Macro Economic Analysis on COVID-19 Stimulus in Indonesia

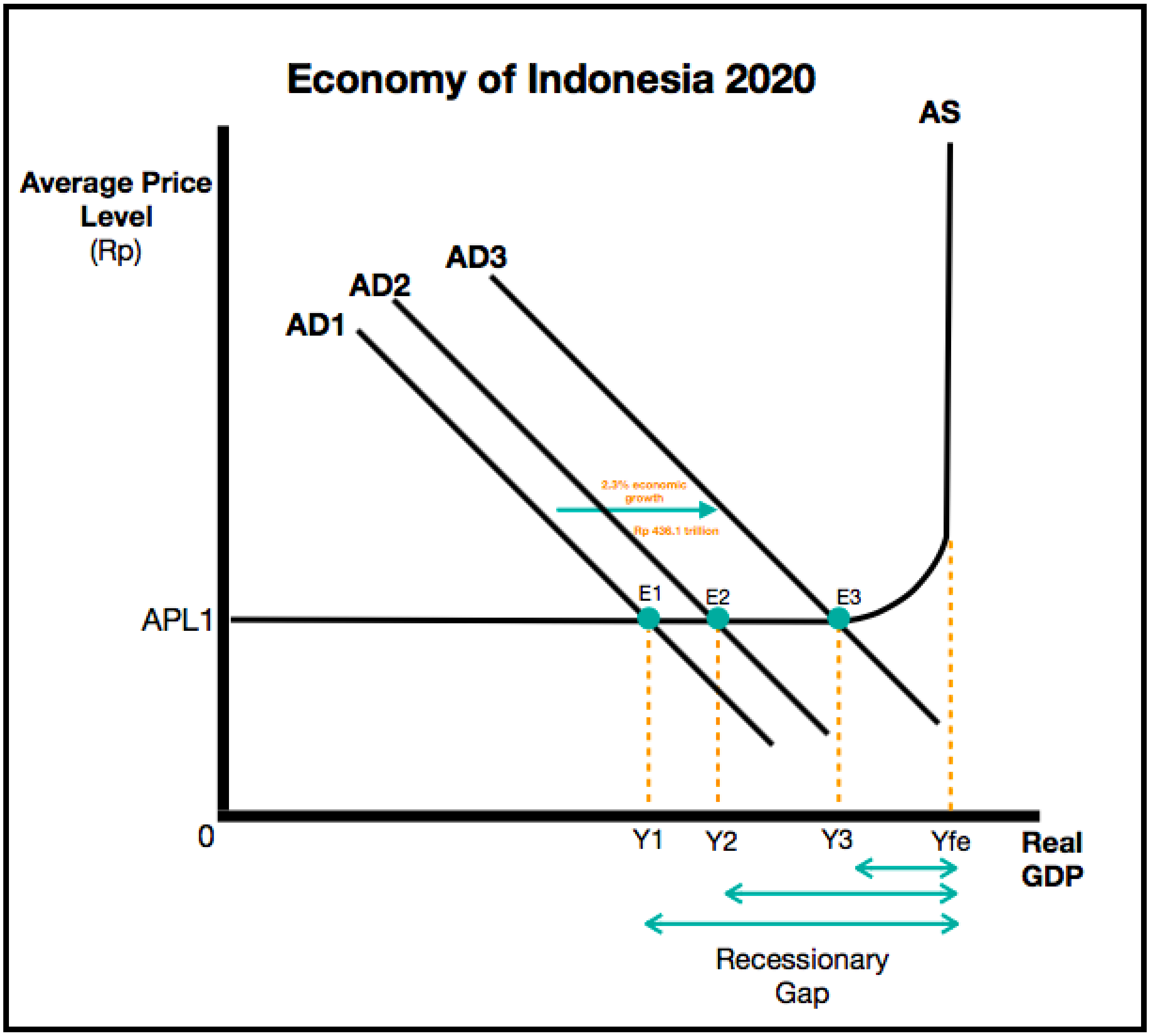
Article Title: Stimulus may not be enough to prevent economic meltdown: Fiscal agency

Full URL of the article:
https://www.thejakartapost.com/news/2020/04/20/stimulus-may-not-be-enough-to-prevent-economic-meltdown-fiscal-agency.html

Commentary:

Question: To what extent is Indonesia's Rp 436.1 trillion fiscal stimulus effective in order to "prevent economic meltdown caused by the COVID-19 pandemic"

The Indonesian Government's Rp 436.1 trillion Fiscal Stimulus (FS) may be inadequate to prevent economic crisis caused by COVID-19, as the Finance Ministry's fiscal policy agency voices concerns (BFK). This macro analysis will be evaluating the effectiveness of this FS to prevent economic meltdown in Indonesia.



The diagram above represents the Economy of Indonesia in 2020. Curve AD1 at point E1 represents where the economy is currently operating at a significant recessionary gap due to COVID-19. The indonesian government has issued a Rp.436.1 trillion FS to "prevent economic meltdown" which will be going towards "healthcare spending, social safety nets and business recovery programs so far focusing on manufacturing and tourism", and Rp.150 trillion of the Rp.436.1 trillion will go towards Small and Medium Enterprises (SMSE). This stimulus is to try and maintain autonomous levels in the economy, as the Indonesian government isn't trying to grow the economy more than it was pre-COVID-19, but rather attempting to maintain autonomous levels. This stimulus has a "baseline scenario for economic growth to reach 2.3 percent", which is represented by the shift from AD1 to AD3, causing the recessionary gap to shrink from Yfe-Y1 to Yfe-Y3, where Yfe is where the economy operates at full employment (where Indonesia strives to be). The Rp.150 trillion to SMSE and the tax breaks to 11 sectors of the economy will lower the cost of production of these firms meaning their average costs will decrease. Therefore, preventing firms from "widespread bankruptcies", and allowing them to keep more of their labour employed, shifting Aggregate Demand (AD) from AD1 to AD2. The shift from AD2 to AD3 can be explained by the consumption multiplier effect. The stimulus has no effect on the economy until that money has been spent, hence why when the stimulus is received by the SMSE's, the healthcare industry, towards the social safety nets, and towards the business recovery programs it doesn't impact the economy it is spent through consumer expenditure. As consumers spend money in the economy, that spending becomes income for others, then they use that income to spend, and the cycle repeats, causing a multiplier effect to occur, hence why the outward shift from AD2 to AD3 is larger than the shift from AD1 to AD2.

This paired with the tax breaks causes the shift from AD2 to AD3 as the tax breaks cause the MRT to decrease, causes MPM to increase, as there import tax deferrals, and causes the MPC to increase, as tax breaks and import tax deferrals lower the cost of production for firms, causing increased consumer expenditure. Since consumption is a direct component of AD, it causes the outward shift from AD2 to AD3. APL is likely to remain the same as the economy is unlikely to face inflation due to the spare capacity of FOPs.

Government spending on healthcare, social safety nets and business recovery programs could all promote economic growth. Increased spending on healthcare causes the workforce to be healthier, making labourers more efficient, which in turn increases output per firm, helping cause the shift from AD1 to AD2. Increased spending on social safety nets creates more disposable income for households as these safety nets subsidies basic needs to poorer families. This increased disposable income could potentially cause an increase in MPC contributing to the shift from AD2 to AD3. Similarly, increased government spending on business recovery programs causes an increase in consumption as less labourers will be fired, causing them to receive wages and spend the money they have received.

It's unlikely that the households benefiting from the social safety nets will save, as they need to spend on their basic needs, and will most probably not have much disposable income left over after that spending.

The main drawback to expansionary fiscal policy is the time lags associated with it. This is why the BKF has concerns that this FS may be insufficient to maintain autonomous levels, as by the time these measures are implemented, the economy could fall into a deeper recession. The head of the BKF stated that "there are some discouraging signs" as the worst case scenario for the economy is a contraction by 0.4% which could leave 5 million Indonesians cyclically unemployed.

The chief economist at Bank Central Asia (BCA) David Sumual stated that the stimulus package was small compared to neighboring countries, hence, both the head of the BFK and David Sumal are skeptical of the FS maintaining autonomous levels and preventing “economic meltdown”.