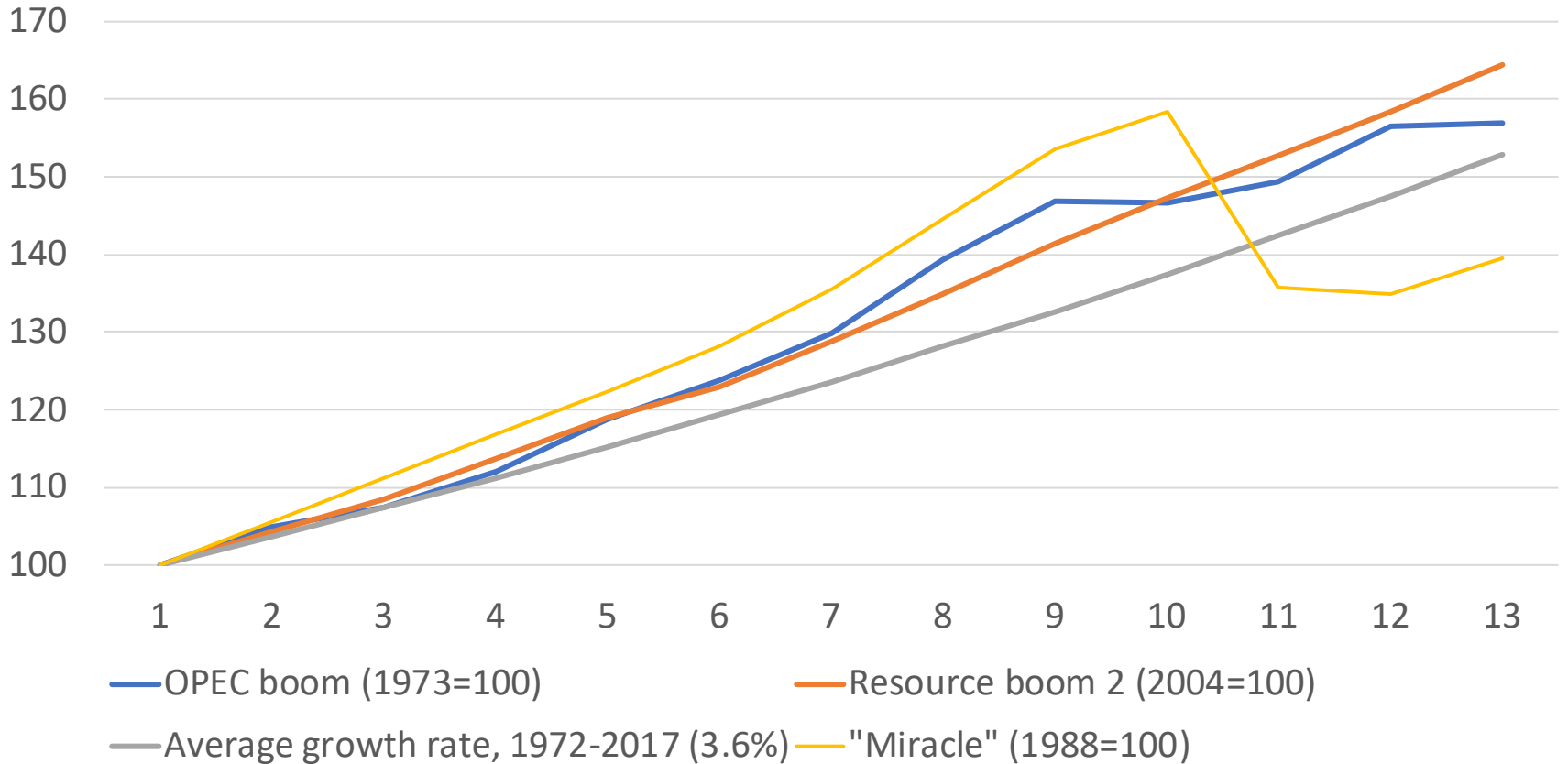


Repair the roof while the sun is shining
Preserving and sustaining gains from recent
economic growth

Rashesh Shrestha, ERIA, Jakarta
and

Ian Coxhead, University of Wisconsin-Madison

Booms compared: per capita growth (in US\$ of 2010) from 1973, 1988 and 2004

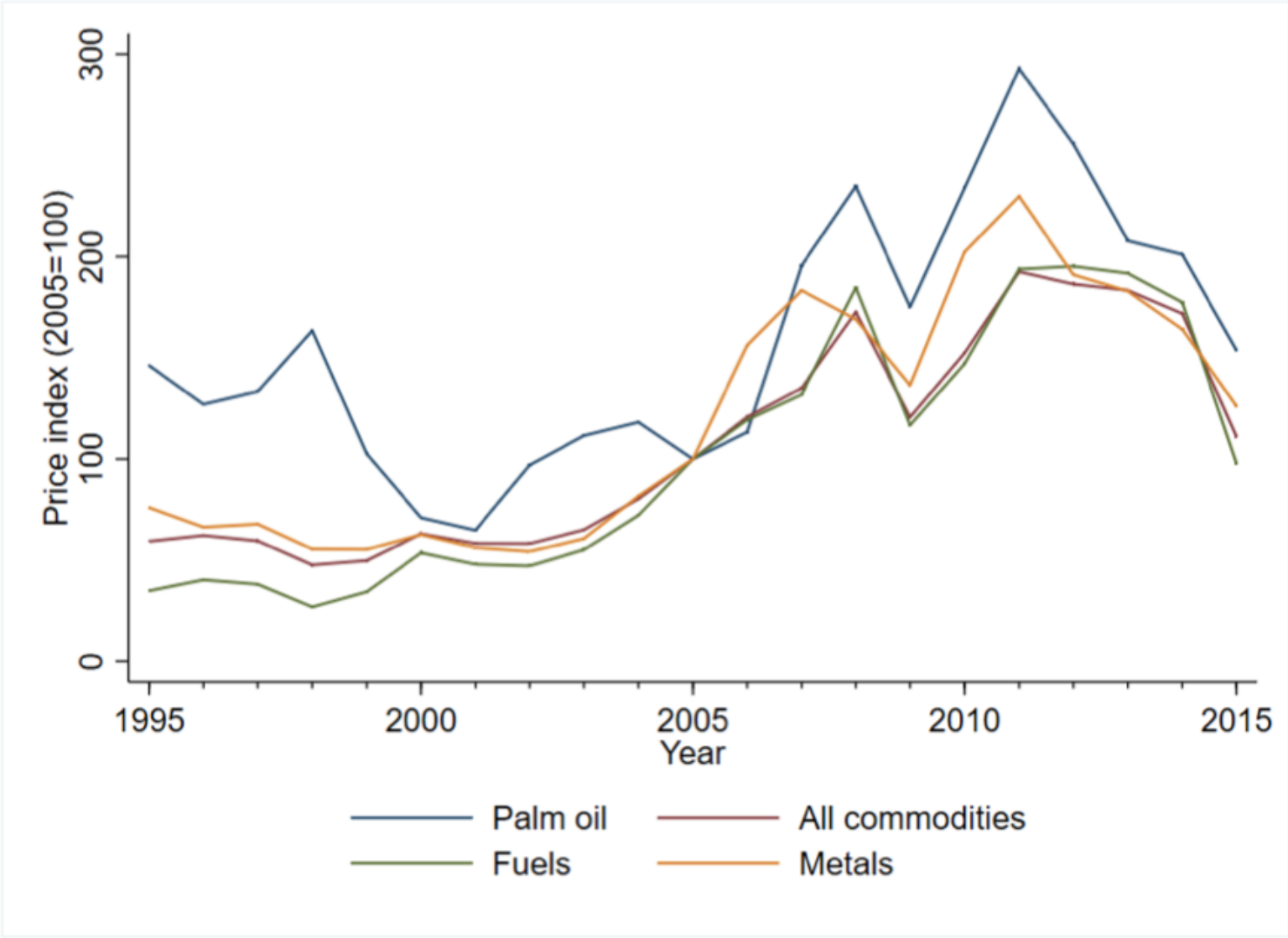


Compared with earlier growth spells, the current expansion is steadier and longer-lived

Current growth: fast, steady and persistent

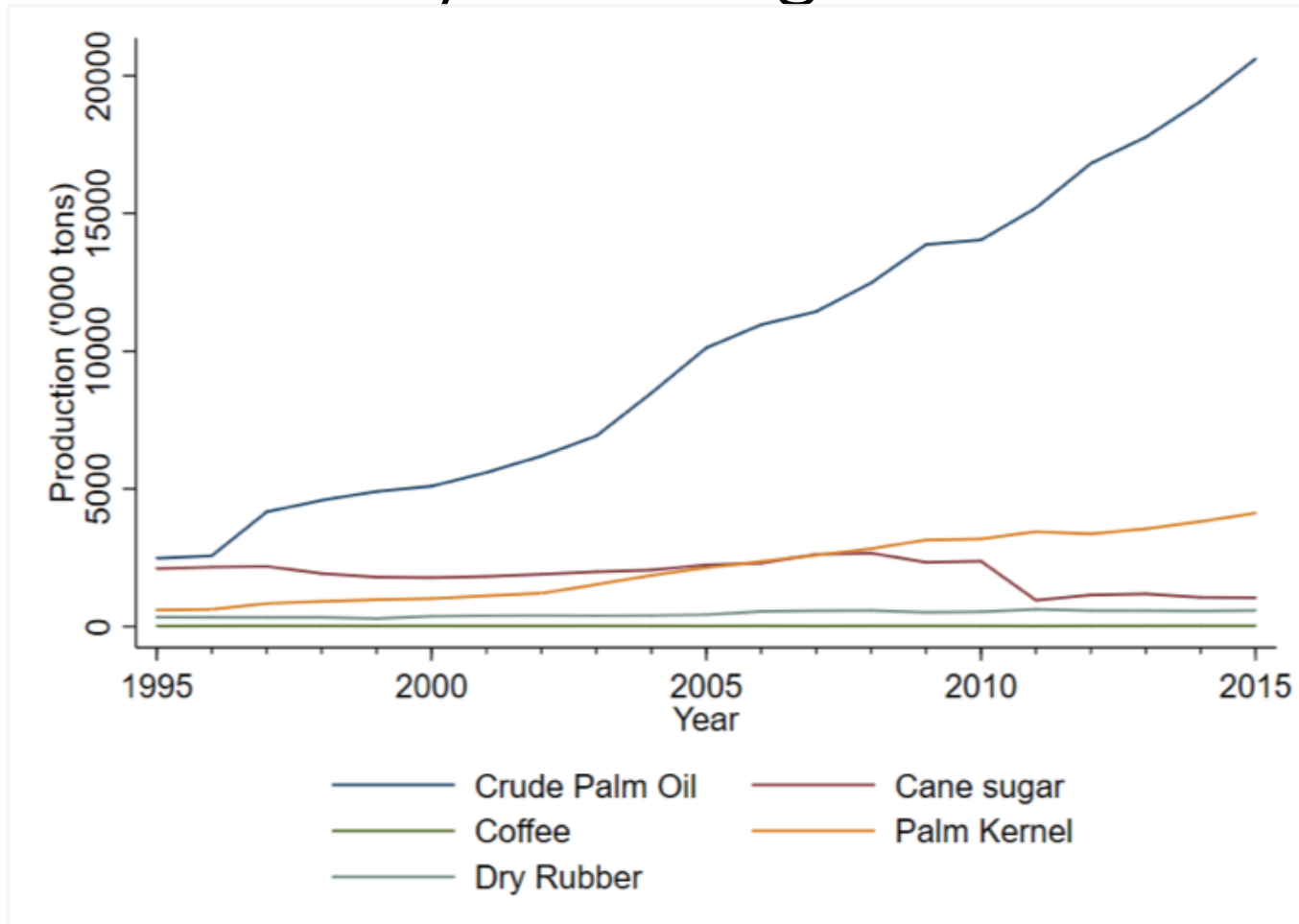
- Fiscal space = opportunity to lock in gains, strengthen basis for future growth
- What can be achieved? What should be attempted?
- Important context: sources of growth
 - Productivity growth, not so much
 - Resource exploitation and export boom, quite a lot
- *Decentralized* resource boom (compare 1970s)
 - Role of agricultural exports, esp. palm oil
 - Distribution of gains: companies, employees, farmers, gov't
- Differences, and implications for development
 - Ideally, windfalls are “saved” (in some form) to smooth and/or raise long-term consumption

Commodity prices in world markets



Source: IMF, IFS (2005 base year) compiled by Derrick (2017)

Palm oil is a key booming sector



- Palm oil exports now account for about 10% of total merchandise exports
- In 2015, about ½ OP production came from smallholders
- Domestic employment in OP/PO production is more than 3m workers

This resource export boom is different

- Macro differences and implications
 - Resource movement v. spending effects
 - Whose windfall to spend? Gov't versus HHs and corporations
- Micro differences, esp. channels to poverty alleviation
 - Household behavior, objectives and constraints
 - Depends on access to financial intermediation, among others
 - Other factors potentially impeding efficient resource allocation: product markets, mkts for labor, skills
- How will *outcomes* differ? How does a decentralized boom translate into sustained gains...
 - For current generation
 - For future generations
 - For economy as a whole?



Source: Authors' compilation from BPS

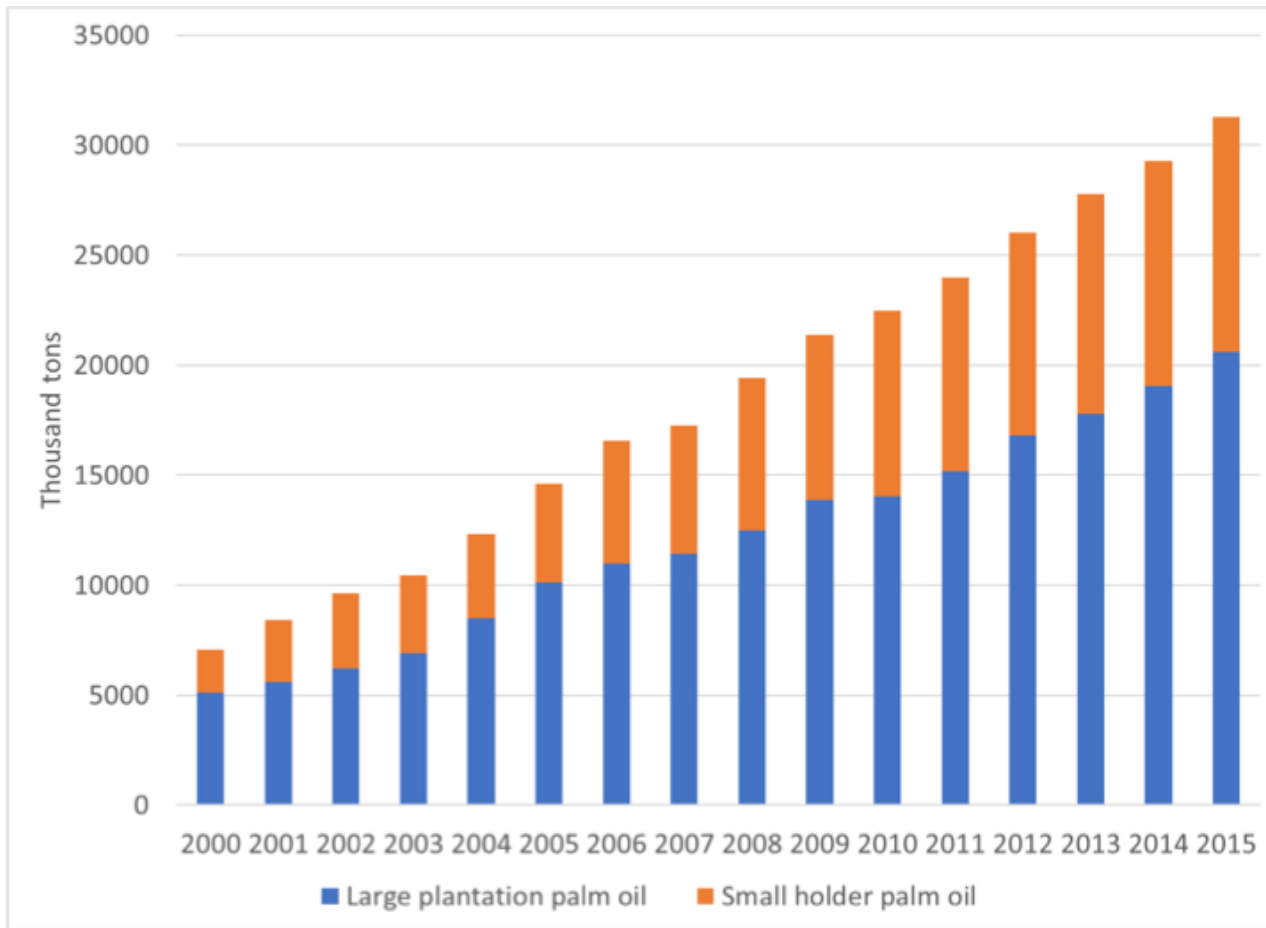
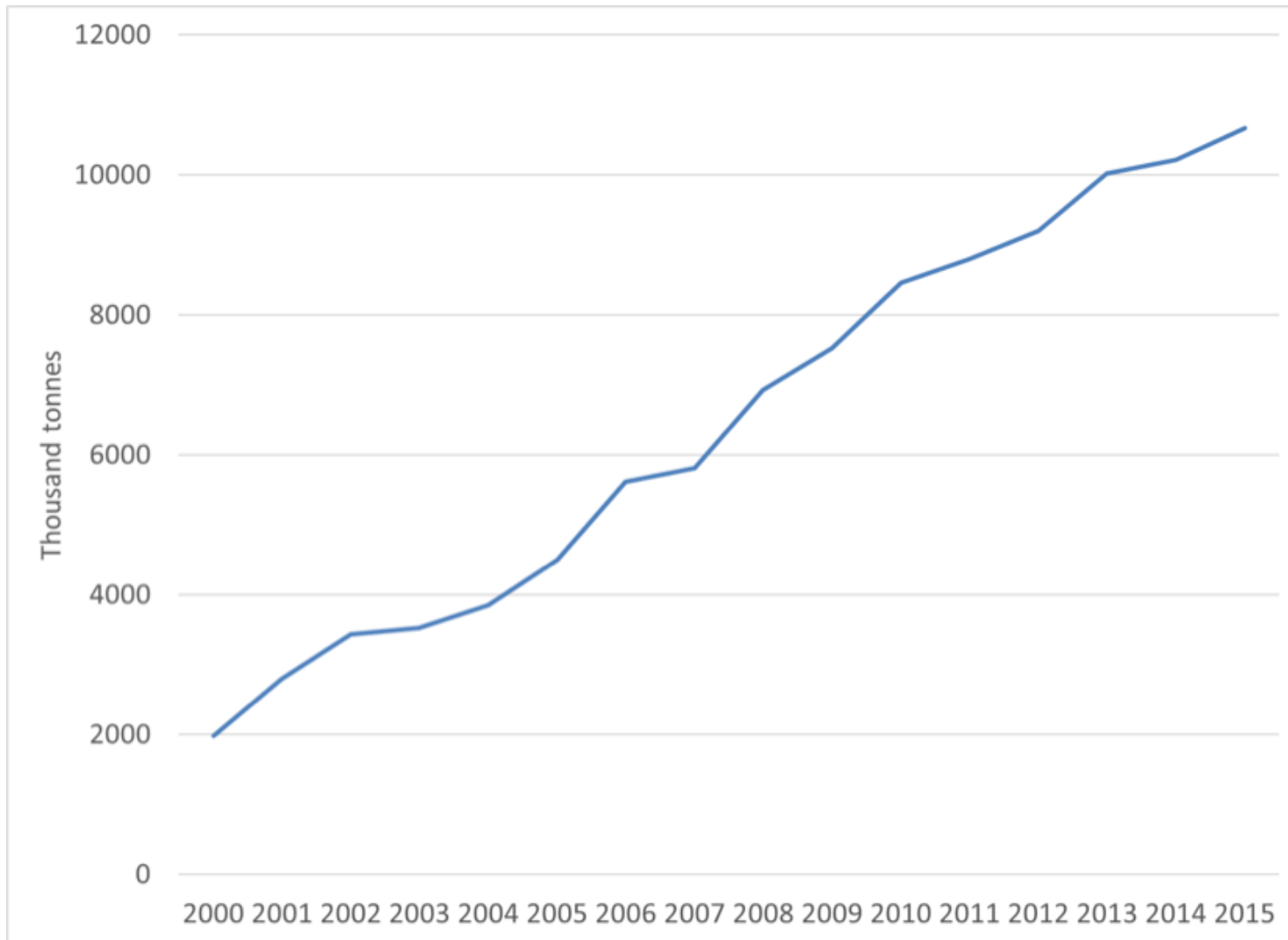


Figure: Crude palm oil production by smallholders and large plantations

Rapid smallholder PO output growth



Crude palm oil production by smallholders

How big a boom?

	2005	2012	2015
Total production (million tons)	15	25	31
Export price/ton	350	1000	650
Value (\$bn)	5.25	25	20
Smallholders:			
Production	5	9	10
Value	1.75	9	6.5
Value increase due to price (\$bn)		6	

Boom's effects on households seem small

- Edwards (2015): 10 *percentage point* increase in OP area in producing districts → 10% reduction in poverty relative to non-OP districts
 - Mean increase in area (2002-10) is 2 percentage points
 - Mean 2002 poverty in OP districts is 20%, so OP effect reduces mean poverty by 0.4%, to 19.6%
- Other studies confirm small welfare effects
- Poverty estimates are based on consumption exp's
- What about other indicators of welfare change?
 - HH savings, investments and cons. smoothing?
 - HH labor supply response (schooling decisions)?

Why it matters (1): Poverty

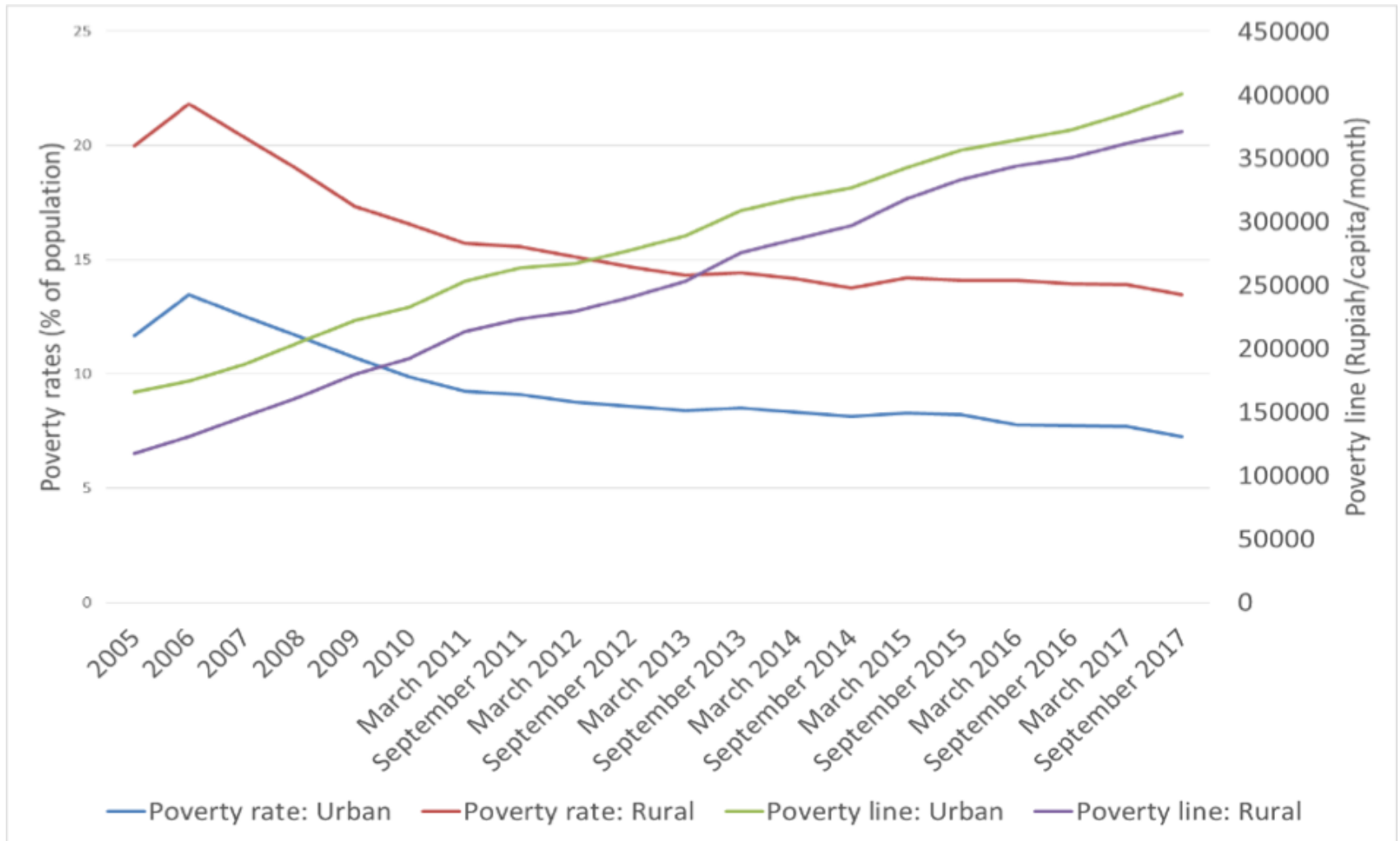


Figure 5: Trends in national poverty rates and poverty lines

Source: Badan Pusat Statistik

No unusual poverty decline in PO provinces

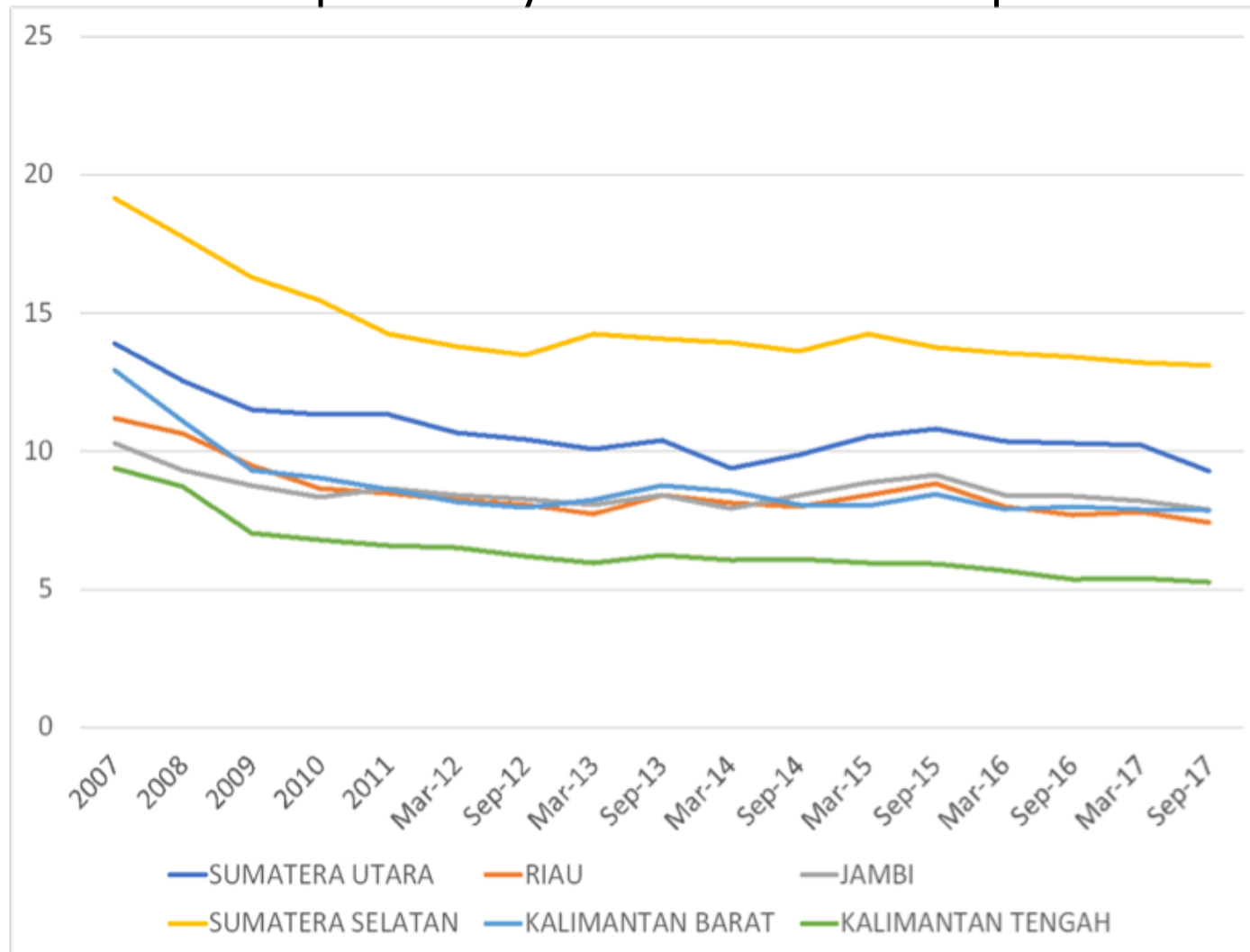


Figure 6b: Poverty rates in key palm producing provinces. Source: BPS

No change in PO poverty relative to non-PO

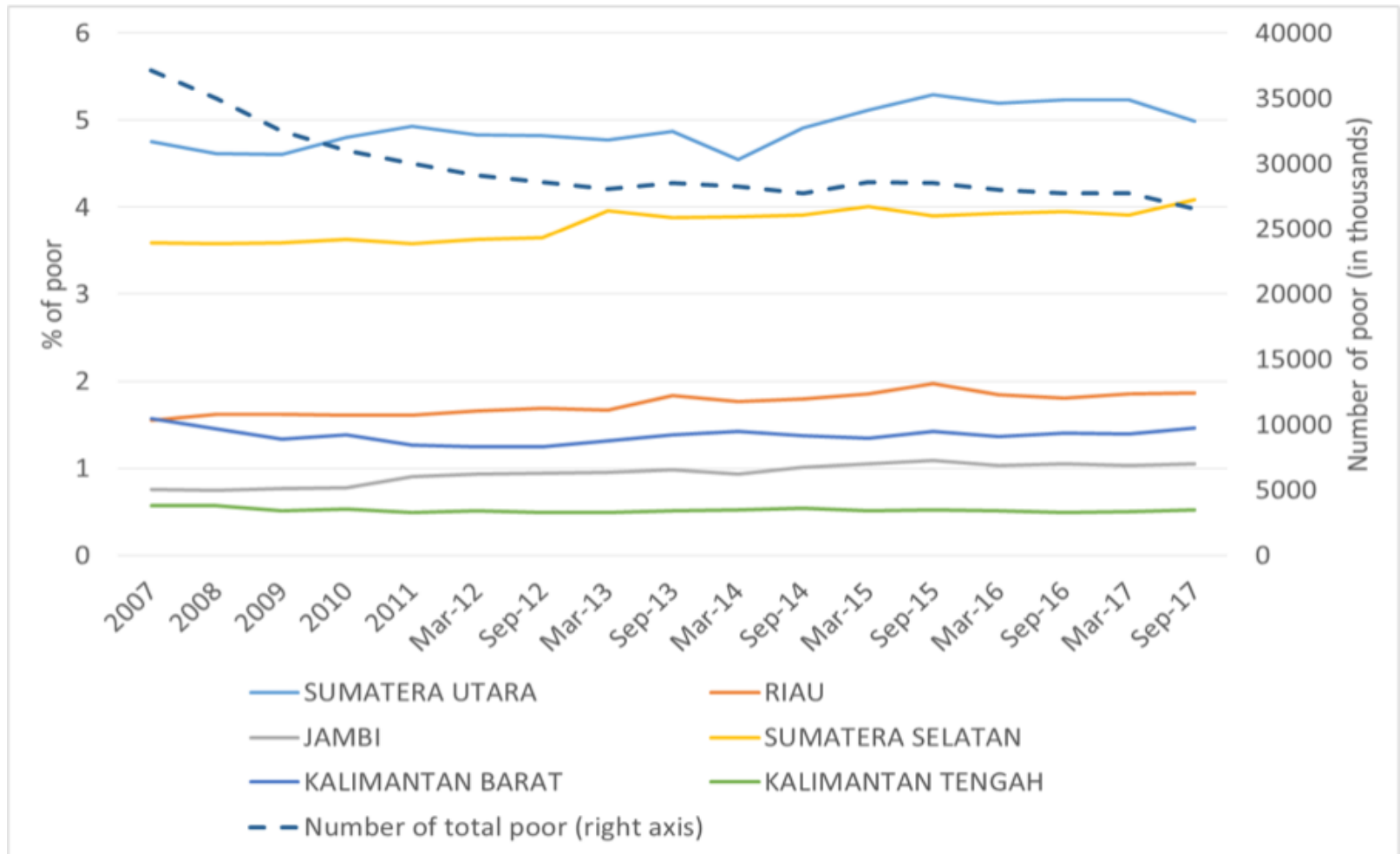
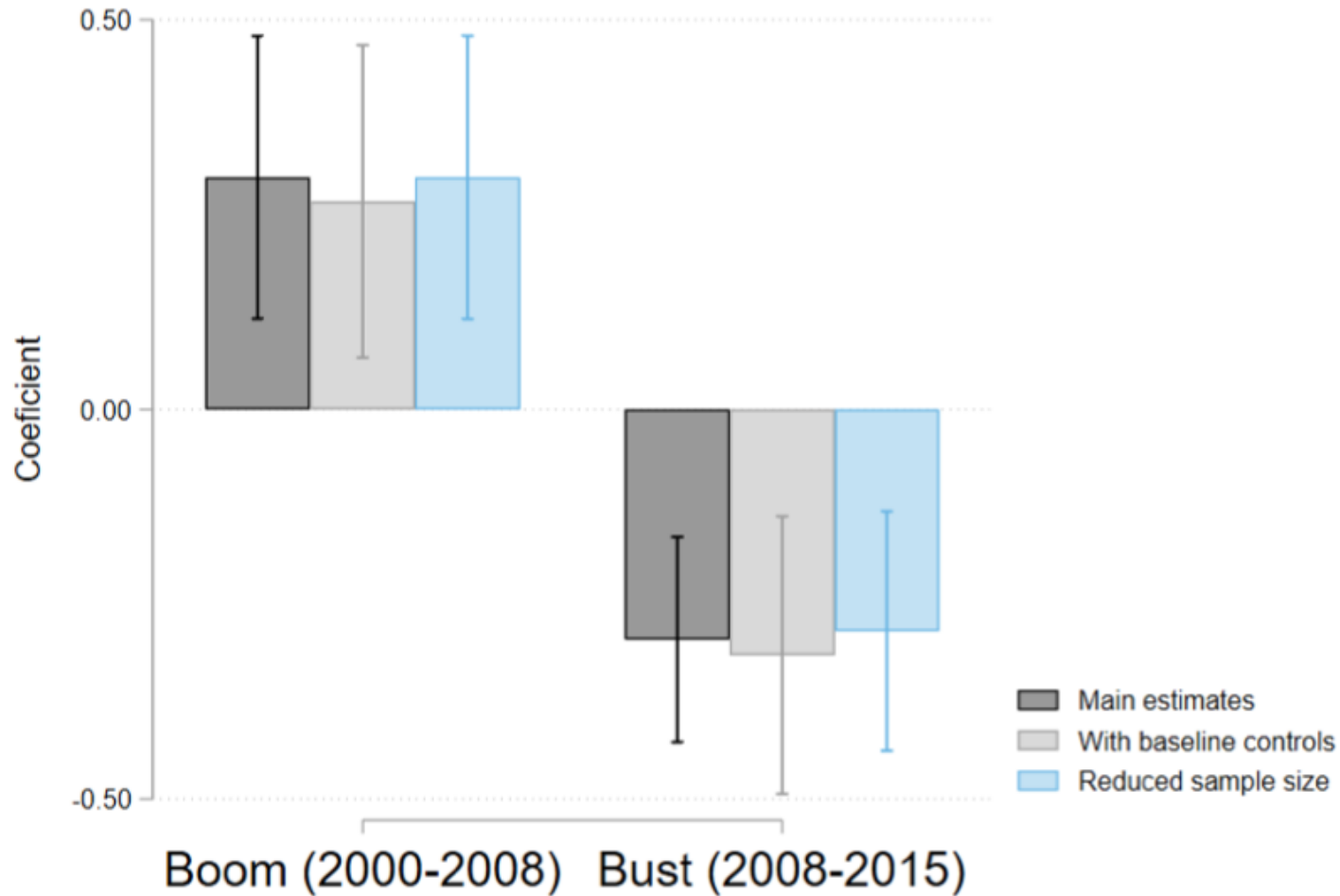


Figure 6a: Share of poor in key palm producing provinces and total number of poor in Indonesia. Source: BPS

Why it matters (2): Volatility



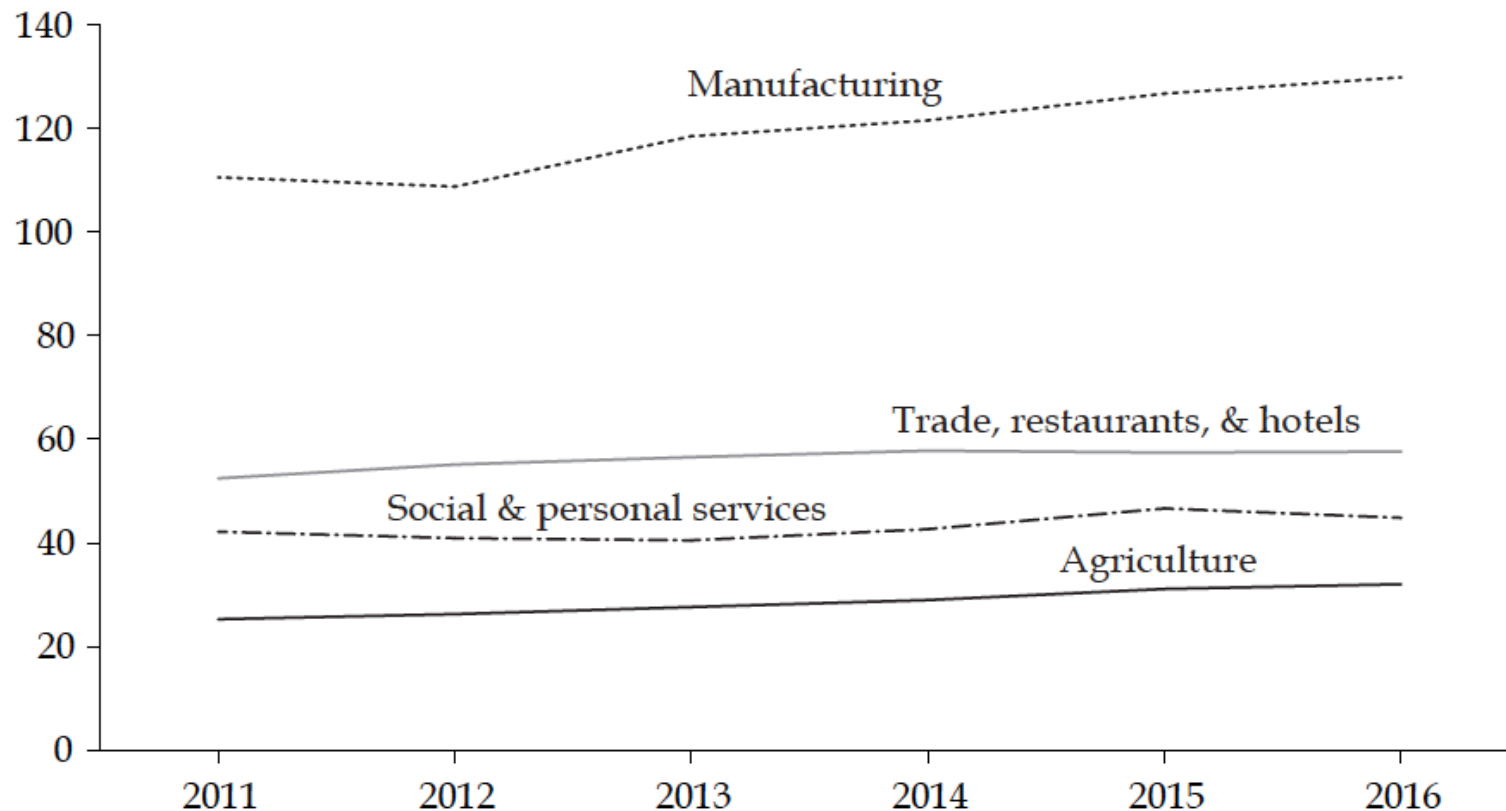
Estimated change in household consumption (%) in OP producing areas (Derrick, 2017)

Why it matters (3): Labor allocation & earnings

- **Macro context: Dutch Disease**
 - Growth of low-skill, informal jobs
 - Stagnant real wages
 - Little increase in returns to skills
 - Less incentive to invest in education
 - Opportunity cost of schooling may have risen in OP districts
- **Mobility out of agriculture still has option value**
 - Intergenerational portfolio diversification
- **Impediments to labor mobility?**
 - “Hotel California” phenomenon: those who enter the agricultural labor force seldom leave

Wages in expanding sectors are flat

FIGURE 4 *GDP per Worker, by Industry, 2011–16 (Rp million)*

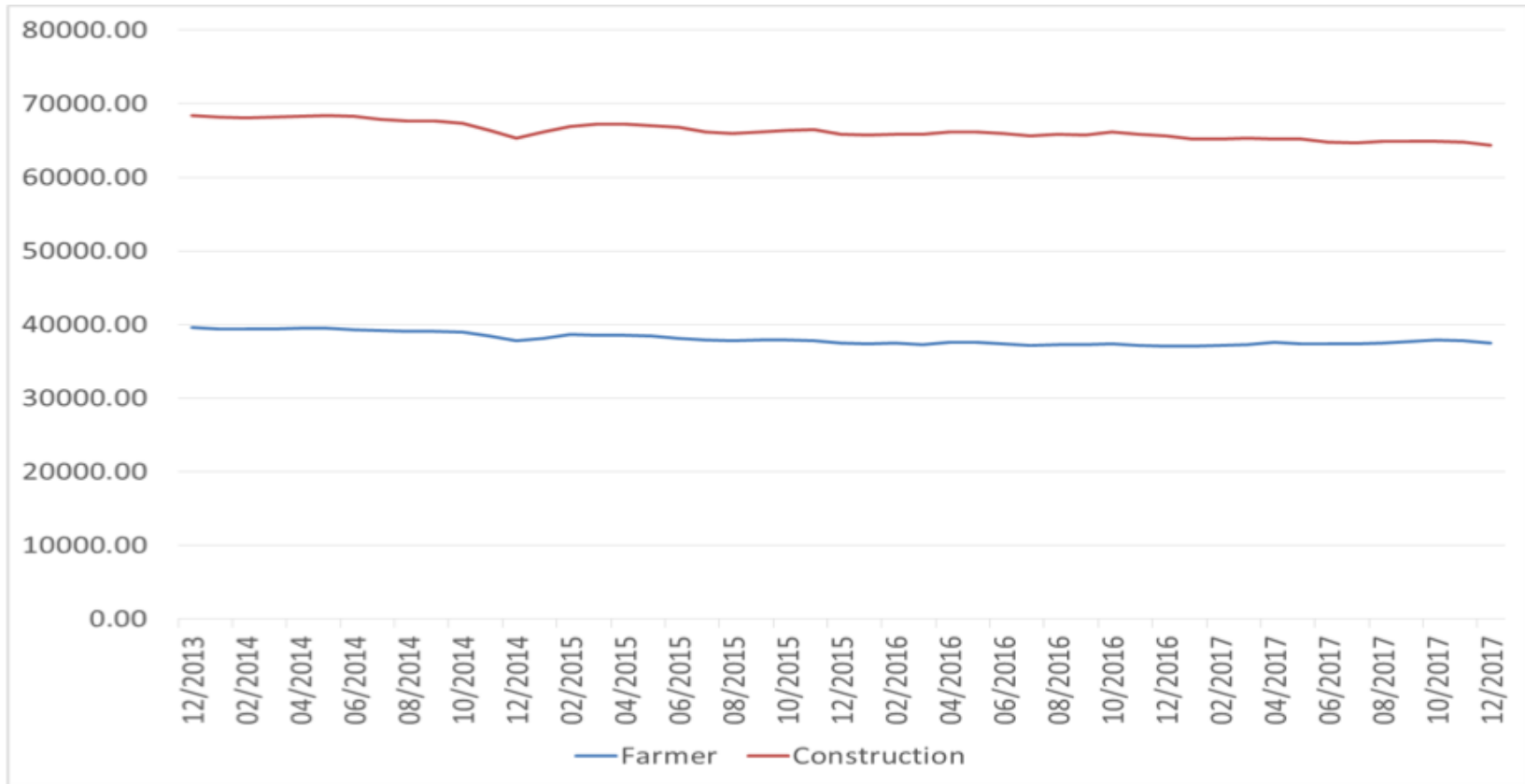


Sources: Data from Statistics Indonesia (BPS), via CEIC, and from Sakernas, 2011–16.

Note: In 2010 constant prices.

Source: Dong and Manning 2017

Real wages in farming and construction since 2014



Real wages by month (2012 base year). Source: Authors' calculation from CEIC data

Mobility may still be advantageous, even for unskilled workers,

Why it matters (4): Allocation of windfall earnings

Households' spending options:

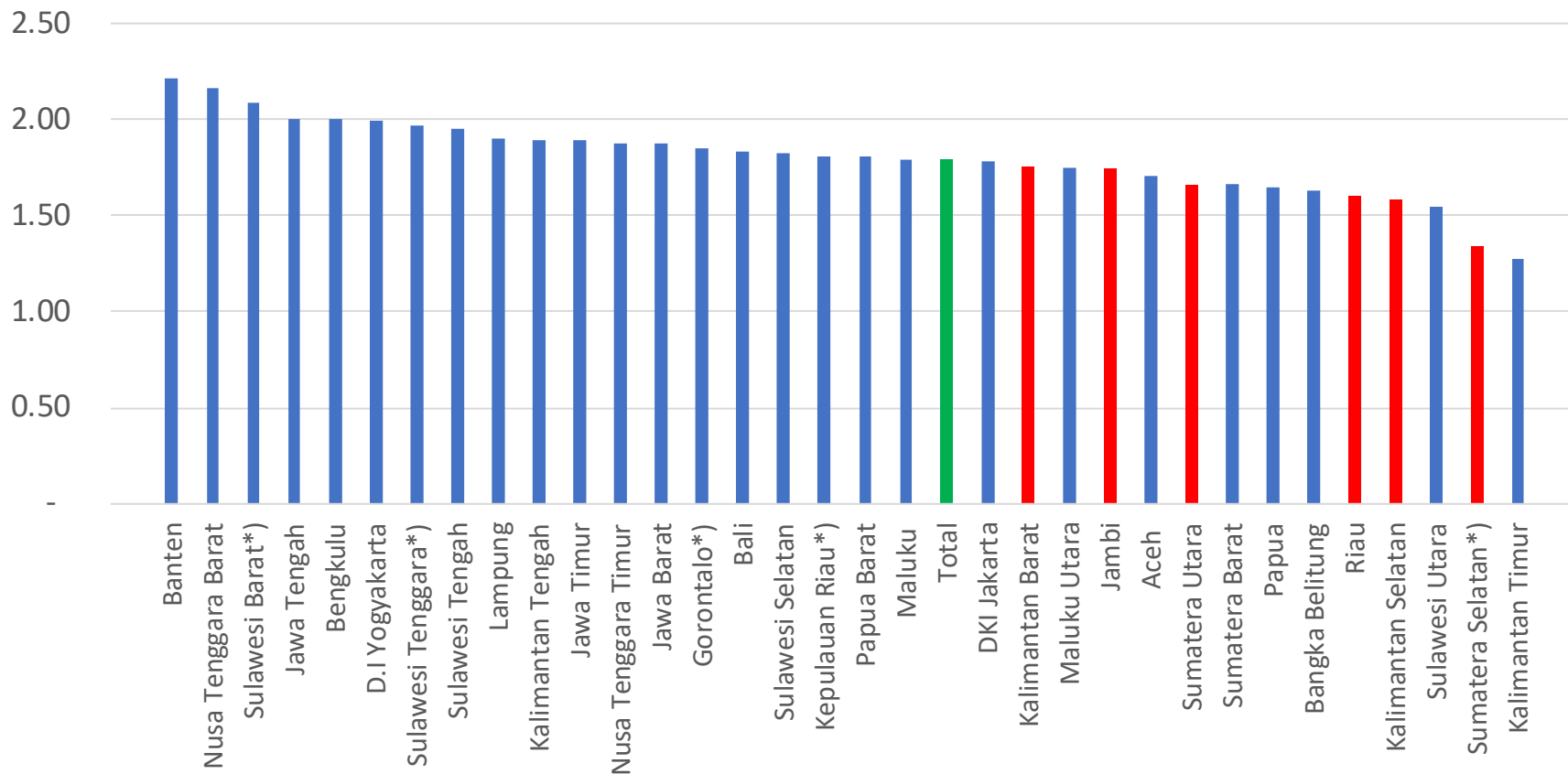
- Current consumption, including consumer durables
 - Short-term poverty reduction
 - Longer term effects?
- Direct investment in real property & capital
 - If in existing operation, vulnerability to shocks will rise
- ✓ Savings through financial intermediaries
 - Secure consumption smoothing & diversification
 - Macro benefits: resource pooling for optimal investment
- ✓ Investment in human capital
 - Raise labor mobility, transfer gains to next generations

Consumption smoothing and financial inclusion: is it happening?

- Why?
 - Secure savings for consumption smoothing
 - Portfolio diversification (real and financial assets)
- Only 12% of rural Indonesians are active bank account users (Fin. Inclusion Insights Survey 2015)
 - Access to physical branch < 5km, only 31%
 - About 4 bank branches/10,000 ppl, all provinces
 - Mobile money uptake is negligible, so far
- Low banking participation not due to ineligibility (Johnson & Morduch, 2008)

Savings growth in PO provinces < average

Change in household savings in banks, 2017/2011, by province

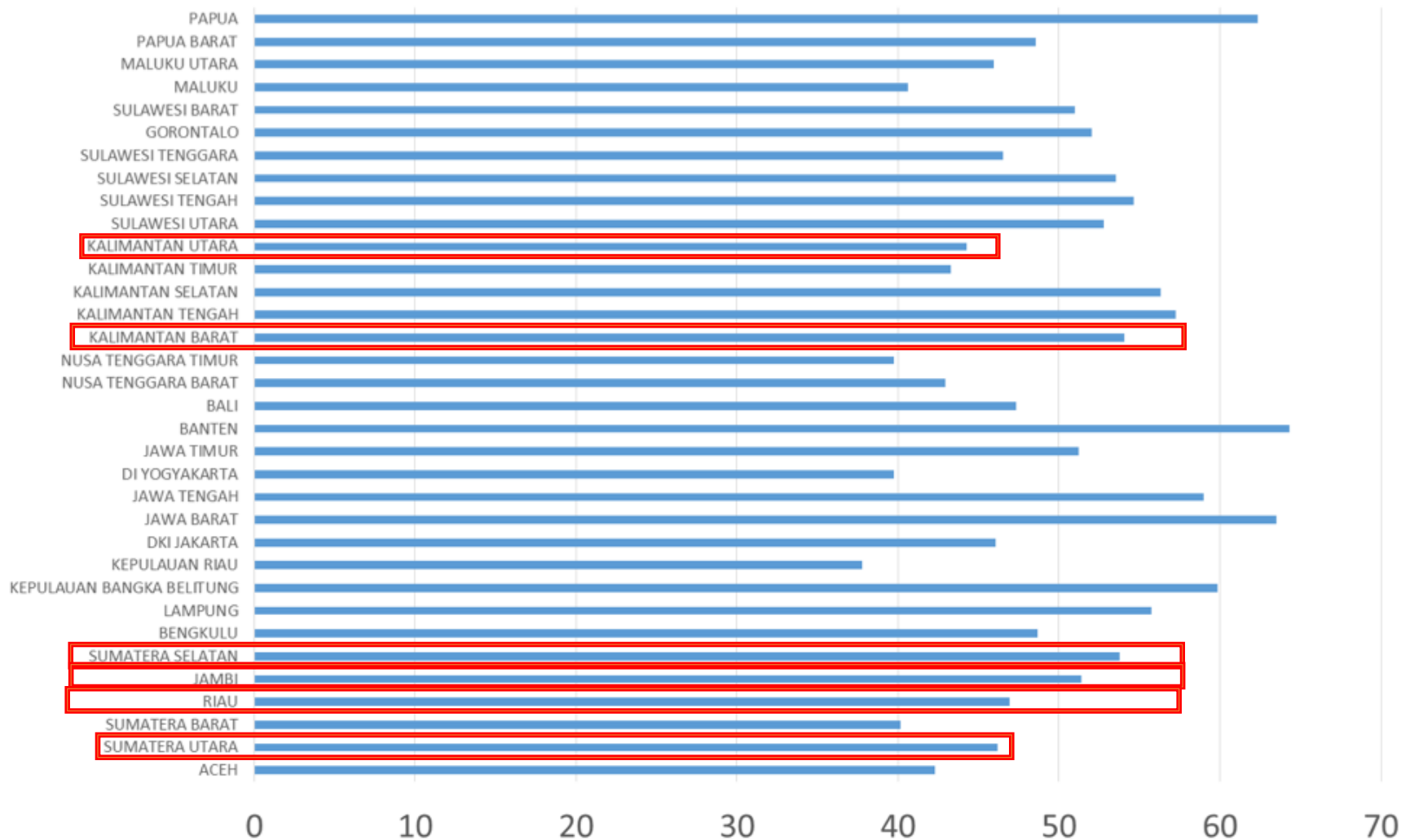


Source: Bank Indonesia. Third-party funds of commercial banks based on location of deposits (Table 1.46a). Smaller provinces (aggregated as "other") excluded from plot. Six top OP producing provinces shown in red.

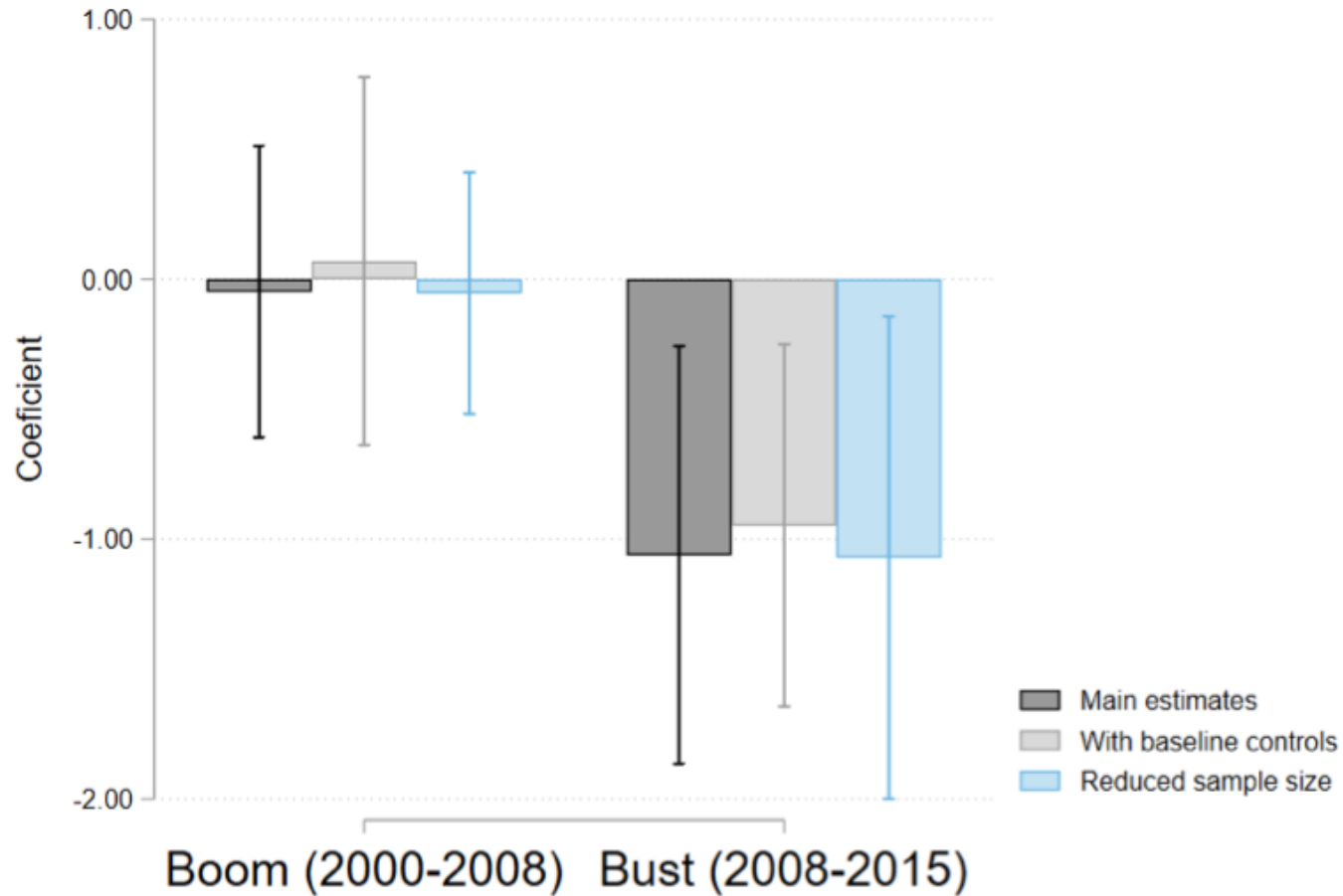
Investments in human capital: are they growing?

- Aggregate schooling growth: progress in quantity, less in quality
- School retention/Out of school children: OP intensive areas are in the middle of the pack
- Boom in OP areas has not translated into increased educational investments (Derrick 2017)

Percentage out-of-school 16-18 year olds in poor households



Income volatility → HC investment volatility



Estimated change in education spending (%) in OP producing areas (Derrick, 2017)

How to lock in (and improve) gains from growth

- Current global conditions → policy reform space
 - But it *will* rain, so roof repairs are timely
 - Link local windfalls to development opportunities
- Assist consumption smoothing & portfolio diversification
 - Step up efforts to improve financial inclusion
 - Branchless banking, mobile money ...
 - Lock in gains to current generation
 - Reduce dependence on volatile industries
 - Promote more efficient *aggregate* investment growth
- Improve labor mobility & human capital investment
 - Counteract Hotel California effect, esp. for adolescents
- But...

Where do the export windfalls go? revisited

- What if the bulk of gains from export growth are being absorbed by intermediaries?
 - No research on world price pass-through!
 - Endogenous margins → rents to millers and traders
 - Gov'ts (including local govt)
 - Still get Dutch Disease spending effect
- Loss of potential gains from resource-based prod'n
 - Higher inequality
 - Smaller effects on poverty and household welfare
 - Crowds in spending on social protection
- Different policy mix is called for 🙄

Thanks for your attention



Work in progress



Comments and suggestions welcome