ECONOMIC AND POVERTY IMPACTS OF INCREASING OIL PRICES AND SUGGESTED POLICY RESPONSE: The Case for Indonesia

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The global economy must face crucial challenge on how to cope with soaring oil prices, which have been on a precipitous increase in the last years. The high rise has alarmed countries around the world, especially the net oil importers, since continuing oil price hikes tend to lower economic growth and reduce productivity by increasing production costs and overall domestic prices. It is also likely to increase poverty by reducing income level of the poor and increasing their consumption costs.
A computable general equilibrium model calibrated to the Indonesian economy and linked to household survey data was developed in this study to shed light on the issue. The results indicate that higher oil prices generate adverse effects to the economy and poverty, working through their impacts on sectoral outputs, household incomes, and consumer prices. Moreover, the welfare effects across different household groups vary considerably, calling for careful policy responses. The government cash transfer program introduced subsequently to mitigate the adverse effects on the poor shows a sensible but modest result. More comprehensive policies are therefore needed to really help the poor to cope with adverse effects and to improve their conditions. This includes incorporating better and progressive targeting and positive conditionalities to maximize the programs benefits and to make the poor taking actions closer to the social optimum that will benefit the economy in the long term.