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Energy price variation and competitiveness: Firm level evidence from Indonesia

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Key words: Energy prices, firms, competitiveness, fossil fuel subsidies

JEL classification: D22, H23, L60, Q48

Abstract
This paper uses firm survey data from the manufacturing and mining sectors in Indonesia, and investigates the extent to which energy prices affect competitiveness (proxied by profitability). Persistent regional price differences due to Indonesia’s insular geography enable this study to show that energy prices have a small (but statistically significant) adverse long-run effect on competitiveness – though different energy types matter in different sectors. By estimating cross and own price elasticities and Uzawa-Allen partial elasticities of (inter-fuel) substitution, this study also shows that firms have the ability to respond to higher energy prices by adjusting their energy mix, i.e. substituting certain energy goods for others. Moreover, this study shows that firms also respond to higher energy prices by increasing energy efficiency, and by passing on costs to end-users. Nevertheless, these response measures are not sufficient to fully mitigate the adverse effect of energy prices on firms. Based on these results, policy recommendations are offered which are of immediate relevance for the design of energy pricing reforms.
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