

Fuel-price policy and social protection floor in Indonesia

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The House of Representatives, in a dramatic turn of events, finally decided to reject an immediate fuel-price hike proposed by the government recently. In itself, the decision was in line with the demands of workers and students who rallied in a number of cities across the archipelago, although it was clearly an artificial opposition.

Although postponing the price increase, the decision has provided the government with the right to increase fuel prices if the price of Indonesian Crude Price (ICP) exceeds the budget forecast of US\$100 per barrel by an average of 15 percent within six months starting from January 2012.

The oil price is expected to increase beyond that amount, which means the fuel-price increase is unavoidable anyway. Even before the House took the “populist” decision, the ICP had already climbed to \$122 per barrel.

The House’s spat with the government proposal was dominated mainly by political considerations rather than economic and social reasoning. The political parties outside and inside the ruling coalition utilized the event as much as possible to win the hearts of voters ahead of the 2014 election.

The results of the delay have been not only to keep the flawed distribution of fuel subsidies intact, but also to postpone the establishment of a comprehensive social protection floor (SPF) that would guarantee access to healthcare and minimum-income security for different age groups, including children, adults of working age and elderly populations, as well as people with disabilities.

Although it was hard to accept the (delayed) decision politically due to the competing interests involved, removing fuel subsidies makes a lot of sense from an economic perspective. Fuel subsidies have tripled from 2004 to 2008.

In the meantime, the budget allocation for gasoline subsidies, which was initially introduced to help the poor as a mechanism to compensate the impact of increased prices, has swelled almost 24 times to Rp 73 trillion on average from only Rp 3 trillion 10 years ago.

The OECD (Organization for Economic Cooperation and Development) report of 2011 says that, apart from creating inefficiency, the oil subsidy in Indonesia is also biased toward the rich, as they consume much more gasoline than the impoverished. Thus, the oil-price subsidy leads to increasing inefficiency as well as inequality.

In theory, the government through its regulations and the market in the mixed economy should play a complementary role in reaching an optimum economic condition to address the inefficiency and inequality, popularly called “Pareto efficiency”; a situation in which no party can be made better off without making at least one party worse off. This includes the government’s efforts to correct the market failure of externality and the misallocation of scarce resources to achieve the highest total social welfare, bearing in mind that Adam Smith’s “invisible hand” does not always work. Similarly, there is a necessity to let the market jump in to correct the government’s failures, such as the inability to control the bureaucracy, political processes and growing inequalities.

Such a condition finds its relevance given the fact that the country is a net oil importing country. Providing subsidies to keep oil prices low has contributed to inefficiency in energy use and reduced the fiscal space of the state budget.

While economic growth has been substantial during the last few years, Indonesia is experiencing greater inequalities, as reflected by the increase of its current gini coefficient from 31 in 1996 to 35 in 2010. Worse, compared with other Asian countries, the figure of Indonesia’s energy per output ratio is much higher, presenting a challenge to reduce energy inefficiency per output of production.

The postponement of the fuel-price increase will prolong the misallocation of the subsidies and result in a deficit. The budget of Rp 30.6 trillion, which is needed to compensate the reduction of the subsidy, actually equals the initial funding (the mid point between low and high scenarios for 2011) required for the establishment of comprehensive universal coverage of the SPF for Indonesia.

In general, a positive correlation exists between gross domestic product (GDP) and social protection program development. However, GDP is not the sole indicator for any country of a better or more comprehensive social-protection scheme. Some countries with lower GDP could establish a better social

protection floor due to more keen political will.

How about Indonesia? The latest Indonesian SPF assessment report projected that the implementation of universal coverage for social protection would only cost between 0.76 and 2.07 percent of its GDP by 2020, depending on the specific scenario selected (International Labor Organization, 2012). This is similar to the budget allocation for the fuel subsidy and its compensation through the planned direct cash assistance (BLT) program.

The delay of the SPF implementation will create an opportunity cost, such as to implement pension schemes. It would bring an adverse consequence when the existing window of opportunity of the current demographic dividend elapses with the relative decline of the working-age population.

The SPF's universal coverage will cost an estimated 2.07 percent of GDP by 2020 (high scenario), as against other middle-income countries, such as Vietnam and Thailand, which have allocated about 5 percent of GDP for social protection. Therefore, there is sufficient fiscal space for Indonesia to establish a social protection floor, but it requires political commitment from the administration.

To ensure sustainability, we have to integrate all the existing scattered social-protection policies and programs, extend coverage to the uncovered and link to job-creation programs. After the floor is set, the next level up would increase gradually the degree of coverage and benefits.

Now is the right time for Indonesia to establish the SPF, as a window of fiscal space currently exists: there is room for more efficient budget reallocations, fairly high economic growth and a demographic dividend that will be completed within the next couple of decades.

Deploying the SPF now will not only contribute to a reduction in inequality and poverty but also simultaneously address crises caused by future shocks resulting from oil-price fluctuations.

<http://www.thejakartapost.com/news/2012/04/14/fuel-price-policy-and-social-protection-floor-indonesia.html>

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