
Indonesia Unemployment and Fiscal Policy

COVID-era unemployment commentary | Key concept: Government intervention

IA 2 | MACROECONOMICS | IB ECONOMICS HL IA EXAMPLE

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- Cyclical unemployment from falling aggregate demand
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- Budget deficit, crowding out and implementation risks

Commentary 2

Title of the article: ‘Indonesia’s unemployment rise to 6.88 million in February’

Source of the article: The Jakarta Post
<https://www.thejakartapost.com/news/2020/05/05/indonesias-unemployment-numbers-rise-to-6-88-million-in-february.html>

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Indonesia's unemployment numbers rise to 6.88 million in February

Adrian Wail Akhlas, The Jakarta Post

Jakarta / Tue, May 5, 2020 / 05:05 pm

The number of unemployed people across the country increased slightly to 6.88 million in February, Statistics Indonesia (BPS) data reveals, although this number does not reflect the impact the COVID-19 outbreak has had on the economy.

The figure was 60,000, or 0.8 percent, higher than the 6.82 million unemployed people recorded in the same period last year, BPS data also show.

"This is relatively flat despite an increase in the unemployment rate in tourism-focused regions," BPS head Suhariyanto said during a press briefing on Tuesday, adding that the COVID-19 pandemic had taken a toll on tourism since February.

In April alone, Indonesian Hotel and Restaurant Association (PHRI) data show that 1,642 hotels were temporarily closed, while Tourism Ministry data reveal that more than 1.7 million workers in the sector have been affected by the COVID-19 outbreak.

However, Indonesia's open unemployment rate dropped slightly to 4.99 percent in February from 5.01 percent recorded in the same month last year.

Suhariyanto said the informal sector remained an important part of the country's workforce, accounting for 56.5 percent of nationwide employment in February, despite a 0.77 percentage point decline year-on-year (yoy).

The BPS data also showed that education and healthcare sectors, among other sectors, hired the most people in February this year.

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“Meanwhile, jobs in several sectors including agriculture, trade and other services declined this year,” he said.

The unemployment data has yet to reflect the overall impact of the pandemic, Suhariyanto said, as the large-scale social restrictions implemented by regional and local administrations to curb the spread of the virus took effect in April.

These measures have upended the job market, with 2.8 million people losing their jobs, according to the Manpower Ministry and the Workers Social Security Agency (BPJS Ketenagakerjaan).

The government predicts that 2.9 million to 5.2 million workers could lose their jobs during the outbreak, which would erase last year’s gains of 2.5 million new jobs.

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The news article depicts that Indonesia has faced a '0.8% higher' level in unemployment which refers to people who are actively looking for a job but who are not employed¹, mainly due to the COVID-19 pandemic. The pandemic has resulted in people having reduced mobility, due to the government's 'large-scale social restrictions' to cut the transmission chain of COVID-19. However, these social restrictions have led to a fall in aggregate demand, which is the total quantity of aggregate output that all buyers in an economy want to buy². This then results in cyclical unemployment (or demand-deficient unemployment) that is resulted due to an initial reduction in aggregate demand³. The resulting cyclical unemployment then should be best tackled through effective **government intervention** methods that will be elaborated throughout this commentary.

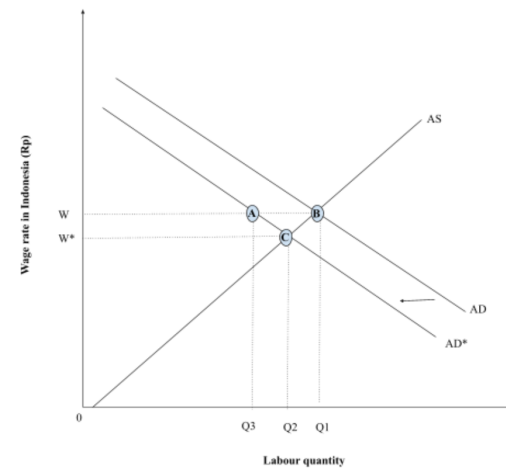


Figure 1: Cyclical unemployment in Indonesia due to the COVID-19 pandemic

¹ Tragakes, 265
² Tragakes, 236
³ Tragakes, 271

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The figure above exhibits cyclical unemployment in Indonesia, emphasizing on its effects on the labour force. The reduction of aggregate demand from AD to AD* sparks a decrease in labor quantity from Q1 to Q3 as there will be less labour needed to produce a lower output, resulting in (Q1-Q3) as the amount in which unemployment will increase. Regarding the wages of the labourers, there will be two instances occurring. The first instance will be to stay the same in W due to wage inflexibilities although employing less labour from Q1 to Q3 (mostly among white-collar workers). On the other hand, the second instance will reduce wages from W to W* and reduce the amount of labour from Q1 to Q2 (mostly among blue-collar workers).

In Indonesia, the cyclical unemployment due to the COVID-19 pandemic is primarily due to how large scale social restrictions act as a barrier for people to purchase physical goods and services, thus resulting in a decrease in demand. The decreasing demand which results in decreasing profits for a firm will result in the firm's employees being unemployed or having reduced wages. Due to a negative change in wealth for employees, this will then exacerbate the cycle as people will be further discouraged to spend their money, thus further decreasing demand. Additionally, as the Indonesian government and the World Health Organisation claims in a public statement that the pandemic will be more 'deadly this year'⁴, the statement can also reduce consumer confidence about the future economic growth and future income. This pessimistic behavior of entertaining the possibility of lower incomes and poor economic conditions will also lead to a further decrease in spending, thereby further reducing present demand, and aggravating the previously explained cycle of cyclical unemployment.

To solve this issue, a possible **government intervention** is to apply expansionary fiscal measures to stimulate demand. The expansionary fiscal policy should be centered on decreasing personal income taxes, business taxes and increasing government spending. Firstly, a decrease in personal income taxes will result in a higher disposable income for employees, thereby encouraging them to increase their spending, resulting in increasing demand. As a consequence, the increase in aggregate demand and real GDP will trigger firms to increase their output, eventually resulting in more employment as firms generally need more labour to facilitate their

⁴ Pidato Presiden Jokowi Untuk Global Health Summit, 21 Mei 2021, Sekretariat Presiden, 21 May 2021, www.youtube.com/watch?v=u6Cs4nSKn2Q.

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increase in production. Next, a reduction of business taxes would also be beneficial as it can help increase the already minimal business retained profits and encourage more investment spending. More investment spending then can trigger jobs as there will be labour needed to run new business activities, thus reducing unemployment. The last fiscal intervention which requires increasing government spending as it will also be beneficial as it can lead to a *multiplier effect* in which the initial government spending could trigger firms to operate in maximum capacity, thereby increasing the revenue and profits of the firm, until it can surpass the initial government spending.

Contrariwise, this kind of **government intervention** which involves implementing expansionary fiscal policy may result in a significant government budget deficit, as the funds originating from tax revenues are reduced (*also note that there can be political manipulations by the government when cutting business taxes with the purpose to support only certain firms. Nevertheless, it can benefit from specific-targeting if conducted wisely*). This should be a cause for concern as a budget deficit will make it challenging for Indonesia as it is rapidly developing its infrastructure, developing social safety nets, and tackling the COVID-19 pandemic⁵ which requires them to devote significant funds to the healthcare sector. Nonetheless, the budget deficit could be momentarily solved through borrowing money from either foreign/domestic entities, although it may lead to a circumstance known as *crowding out* in which the private sector who lends money to the government do not have any funds left to invest and spend in the economy; leading to the same instance as before except worse since Indonesian government spending which is known to be inefficient⁶ can result in a declining output.

⁵ BAPPENAS. "Ringkasan Eksekutif Visi Indonesia 2045 Final." BAPPENAS, May 2019.

⁶ Parama, Mardika. "Corruption Risk to Indonesia's Infrastructure Push: Experts." *The Jakarta Post*, The Jakarta Post, 28 July 2020, www.thejakartapost.com/news/2020/07/27/corruption-risk-to-indonesias-infrastructure-push-experts.html.

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