

# ANALYSIS OF TRENDS AND CHALLENGES IN THE INDONESIAN LABOR MARKET

*Emma R. Allen*

No. 16

March 2016

ADB PAPERS ON INDONESIA



Creative Commons Attribution 3.0 IGO license (CC BY 3.0 IGO)

© 2016 Asian Development Bank  
6 ADB Avenue, Mandaluyong City, 1550 Metro Manila, Philippines  
Tel +63 2 632 4444; Fax +63 2 636 2444  
[www.adb.org](http://www.adb.org); [openaccess.adb.org](http://openaccess.adb.org)

Some rights reserved. Published in 2016.

The views expressed in this publication are those of the authors and do not necessarily reflect the views and policies of the Asian Development Bank (ADB) or its Board of Governors or the governments they represent.

ADB does not guarantee the accuracy of the data included in this publication and accepts no responsibility for any consequence of their use. The mention of specific companies or products of manufacturers does not imply that they are endorsed or recommended by ADB in preference to others of a similar nature that are not mentioned.

By making any designation of or reference to a particular territory or geographic area, or by using the term “country” in this document, ADB does not intend to make any judgments as to the legal or other status of any territory or area.

Unless otherwise noted in this publication, “\$” refers to US dollars.

This work is available under the Creative Commons Attribution 3.0 IGO license (CC BY 3.0 IGO) <https://creativecommons.org/licenses/by/3.0/igo/>. By using the content of this publication, you agree to be bound by the terms of said license as well as the Terms of Use of the ADB Open Access Repository at [openaccess.adb.org/termsfuse](http://openaccess.adb.org/termsfuse)

This CC license does not apply to non-ADB copyright materials in this publication. If the material is attributed to another source, please contact the copyright owner or publisher of that source for permission to reproduce it. ADB cannot be held liable for any claims that arise as a result of your use of the material.

The ADB Papers on Indonesia is an ongoing, quick-disseminating, informal publication whose titles could subsequently be revised and developed into other forms of publication. Each paper is subject to formal revision and correction before they are finalized and considered published. The series is maintained by the ADB Indonesia Resident Mission based in Jakarta, Indonesia.

# Analysis of Trends and Challenges in the Indonesian Labor Market

## EXECUTIVE SUMMARY

Performance in the labor market has been weak, with slow job growth and high levels of labor underutilization. Different groups of workers, particularly youth, women and rural dwellers, have had disparate labor market outcomes, highlighting problems posed by labor market segmentation. Increasing investment in education has expanded the pool of educated workers; although, these investments have not translated into substantial gains in labor productivity. Under-qualified workers still fill many positions, with skills shortages a continuing challenge. Access to up-skilling and re-skilling opportunities are limited; however, analysis shows that without investment in better quality education and training, access to quality jobs and career mobility is extremely limited.

Over time, regular wage employment has expanded, while informal employment has declined. However, the majority of workers are employed on short-term contracts and/or earning an income that is below the minimum wage. An over reliance on short-term contracting has discouraged skills investment and is reinforcing segmentation in the labor market. Growth in minimum wages has been outpacing growth in average wages and this may be one reason for weak demand labor market performance.

Moving forward, the key priority is expanding productive employment, including better quality jobs and boosting the employment elasticity of growth. Strengthening linkages between economic growth and employment outcomes can support the expansion of quality jobs. In addition, it is important to strengthen incentives for skills formation in order to promote labor productivity improvements. In this regard, training policies that support structural transition from school to work are needed, including the strengthening of vocational training and apprenticeship systems.

A more flexible labor market is needed to ensure that the ongoing structural transformation process does create quality jobs. Ensuring that the regulatory framework provides the right combination of flexibility for enterprises and security for workers is critical. Current incentive systems in the labor market tend to discourage stable employment and career progression. Labor law provisions on short-term contracting, worker dismissal, severance payment and unemployment insurance, should be reviewed in the light of the need to accelerate skills formation and foster productivity gains.

Sustainable solutions are needed for wage policies. Trends indicate that the minimum wage is becoming close to the average wage and efforts are needed to return the minimum wage to its safety net function. This includes strengthening alternative avenues for wage negotiation at the industry and enterprise level and building a culture of good faith bargaining. In parallel with this, it will be important to strengthen labor market governance to ensure that a larger majority of Indonesian workers benefit from the standards outlined in regulations.

**Keywords:** *Employment, education, skills, training, wages, productivity, labor market flexibility*

## I. INTRODUCTION

1. **Employment.** Owing to its rapid growth, the services sector became the key source of employment, creating 14.2 million jobs in the last decade. The industry<sup>1</sup> sector, with its modest performance, contributed only 7.1 million new jobs, including 4.4 million jobs in manufacturing. The agriculture sector lost 900,000 jobs in the last decade. Most new jobs were generated in urban areas. The majority of jobs created use short-term contracting arrangements or are in the informal sector. Employment quality is a major issue, and compliance with existing labor regulations is very low. Youth unemployment, skills shortages, and skills mismatches are also persistent challenges. Gains in labor productivity have been slow, and a multifaceted approach for accelerating labor productivity is required to support growth in higher value-added activities

2. Indonesia needs to ensure that new entrants to the labor force are equipped to support economic development. Labor market institutions need to provide an enabling environment for supporting economic growth and job creation. Social protection and social security systems need to support the productivity of the labor force and help to resolve issues related to poverty and inequality. Integrated solutions are required across education, infrastructure, economic sectors, and the social sectors, in order to promote quality employment and support employment creation.

3. The following paper provides an overview of trends in the labor market, including general employment trends, trends related to skills and education, employment quality trends, and earnings and governance trends. Section III provides an overview of the government's framework for promoting employment. Section IV discusses challenges in the labor market, including promoting productive employment, training and skills development, labor market flexibility, sustainable wage policies and labor market governance.

## II. OVERVIEW OF LABOR MARKET TRENDS

### A. General employment trends

4. **Slow job growth, with many workers likely to be discouraged.** Formal job creation has slowed considerably in recent years. In August 2015 growth in employment slowed sharply year-on-year. As table 1 illustrates, fewer than 200,000 jobs were created between August 2014 and August 2015, while the population aged 15 years and over increased by 3.1 million persons. In the same period, the number of unemployed workers increased by over 300,000 people, while the number of people not economically active rose by 2.6 million.

**Table 1: Key labor market indicators (2013-2015)**

Key indicator	Feb 2013	Aug 2013	Feb 2014	Aug 2014	Feb 2015	Aug 2015
Total population (millions)	247.7	249.4	251.0	252.7	254.4	256.0
Population aged 15 years and over (millions)	178.1	180.0	181.2	183.0	184.6	186.1
Economically active (millions)	123.2	120.2	125.3	121.9	128.3	122.4
Employed (millions)	115.9	112.8	118.2	114.6	120.8	114.8
Unemployed (millions)	7.2	7.4	7.2	7.2	7.5	7.6
Not economically active (millions)	56.0	59.8	55.9	61.1	56.3	63.7

<sup>1</sup> Industry sector includes manufacturing, mining, utilities, and construction.

Employment-to-population ratio (%)	65.1%	62.7%	65.2%	62.6%	65.5%	61.7%
Labor force participation rate (%)	69.2%	66.8%	69.2%	66.6%	69.5%	65.8%
Unemployment rate (%)	5.8%	6.2%	5.7%	5.9%	5.8%	6.2%

Source: BPS (2015) SAKERNAS, Badan Pusat Statistik, Jakarta. \*Based on revised population weights and backcast.

5. **Labor market performance fluctuates throughout the year.** Employment outcomes tend to fluctuate substantially between February and August of each year, while estimates of unemployed workers remain comparatively stable throughout the year. Data presented in table 1 illustrates that employment declined by 6 million people between February 2015 and August 2015, while unemployment increased by only 100,000 workers. Normally fluctuations in employment outcomes should be reflected in variations in the unemployment rate. However, as Indonesia does not provide unemployment benefits for the working age population, many workers tend to shift between short-term work opportunities and then exit the labor force. Such workers could be considered to be discouraged workers who are marginally attached to the labor force. Closer examination of the employment-to-population ratio or the labor force participation rate can provide more information on this trend.

6. Table 1 illustrates that in February 2015 the labor force participation rate and employment-to-population ratio were estimated at 69.5% and 65.5% respectively. By August 2015, the labor force participation rate had dropped to a historical low of 65.8% and the employment-to-population ratio was estimated at 61.7%. While seasonal factors and economic performance may influence labor market outcomes throughout the year, the great variation in the labor force participation throughout the year is a concern. The combination of jobless growth and high number of workers exiting in the labor market throughout the year suggests that the growth process is both generating few jobs and is contributing to higher turnover in the labor market.

7. **Outcomes are uneven across social group and regions.** Different groups of workers, particularly men and women, youth and older workers, and urban and rural dwellers, have disparate labor market outcomes. Table 2 presents selected statistics for these groups of workers. It shows that the labor force participation rate of women was estimated at 48.9% in August 2015, while the labor force participation rate of men was 82.7% in the same period. Similarly, youth unemployment was estimated at 22.6% in August 2015 while unemployment for those aged 25 years and over was 2.9%. 41.3% of the rural employed population worked less than normal working hours in August 2015, while only 19.2% of the urban employed population worked less than normal working hours in the same period. Uneven outcomes tend to be even further concentrated among urban youth and women in rural areas. Trends related to high youth unemployment, the high rate of people working less than normal working hours in rural areas and the low labor force participation of women, highlight labor underutilization as a key employment challenge for Indonesia. Strategies to increase women's labor force participation, support youth to access employment, and the promotion of productive employment in rural areas, are needed to promote a more inclusive growth process.

**Table 2: Selected key labor market indicators (2013-2015)**

Key indicator	Feb 2013	Aug 2013	Feb 2014	Aug 2014	Feb 2015	Aug 2015
<b>Labor force participation rate (%)</b>						
- Men	85.0	83.4	85.0	83.0	84.6	82.7
- Women	53.4	50.3	53.4	50.2	54.5	48.9

**Unemployment rate (%)**

- 15-24 years	17.5	21.6	17.1	22.2	18.3	22.6
- 25 + years	3.5	3.0	3.3	2.7	3.3	2.9

**Employed people with less than normal working hours (%)**

- Urban	20.5	22.0	20.9	19.4	20.7	19.2
- Rural	41.6	44.2	41.2	42.3	40.0	41.3

Source: BPS (2015) SAKERNAS, Badan Pusat Statistik, Jakarta. \*Based on revised population weights and backcast.

8. **Slow job growth has been a persistent challenge for Indonesia.** The government has set targets to create as many as 2 million jobs per year. This would require measures to both increase the employment intensiveness of growth and to grow the economy at a faster pace. To provide further insight on this issue table 3 presents an overview of trends in GDP growth, employment growth and employment elasticities by sector between 2005 and 2014. It can be observed that GDP growth performance improved slightly over the period, while employment outcomes deteriorated. Subsequently, the employment elasticity of growth declined over the period, largely influenced by trends in agriculture and mining. Parts of the service sector also experienced a slowdown in employment growth and a decline in the employment elasticity. This is particularly evident in both the trade sector and the transport sector. These developments reflect technological innovation and increases in economies of scale, as supermarkets and mega malls have replaced traditional markets.<sup>2</sup> This has decreased the demand for unskilled labor within these sectors, particularly demand for unpaid family workers, and increased demand for workers with higher levels of education attainment.

**Table 3: Sector output growth and employment growth, 2005-2014<sup>3</sup>**

Variable	2005-2009	2010-2014
<b>GDP growth rate</b>		
Agriculture, Forestry, Hunting and Fishery	3.9%	4.2%
Mining and Quarrying	2.2%	2.4%
Manufacturing	3.8%	5.2%
Electricity, Gas and Water	10.3%	6.4%
Construction	7.9%	7.2%
Wholesale Trade, Retail Trade, Restaurant and Hotels	5.8%	6.2%
Transportation, Storage and Communication	15.2%	9.4%
Financing, Insurance, Real Estate and Business Services	6.7%	7.4%
Community, Social, and Personal Services	6.3%	5.8%
<b>Total</b>	<b>5.6%</b>	<b>5.7%</b>
<b>Employment growth rate</b>		
Agriculture, Forestry, Hunting and Fishery	0.2%	-1.6%
Mining and Quarrying	6.3%	2.7%
Manufacturing	1.8%	2.0%
Electricity, Gas and Water	3.5%	4.3%
Construction	4.7%	5.4%
Wholesale Trade, Retail Trade, Restaurant and Hotels	5.2%	2.0%
Transportation, Storage and Communication	2.0%	-1.9%
Financing, Insurance, Real Estate and Business Services	6.8%	11.7%

<sup>2</sup> Aswicahyono, H., Hill, H. and Narjoko, D. (2012) Industrialization: Patterns, issues and constraints, in Hill, H., Khan, M and Zhuang, J (eds) Diagnosing the Indonesian economy: Towards inclusive and green growth, Asian Development Bank, Manila.

<sup>3</sup> For previous years see Aswicahyono, H., Hill, H. and Narjoko, D. (2012) Industrialization: Patterns, issues and constraints, in Hill, H., Khan, M and Zhuang, J (eds) Diagnosing the Indonesian economy: Towards inclusive and green growth, Asian Development Bank, Manila. Calculations are based on CAGR; 2010-2014 GDP growth based on gross value added; 2011-2014 employed data based on revised population weights; 2010-2014 GDP at 2010 constant prices; 2000-2009 GDP at 2000 constant prices.

Community, Social, and Personal Services	7.9%	2.9%
<b>Total</b>	<b>2.8%</b>	<b>1.5%</b>
<b>Employment elasticity</b>		
Agriculture, Forestry, Hunting and Fishery	0.0	-0.4
Mining and Quarrying	2.9	1.1
Manufacturing	0.5	0.4
Electricity, Gas and Water	0.3	0.7
Construction	0.6	0.8
Wholesale Trade, Retail Trade, Restaurant and Hotels	0.9	0.3
Transportation, Storage and Communication	0.1	-0.2
Financing, Insurance, Real Estate and Business Services	1.0	1.6
Community, Social, and Personal Services	1.2	0.5
<b>Total</b>	<b>0.5</b>	<b>0.3</b>

Source: ADB staff calculations based on BPS (2015) National Accounts and SAKERNAS, Badan Pusat Statistik, Jakarta.

9. **Employment outcomes in manufacturing have been modest.** Expanding productive employment in manufacturing has been a longstanding challenge for policy makers, given a desire to boost added-value in the commodity sectors and to diversify exports. Annual growth in manufacturing output was 3.8% between 2005 and 2009, and accelerated to 5.2% between 2010 and 2014. However, employment performance was not as robust, increasing marginally over the period. Subsequently, the employment elasticity of the manufacturing sector declined over the period. An important explanation for this trend relates to poor performance in export-oriented manufacturing, rising labor costs, the comparative advantage of PRC manufactures, as well as congested ports and high logistic costs.<sup>4</sup> The modest performance of the manufacturing sector over the last two decades has also hindered the overall modernization of the sector and allowed a dualistic industrial structure to persist. To illustrate, large manufacturing firms account for approximately 80% of value added and only 30% of employment within the sector.<sup>5</sup> The larger firms are more likely to innovate, attract foreign direct investment, and become more efficient over time. Micro and small firms account for 10% of value added and two thirds of employment within the sector. They use simple technologies, have low productivity, and are constrained by limited access to finance.

10. **Linking economic and employment outcomes can support the expansion of quality jobs.** Employment growth in construction outpaced economic growth within the sector, resulting in gains in the employment elasticity. Some 90% of those working in the sector are employed as construction laborers, many of whom are on casual contracts, have an education attainment of junior high school or less, and receive comparatively low levels of remuneration. Increases in the employment elasticity within construction therefore coincides with higher demand for low skilled labor, rather than structural changes that includes an upgrade of technologies and increased demand for workers with greater skills.

11. Trends in the finance, real estate, insurance and business services sector contrast with trends in the construction sector. Both economic and employment growth in the sector was strong, resulting in gains in the employment elasticity. Closer examination of the sector reveals that demand for highly skilled workers has been increasing, while demand for unskilled workers has contracted. Most people employed in the finance and banking sector work on employee contracts in skilled or semi-skilled positions and receive comparatively high levels of

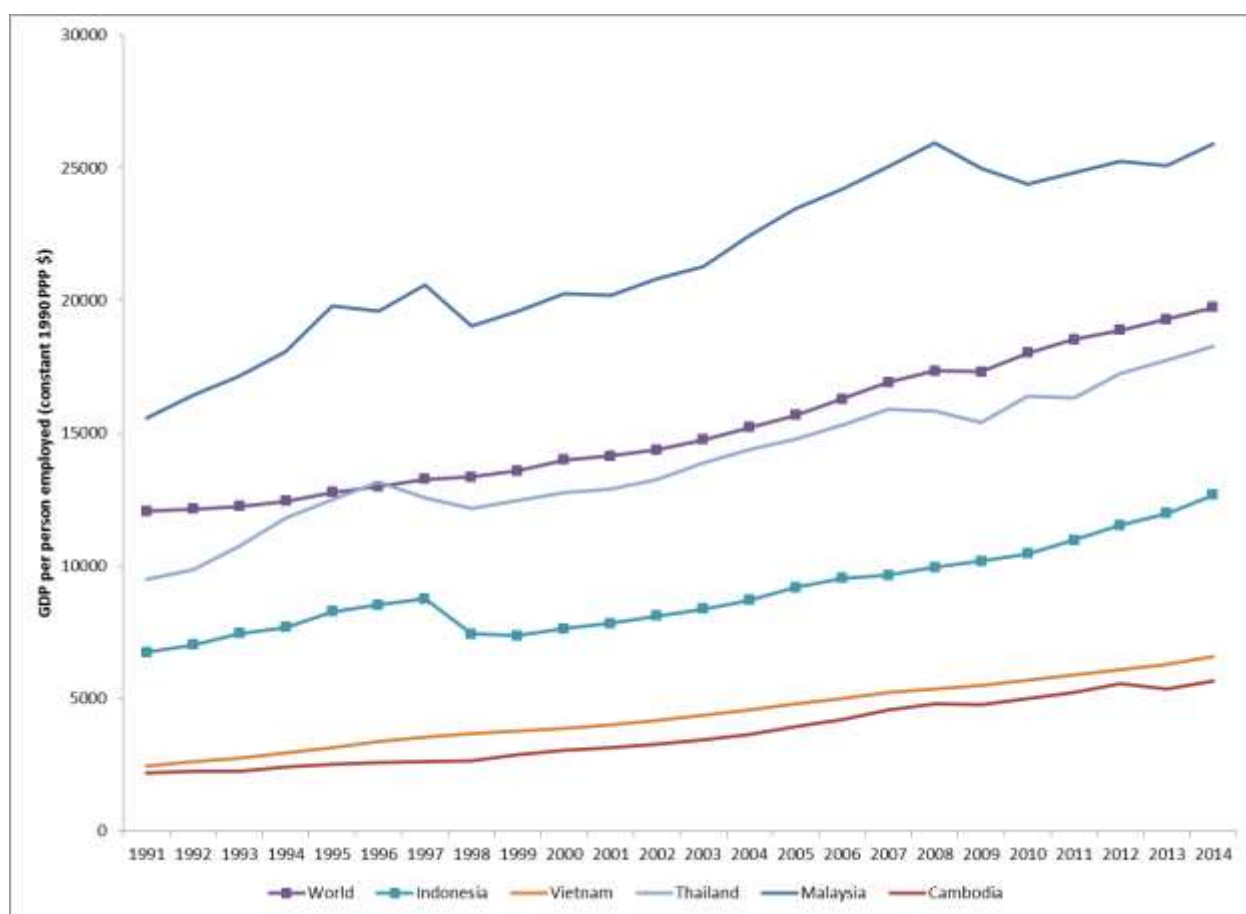
<sup>4</sup> Tabor, S. (2015) Constraints to Indonesia's economic growth, ADB Papers on Indonesia, No. 10 December 2915, Asian Development Bank, Manila.

<sup>5</sup> BPS (2013) Profile of micro and small manufacturing enterprises, Badan Pusat Statistik, Jakarta; BPS (2013) Manufacturing industry indicators, Badan Pusat Statistik, Jakarta.

remuneration. Therefore the increase in the employment elasticity within the sector coincides with increasing demand for workers with greater capacity, increasing productivity within the sector, and the expansion of quality jobs.

12. **Productivity gains need to accelerate at a faster pace.** Figure 1 illustrates that gains in labor productivity trends, broadly defined as GDP in purchasing power parity terms per person employed, are lagging in comparison to both the global average and in comparison with neighboring countries such as Thailand and Malaysia. Trends in labor productivity in the mid-1990s showed signs of convergence with global norms; however, this changed after the Asian Financial Crisis. Recent trends point to a slight upturn in labor productivity growth, although this trend likely reflects the slowing of job growth in recent years, rather than substantial gains in economic and labor market efficiency. On the demand side, the combined slower rates of economic growth and job creation have limited the expansion of quality jobs and slowed the pace of structural transformation. On the supply side, weaknesses in the education and skills profile of the labor force have also hindered productivity gains and a more rapid convergence with global productivity norms.

**Figure 1: GDP per person employed for Indonesia and selected countries  
(constant 1990 PPP \$)**



Source: World Bank (2015) World development indicators, World Bank, Washington D.C.



13. **Employment patterns have changed over time.** In 1985, 54.7% of employed people worked in agriculture, 13.4% worked in industry and 31.8% worked in services. By 2015, the composition of employment had further developed, with 34.0% of employed people working in agriculture, 19.7% in industry and 44.8% in services. Changes in employment patterns mirrored changes in economic activity, but with a lag, as the proportion of GDP accounted for by the agriculture sector fell from 23.2% in 1985 to 13.4% in 2015 and that in industry rose from 15.9% to 41.9% over the same period. Services share of GDP hovered at 42% across the period.

14. **By 2035 two thirds of the population will be living in urban areas.** Table 4 highlights that in 2010 half the population lived in urban areas, and with the increasing pace of urbanization it is expected that an additional 85 million people will be living in urban areas by 2035. This shift will have profound implications for the labor market. In particular, rural labor force participation tends to be higher than urban labor force participation, and urban unemployment tends to be higher than rural unemployment. If these trends continue, there is a risk of lower labor force participation and higher unemployment in the years to come.

**Table 4: Population projections for urban and rural areas, 2010-2035**

Variable	2010	2015	2020	2025	2030	2035
<b>Number of people (millions)</b>						
Urban	118.8	136.2	153.7	170.9	187.9	203.6
Rural	119.7	119.3	117.4	113.9	108.5	102.1
Total	238.5	255.5	271.1	284.8	296.4	305.7
<b>Percentage of the population (%)</b>						
Urban	50%	53%	57%	60%	63%	67%
Rural	50%	47%	43%	40%	37%	33%

Source: BPS (2013) Indonesia population projection, 2010-2035, Badan Pusat Statistik, Jakarta.

15. **Demographic shifts will also influence the labor market.** The workers that are entering the labor market today are better educated and have greater capacity for adopting new technology than the average worker of today. However, the share of younger groups (aged 15-29) in the working age population is projected to decline from 40% to 34% between 2010 and 2035, entailing an increase in the mature age population.<sup>6</sup> As the labor force matures, the demographic gains from a younger and better educated workforce will dissipate.

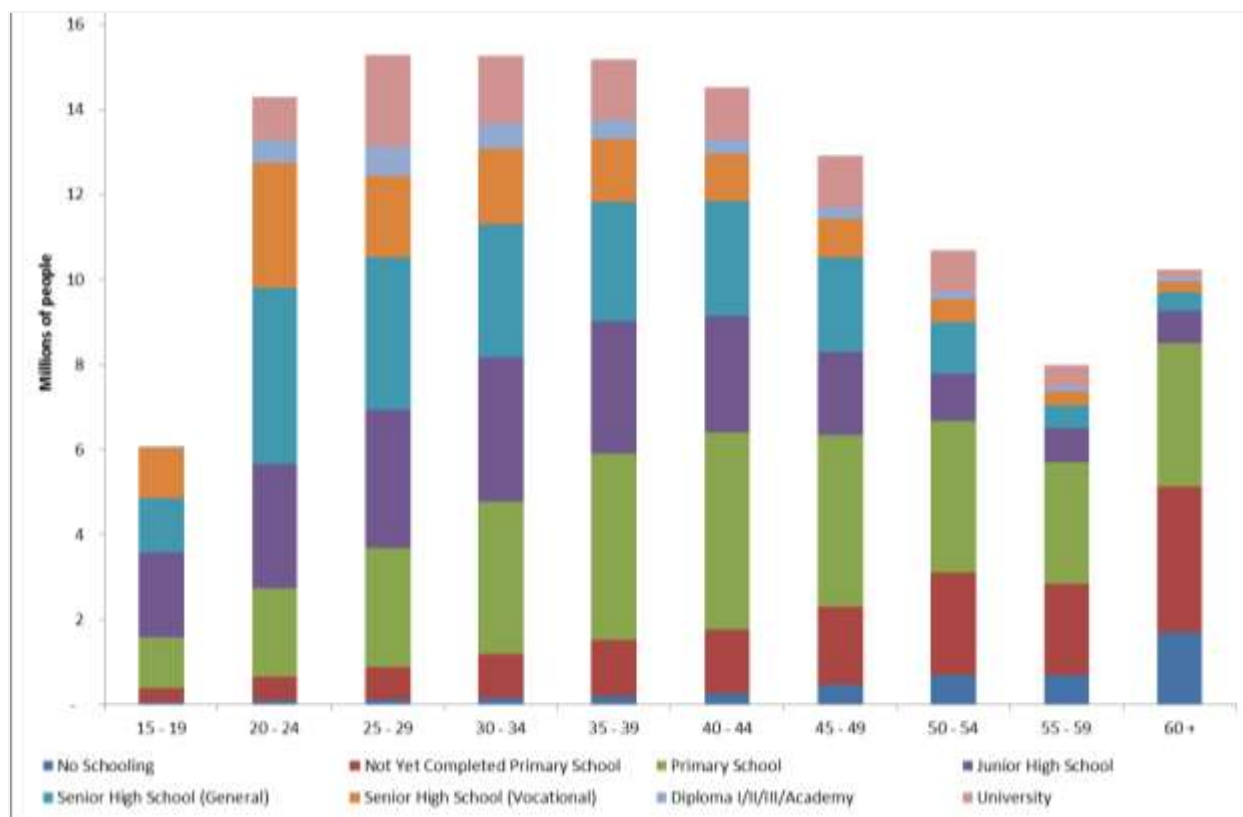
## **B. Education and skills trends**

16. **Increasing investment in education has expanded the pool of educated workers.** Indonesia has dramatically increased rates of school enrollment and the average years of schooling since its transition to democracy. The country is now close to achieving universal literacy among the youth population and the government has made clear commitments to continuing education funding. Figure 2 provides an overview of education attainment by age group for the economically active population. It illustrates that the supply of workers with more years of schooling and higher levels of education is increasing; however, the composition of the labor force continues to be dominated by workers with lower levels of education. In particular, it is more common for the population aged over 40 years to have primary school or below as their highest level of education. Those aged below 40 years are more likely to have completed junior high school or senior high school. Those aged below 30 years have the highest rates of high school completion and many have completed tertiary education. The figure illustrates that the

<sup>6</sup> Jones, G. (2013) The 2010 – 2035 Indonesian Population Projection Understanding the Causes, Consequences and Policy Options for Population and Development, United Nations Population Fund, Jakarta.

overall trends in education attainment for young people are largely positive, while the low levels of education of the mature age population remain a challenge. In addition, there are still many young people that report to have primary school as their highest level of education, entailing a need for a continuing focus on school retention rates.

**Figure 2: Education attainment by age groups for the economically active population, August 2015 (millions of people)**



Source: BPS (2015) Labor force situation: August 2015, Badan Pusat Statistik, Jakarta.

**17. However, gains in the quality of education have not been forthcoming.** For Indonesia to continue along the path of structural transition, its workers will need to have more sophisticated and specialized skills if labor productivity is to improve. Challenges remain, particularly in terms of the quality of education outcomes. Indonesia's performance in various international education assessment programs has uncovered issues related to the quality of mathematics, science and literacy education. In particular, Indonesia performs well below the OECD average in all assessment areas and there has been little progress in the quality of education outcomes over time.<sup>7</sup> There are also significant disparities in education services across the country, with the eastern parts of Indonesia lagging even further behind. In addition, almost half of the country's primary schools lack access to electricity, which has implications for access to technology and e-learning.<sup>8</sup>

<sup>7</sup> OECD and ADB (2015) Review of national policies for education: Education in Indonesia – Rising to the challenge, OECD, Paris.

<sup>8</sup> Tabor, S. (2015) Constraints to Indonesia's economic growth, ADB Papers on Indonesia, No. 10 December 2015, Asian Development Bank, Manila.

18. **Building a critical mass of educated workers is a priority.** Building a critical mass of highly educated and skilled workers provides increased returns to economic growth, especially in times of structural transformation.<sup>9</sup> This is because highly educated workers tend to have positive spillovers effects for those with lower levels of education. The challenge for Indonesia is therefore related not only to improving the quality of primary and secondary education, but also to building a tertiary education system that allows the labor force to develop high quality cognitive and technical skills that are relevant for supporting economic development.

19. **Skill gaps.** There are now more than 30 million senior secondary graduates and more than 10 million tertiary education graduates in Indonesia's labor force. From 2010 to 2015, the number of workers with a tertiary education has increased by more than 1 million annually and those with a senior secondary education by more than 2 million annually. However, the quality of tertiary education is low and the learning achievement of most students is inadequate. In a 2008 World Bank survey of employers, two-thirds complained that finding employees for professional and management positions was difficult or highly difficult. In some sectors, the education system is not providing enough graduates, while in other sectors those who are graduating do not have the right skills. Consequently, a large number of individuals with post-secondary qualifications work in low-skill occupations, which suggests that despite holding degrees, they lack the right skills.<sup>10</sup> In 2015, 52% of the employed population was under-qualified for their positions. McKinsey estimated that demand for semi-skilled and skilled workers may rise to 113 million by 2030, which is likely to see skills shortages and skills mismatches worsen throughout the economy.<sup>11</sup>

20. Demand for students with quality vocational and technical skills outstrips supply. Of the 5.2 million students enrolled in more than 3,000 Indonesian higher education institutions, just 110,000 receive polytechnic education—less than 3%—which is extremely low compared to other countries. The quality of polytechnic education is also generally poor. Polytechnic management tends to be rigid, work placements badly organized, financing support low, and links with the private sector weak. In addition, society tends to view polytechnic education as a second-class alternative to university education.<sup>12</sup>

21. **Variable quality of university graduates.** State-run universities dominate the higher education system but receive low levels of government funding (some 0.3% of GDP) and are tightly regulated. Private funding has come to dominate higher education, but without credible accreditation and quality control mechanisms in place. The quality of tertiary institutions is highly variable, with small pockets of excellence alongside large numbers that provide training of sub-standard quality. Funding support mechanisms, particularly for able but needy students, are limited. None of Indonesia's tertiary institutions rank prominently in international comparisons. Moreover, almost 40% of unemployed people with post-secondary qualifications are still unemployed 12 months later. This highlights serious challenges associated with the skills of graduates and labor market information systems.

---

<sup>9</sup> ADB (2015) *A Smarter Future: Skills, Education, and Growth in Asia—Key indicators for Asia and the Pacific 2015 special chapter*, Asian Development Bank, Manila.

<sup>10</sup> World Bank (2014) *Development Policy Review: Indonesia: Avoiding the Trap*. Jakarta.

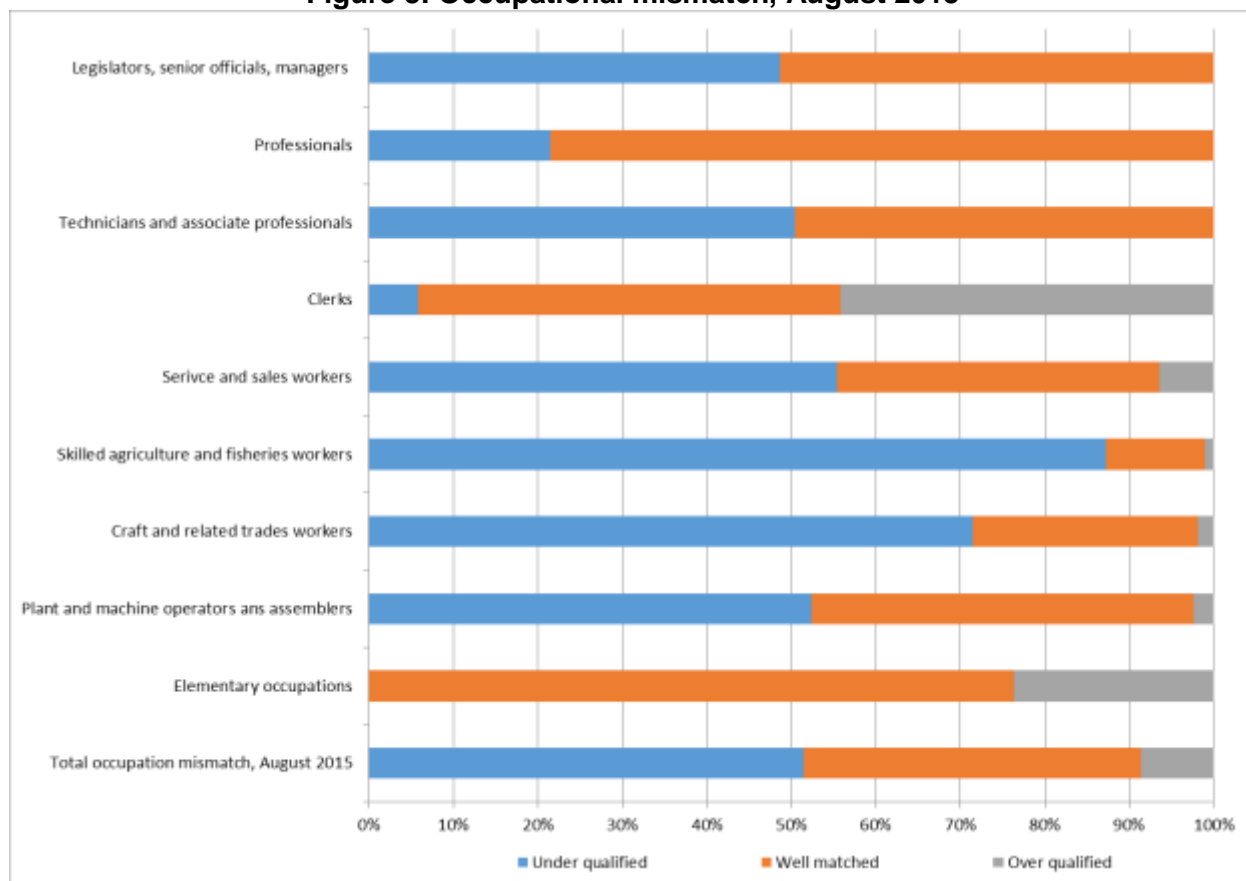
<sup>11</sup> McKinsey Global Institute. 2012. *The archipelago economy: Unleashing Indonesia's Potential*. Washington D.C.

<sup>12</sup> ADB (2012) *Polytechnic Education Development Project. Sector Assessment: Polytechnic Education*. Manila.

**22. Skills shortages are prevalent, with under-qualified workers filling many positions.**

Figure 3 presents an analysis of the share of workers who are under-qualified, well-matched, and over-qualified for their occupations.<sup>13</sup> It is estimated that 51.5 % of workers are under-qualified, 40.0 % are well-matched, and 8.5 % are over-qualified for their occupations. Occupation mismatch in Indonesia tends to be associated with the low education levels of production workers and agriculture laborers, as well as a large number of clerks that are over-qualified for their jobs. Under-qualification is also a challenge in higher level occupations. High levels of under-qualification and lower levels of over-qualification point towards an issue of skill shortages. This is an important issue, as high levels of skill and qualification mismatch are typically associated with lower levels of labor productivity.<sup>14</sup> The high proportion of under-qualified workers may therefore be one reason for weaker labor productivity growth and slow transition to higher value activities throughout the economy.

**Figure 3: Occupational mismatch, August 2015**



Source: BPS (2015) Labor force situation: August 2015, Badan Pusat Statistik, Jakarta. \* ADB staff calculations based on revised population estimates. \*\* Excludes armed forces occupations.

<sup>13</sup> Measurement of this type of skills mismatch is based analysis using the International Standard Classification of Occupations (ISCO) and the International Standard Classification of Education (ISCED). This measure of mismatch divides major occupational groups (first-digit ISCO levels) into four groups and assigns a level of education to each occupational group in accordance with the ISCED. Workers in a particular group who have the assigned level of education are considered well matched. Those who have a higher (lower) level of education are considered overeducated (undereducated).

<sup>14</sup> McGowan, M. and Andrews, D. (2015) Labor Market Mismatch and Labor Productivity: Evidence from PIAAC Data, Economics department working papers, No. 1209, OCED, Paris.

23. **Access to up-skilling and re-skilling opportunities is limited.** In some occupations and industries, having a technical qualification or certification and keeping skills up-to-date can be critical for maintaining competitiveness. In particular, technological innovations in the manufacturing and finance sectors require employers and workers within these sectors to develop strategies to ensure that their skills remain current in order to retain comparative advantages. Examination of trends in the employed population's participation in certified training courses can shed light on this. Analysis presented in table 5 reveals that 0.9 % those with an education attainment of junior high school or less have participated in certified courses, while 9.0 % those with senior high school and 25.7 % of those with tertiary qualifications have participated in certified courses. This highlights that a large proportion of those with lower education levels have limited access to up-skilling or re-skilling opportunities. However, educated workers participate in certified training to keep their skills up-to-date. In addition, it was more common to have participated in certified training courses in the services sectors than in manufacturing or agriculture across all levels of education attainment. Training in the services sector tends to be dominated by in-service training for teachers and health workers. Training is also more common in the sectors that employ the least number of people. The limited participation in certified training in the agriculture, manufacturing and construction sectors may also contribute to lagging productivity growth within these sectors.

**Table 5: Participation in certified training courses by sector and education for the employed population (% , August 2015)**

Sector	Junior high school or less	Senior high school	Diploma and university
Agriculture, Forestry, Hunting and Fishery	0.4	5.7	15.3
Mining and Quarrying	1.2	17.1	29.6
Manufacturing Industry	1.3	8.4	20.0
Electricity, Gas, and Water	2.2	18.1	23.8
Construction	0.5	6.1	17.2
Wholesale Trade, Retail Trade, Restaurants and Hotels	0.8	7.1	14.8
Transportation, Storage, and Communications	1.0	8.4	19.6
Financing, Insurance, Real Estate and Business Services	3.0	12.0	20.5
Community, Social, and Personal Services	3.2	15.3	31.6
<b>Total</b>	<b>0.9</b>	<b>9.0</b>	<b>25.7</b>

Source: BPS (2015) Labor force survey, Badan Pusat Statistik, Jakarta.

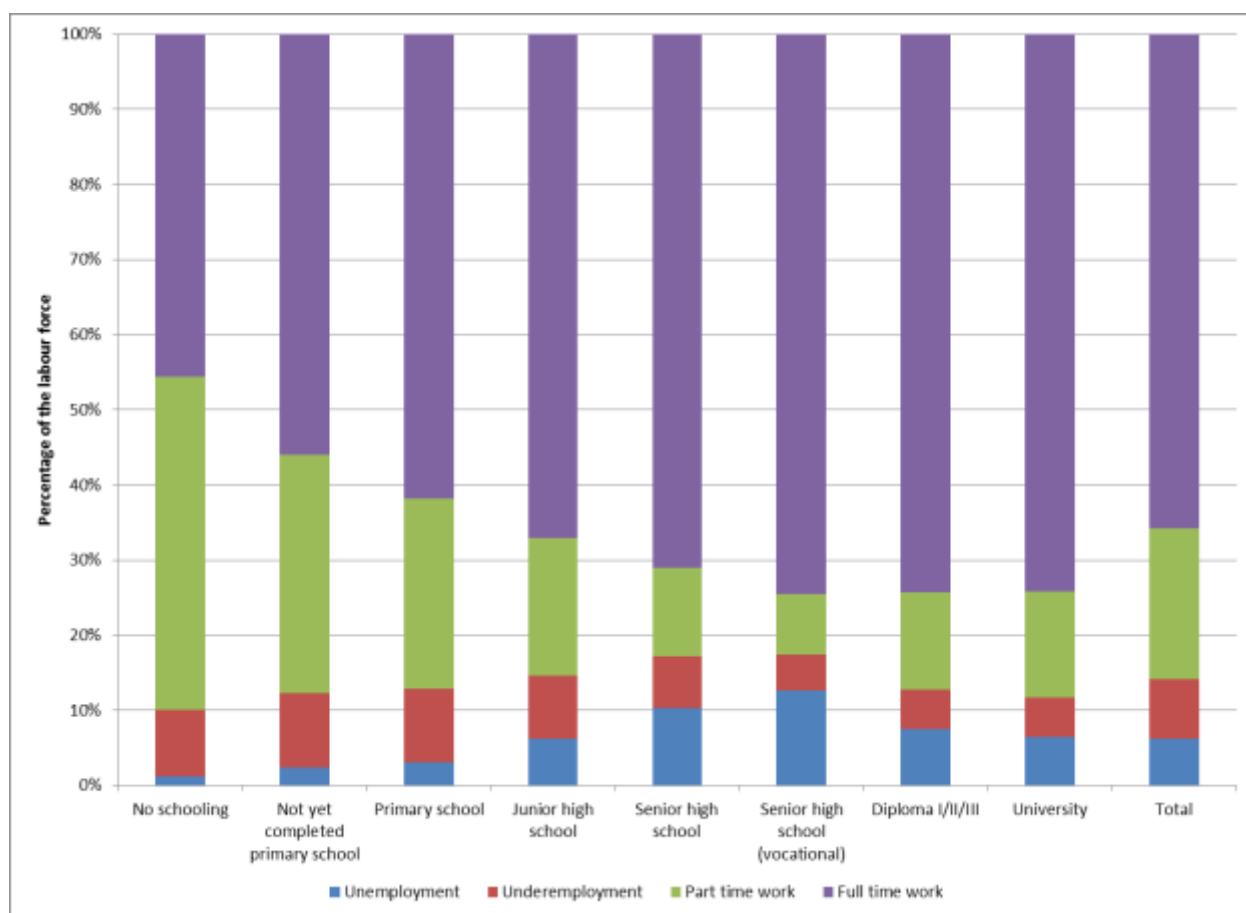
24. **Job growth is slowing for those with low levels of education.** Although the data from Indonesia's public employment service has many caveats, it provides some information on the qualifications of job seekers and on the education requirements of job vacancies. According to the public employment services, approximately 40 % of the job vacancies that are formally registered with the public employment office require tertiary qualifications, a further 40% require job seekers to have completed high school and 20 % require junior high school or less.<sup>15</sup> This information reflects general trends in the economy, which indicate that job growth is slowing for those with low levels of education and most new jobs are being filled by workers with higher levels of education.

<sup>15</sup> Allen, E. and Kim, K. (2014) Indonesia: Labor market information systems and services, ILO Country Office for Indonesia and Timor-Leste, Jakarta.

25. **High levels of youth unemployment.** In recent years, Indonesia has recorded very high rates of youth unemployment. Part of the reason for this is the long transition that many youth have between leaving school and finding their first job. Few school leavers have been employed before leaving school, one in three unemployed youth aged between 15 and 24 are still unemployed 12 months later. This is particularly the case amongst youth with tertiary education, whose expectations may exceed the jobs on offer. Unemployment rates drop-off considerably for the population as a whole, but this may partly be explained by falls in labor participation rates and high levels of underemployment. In addition, the lack of unemployment insurance and fairly weak job placement services combine to discourage middle-aged workers from registering as unemployed.

26. **Labor utilization increases with education attainment.** Figure 4 illustrates that it is more common for those with higher levels of education to be employed in full time work, while those with lower levels of education are more likely to be underemployed or work part-time. Interestingly, those who have completed vocational senior high school have both the highest unemployment rates and the highest rates of employment in full time work. Slow job growth and high rates of labor underutilization for those with lower education points towards an issue of segmentation in the labor market.

**Figure 4: Labor utilization, August 2015 (%)**



Source: BPS (2015) SAKERNAS, Badan Pusat Statistik, Jakarta.

27. **Access to quality jobs improves with education.** The likelihood of securing both salaried and formal employment rises dramatically with education. Workers who have completed high school are twice as likely to move into permanent, full-time employment that pays above the minimum wage when compared to those with junior high school or below. Workers with post-secondary qualifications were 3.5 to 4.5 times more likely to move into such employment than those with junior high school or below.<sup>16</sup> This situation highlights challenges for the inclusiveness of growth, with certain segments of the labor force likely to be cycling between temporary jobs and have limited opportunity to transition into more secure employment. Interventions to promote the movement of unskilled and low skilled workers into quality jobs may therefore be needed.

28. **Education is the most important factor in career progression.** Analysis with linked micro-data files from the labor force survey reveal that production workers with post-secondary education are likely to have upward career mobility into more technical or managerial occupations over a 12 month period. Moreover, once workers with tertiary education move into professional and technical occupations, they are likely to still be working in such occupations 12 months later. A downside is that workers with tertiary qualifications also tend to have a higher incidence of long-term unemployment, which may be a reflection of underdeveloped labor market information systems.

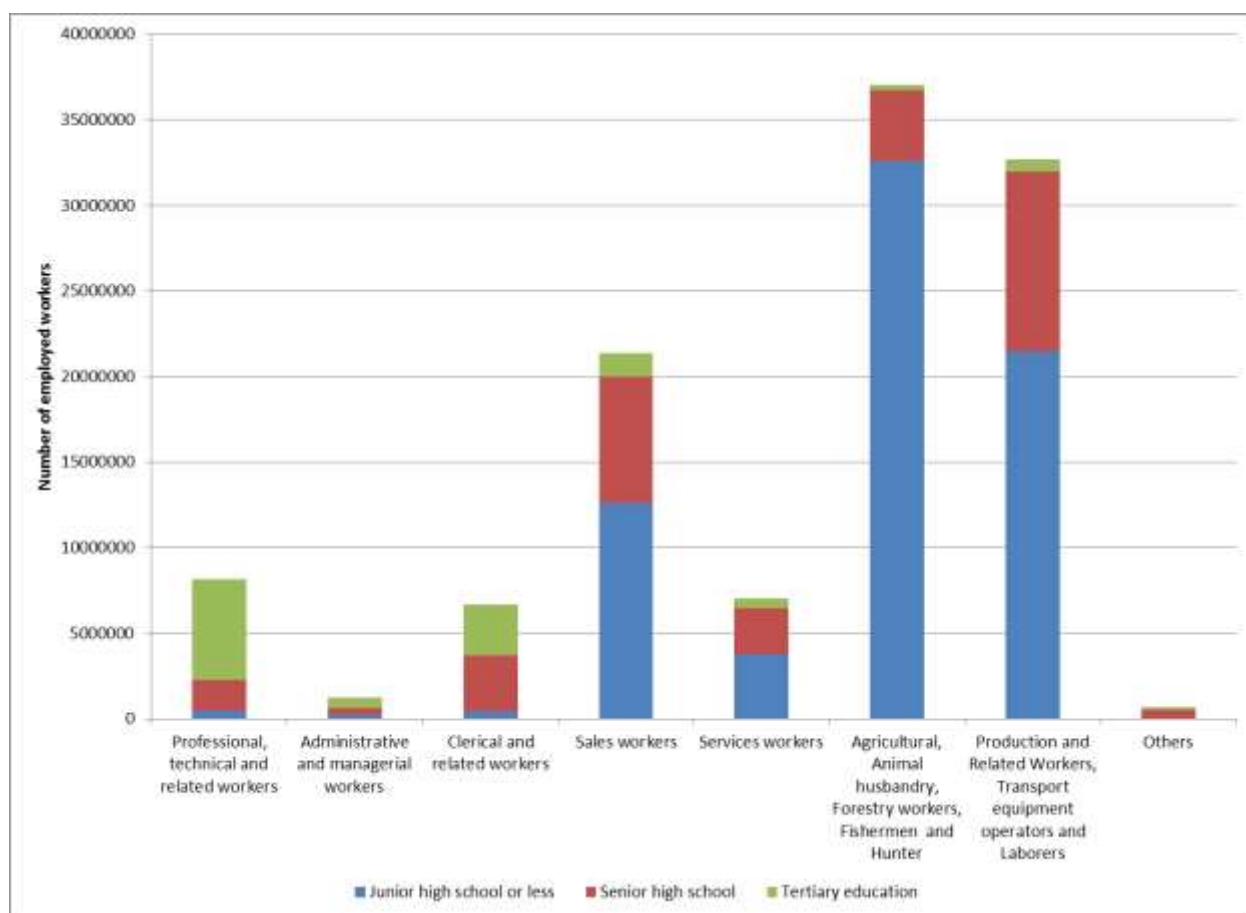
29. While the outlook is quite positive for educated workers, workers with lower levels of education attainment tend to shift between low-skill occupations, with little evidence of career progression. For example, workers with junior high school or less as their highest level of education attainment are likely to shift between working as a production worker and an agriculture labor throughout the year. It is rare for these workers to climb the career ladder and graduate into more highly skilled occupations. The evidence highlights that limited education attainment may tend to act as a barrier to career progression, indicating that education and skills training are important determinants of access to higher quality jobs.

30. **The occupation structure in Indonesia is compressed.** Indonesia has a concentrated spectrum of occupations within its labor force, with many workers having low levels of education attainment and being employed in low skill occupations. As figure 5 illustrates, the majority of the employed population have junior high school or less as their highest level of education attainment and still work as agriculture laborers, production laborers or as low skilled service sector workers. Given the limited opportunities for career progression for low skilled workers, as discussed above, this trend is likely to reinforce segmentation in the labor market. Moreover, limited provision of workplace training, along with the limited scale of collective bargaining and limited use of productivity based pay structures, are likely to compound this trend.

---

<sup>16</sup> BPS (2015) Logit model of labor mobility from non-standard to standard employment using a panel data series from the labor force survey August 2012-August 2014, Badan Pusat Statistik, Jakarta (Unpublished).

**Figure 5: Occupations by level of education attainment, August 2015 (%)**



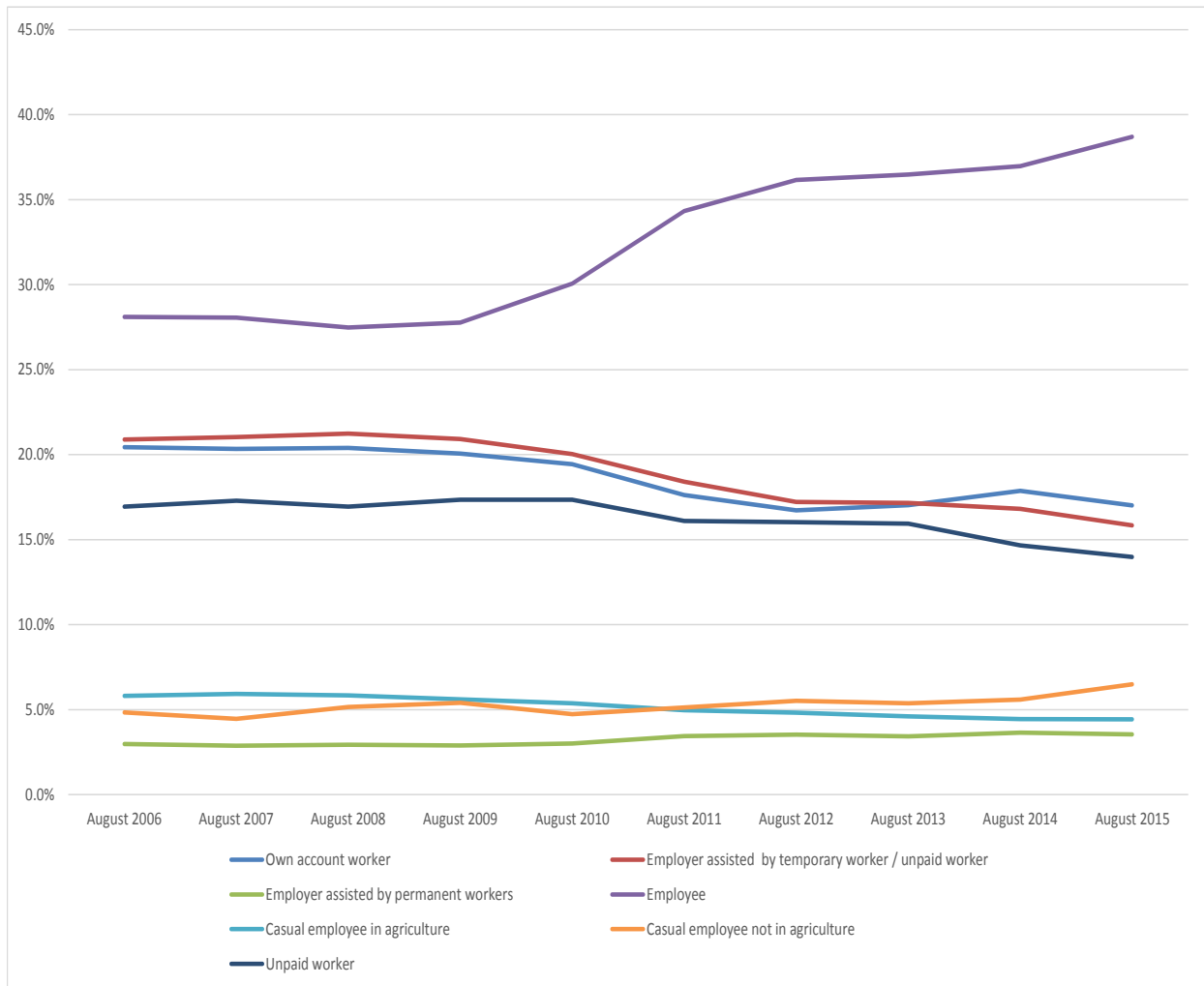
Source: BPS (2015) SAKERNAS, Badan Pusat Statistik, Jakarta.

### **C. Employment quality trends**

31. **Regular employment has expanded, while informal employment has declined.** Figure 6 illustrates that in recent years the expansion of regular wage employment has accelerated and reliance on workers that are closely associated with the informal economy, such as own account workers and unpaid workers, has reduced somewhat. In 2006 there were 26.8 million workers employed as regular employees, and by 2015 this had increased to 44.4 million. As a result the percentage of regular employees in total employment rose to 38.7 % and informal employment declined to 51.7 % of total employment in 2015. One factor behind the increase in regular wage employment is the structural transformation of the economy, with wage employment expanding as manufacturing and services have grown and as employment in agriculture declined. More precisely, of the 17.6 million new jobs for regular employees created between 2006 and 2015, 5.2 million were in the industrial sectors and 11.2 million in the services sectors.



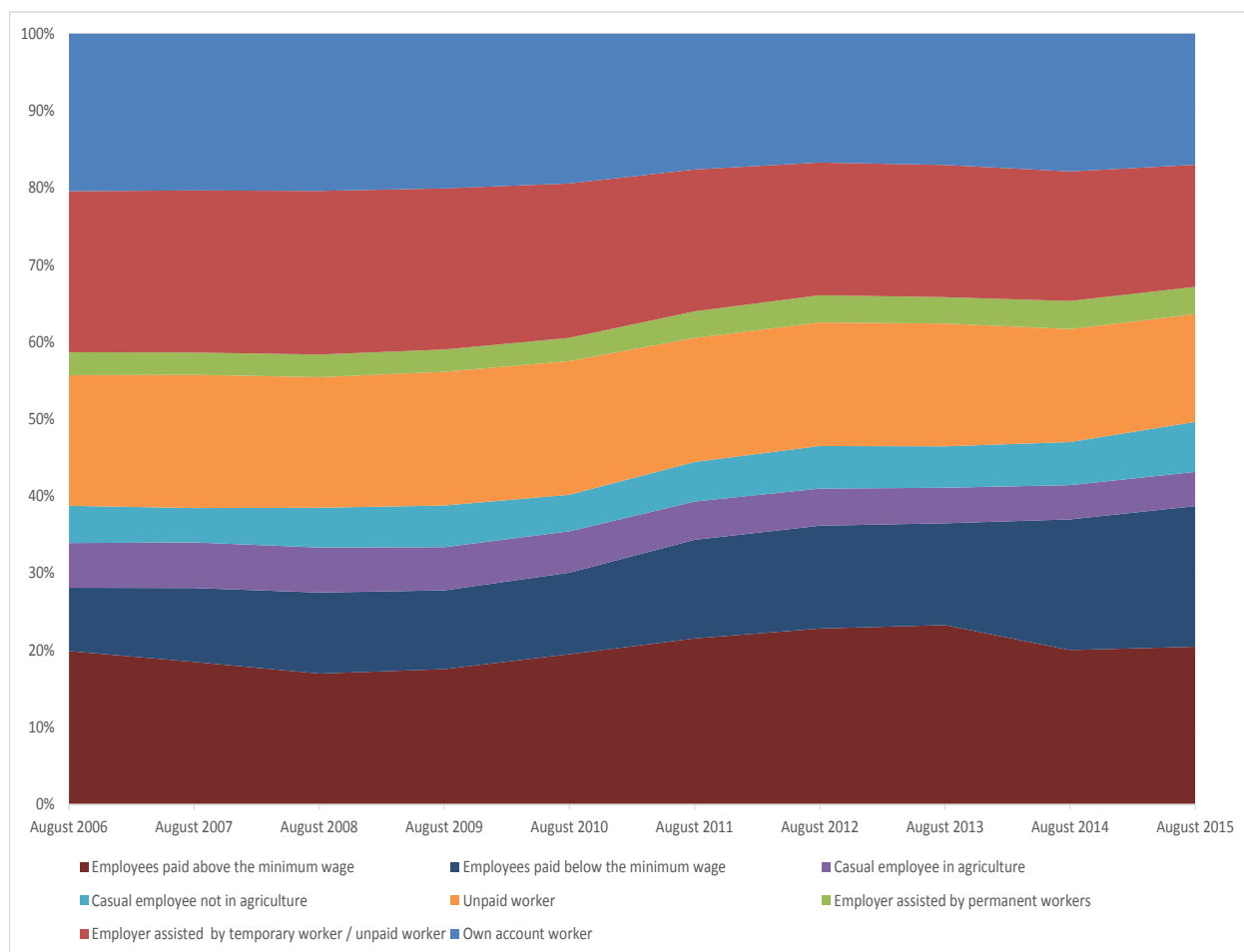
**Figure 6: Status in employment, 2006-2015 (%)**



Source: BPS (2015) SAKERNAS, Badan Pusat Statistik, Jakarta.\* 2011-2015 based on revised population weights and backcast.

32. **However, job quality is still lacking.** Figure 7 divides workers considered to be “regular employees” into regular employees paid above and below the minimum wage. Over time the share of regular employees receiving wages that pay the minimum wage or higher has remained relatively constant, while regular employees that are paid wages lower than the minimum wage has increased. This may be a reflection of increases in minimum wages outstripping productivity as well as limited growth in quality jobs.

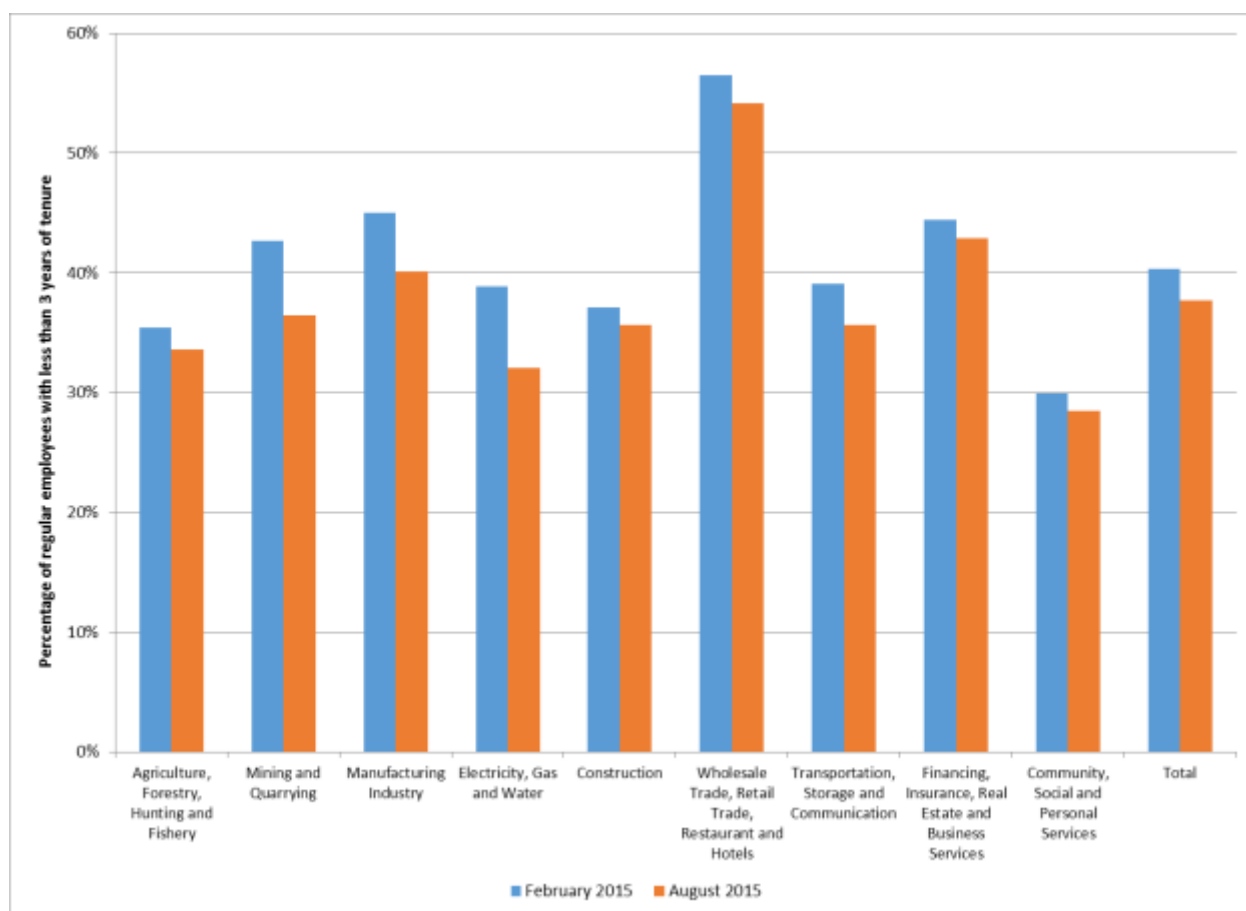
**Figure 7: Status in employment and minimum wage compliance for regular employees, 2006-2015 (%)**



Source: BPS (2015) SAKERNAS, Badan Pusat Statistik, Jakarta.\* 2011-2015 based on revised population weights and backcast. \* Authors' calculations for minimum wage compliance for regular employees.

**33. In addition, many employees work on short-term contracts.** In Indonesia, the main form of labor market flexibility in the formal economy is through short-term contracting or outsourcing arrangements. According to the Manpower Law 13/2003, short-term contracts cannot be provided for work that is permanent in nature and short-term work agreements can only be made for an initial period of two years with an option to extend for an additional 12 months. Official labor force statistics do not provide a distinction between short-term contract employees and those on permanent contracts. However, these trends can be understood through analysis of indicators on job tenure. According to the data presented in figure 8, approximately 40 % of regular employees have job tenure of 36 months or less. Those working in the community and social services sector tend to have the longest job tenure, while those in the retail and trade sector have the shortest job tenure. Job tenure also tends to be shorter in finance and manufacturing, which are sectors where skills investment is particularly important for boosting labor productivity.

**Figure 8: Regular employees with less than 36 months of job tenure by sector, 2015<sup>17</sup>**



Source: BPS (2015) SAKERNAS, Badan Pusat Statistik, Jakarta. \* ADB staff calculations.

**34. The share of the workforce in regular wage employment varies from island to island.** It is important to note that most regular wage employment in Indonesia has historically been concentrated in industrial and urban areas on Java or in special economic zones on Sumatera and Kalimantan. For example, in August 2015 regular wage employment reached 41.9% of total employment on Java. However, regular wage employment was highest in areas with special economic zones, including Riau Islands at 68.5% and East Kalimantan at 56.0%. Provinces with the lowest share of regular wage employment in total employment included East Nusa Tenggara at 19.8% and West Nusa Tenggara at 24.0%. These are also the provinces with higher incidence of poverty and lower incomes.

<sup>17</sup> 36 months is the maximum contract duration that can be offered to a regular employee on a short term contract.

35. **Regular employees tend to have shorter periods of job tenure than other workers.** Table 6 provides data on job tenure for own account workers, employers assisted by temporary and unpaid workers, employers of permanent workers, and regular employees. The data suggests that regular employees tend to have shorter job tenure than do other workers.<sup>18</sup> In addition, youth, women and those with lower levels of educational attainment also tend to have shorter job tenure in comparison to the average. This would suggest that these groups are more likely to work on short-term contracts than on permanent contracts, due to segmentation in the labor market.

**Table 6: Distribution of status in employment by job tenure (% , 2012-2015)**

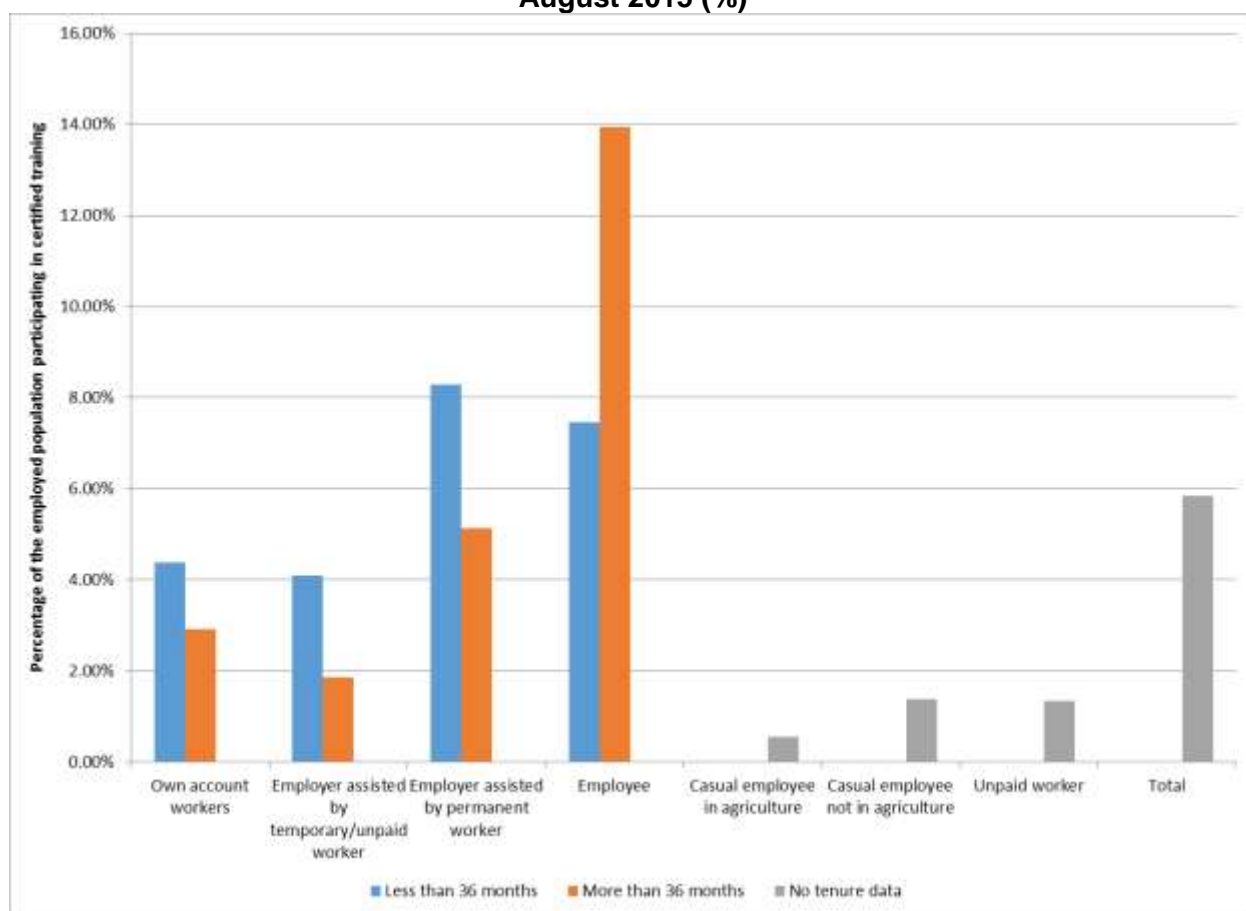
Time frame	Own account workers		Employers assisted by temporary and unpaid workers		Employers of permanent workers		Regular employees	
	Less than 2 years	2 years and over	Less than 2 years	2 years and over	Less than 2 years	2 years and over	Less than 2 years	2 years and over
2012 Q1	16.63	83.37	8.47	91.53	10.59	89.41	26.99	73.01
2012 Q2	16.25	83.75	8.37	91.63	9.37	90.63	26.23	73.77
2012 Q3	14.18	85.82	7.25	92.75	9.30	90.70	22.72	77.28
2012 Q4	16.15	83.85	8.04	91.96	9.44	90.56	26.58	73.42
2013 Q1	15.89	84.11	8.23	91.77	10.25	89.75	24.00	76.00
2013 Q2	15.94	84.06	8.25	91.75	10.66	89.34	26.84	73.16
2013 Q3	12.94	87.06	6.74	93.26	8.27	91.73	23.58	76.42
2013 Q4	15.57	84.43	7.16	92.84	8.28	91.72	25.69	74.31
2014 Q1	16.78	83.22	8.12	91.88	9.10	90.90	26.00	74.00
2014 Q2	15.62	84.38	7.80	92.20	9.01	90.99	25.31	74.69
2014 Q3	12.85	87.15	6.88	93.12	7.59	92.41	22.92	77.08
2015 Q1	17.70	82.30	9.58	90.42	12.25	87.75	29.52	70.48
2015 Q3	15.93	84.07	7.89	92.11	9.49	90.51	26.03	73.97

Source: BPS (2015) SAKERNAS, Badan Pusat Statistik, Jakarta.

36. **Reliance on short-term contracting discourages skills investment.** For employers who only expect to have an employee in their enterprise for a short time, the cost of training is often perceived to outweigh the potential rate of return from the investment. Therefore, provision of training is not always seen as an investment in the productivity of an enterprise. A similar situation exists for workers. Employees on short-term contracts may not see the potential for career progression or gains in employment quality within their short term jobs, and subsequently experience a disincentive to further develop skills under their own volition. This trend is illustrated in figure 9, which provides an overview of participation in certified training by status in employment and job tenure. It shows that employees with job tenure of 36 months or less are less likely to have participated in certified training than permanent employees.

<sup>18</sup> Data is not available for casual workers or unpaid family workers.

**Figure 9: Participation in certified training by status in employment and job tenure, August 2015 (%)**



Source: BPS (2015) SAKERNAS, Badan Pusat Statistik, Jakarta. \* ADB staff calculations.

**37. Job flows indicate that worker reallocation exceeds net employment changes.** Each year a large number of jobs are created and destroyed, with workers being hired or separating from their employer. Incentives for short-term contracting, the scale of the informal economy, changes to labor market regulations, and dismissal regulations tend to influence worker reallocation rates. Structural transformation in the economy also influences worker reallocation rates. Table 7 highlights that worker reallocation exceeds employment growth, with a large proportion of worker reallocations associated with a reshuffling of workers to different jobs or churning in the labor market.

**Table 7: Worker reallocation rates for the labor force<sup>19</sup>**

Time frame	August 2012 – August 2013	August 2013-August 2014
Hirings	6.79	7.78
Separations	7.39	5.88
Total worker reallocation	14.19	13.66
Absolute net employment growth	0.23	1.66
Excess worker reallocation	13.96	12.00

Source: BPS (2015) SAKERNAS, Badan Pusat Statistik, Jakarta.

<sup>19</sup> Total worker reallocation is equivalent to the sum of hirings and separations between t-1 and t. Excess worker reallocation represents total worker reallocation minus absolute net employment growth. It provides a measure of the number of job matches that are created and destroyed, over and above the minimum necessary to accommodate net employment growth.

38. Further analysis highlights that women have much higher reallocation rates than men, which may be due to the high proportion of women that work as unpaid family workers (1 in 4), as these workers exit the labor force frequently in accordance with their domestic responsibilities. Limited access to childcare services and a lack of flexible work time arrangements are some further reasons why excess worker reallocation rates may be higher for women than men. Trends in worker reallocation also tend to reflect structural shifts in the demand for skills, with less educated workers having higher reallocation rates than those with tertiary qualifications. If worker reallocation is well managed, it has the potential to strengthen economic growth and reinforce structural changes, with workers being reallocated to more productive opportunities and strengthening their contributions to productivity growth. However, underdeveloped job-matching and social protection systems, as well as a limited culture of workplace training, can reinforce labor market segmentation during reallocation processes, which detracts from the potential vibrancy of reallocation.

39. **Severance conditions.** Generous severance conditions are one of the key reasons why firms tend to employ workers on a temporary basis. Indonesian Labor Law 13 of 2003 regulates termination conditions for employees. Under this law, employers are restricted from discharging employees without cause, and must provide discharged workers with a combination of severance pay, long service pay, compensation rights pay and separation pay. Many firms choose to hire employees on short-term contracts to avoid provisions on severance pay, which are high in comparison to other countries in ASEAN. Alternatively, when companies want to dismiss a worker, they often use the tool of “negotiated separations” rather than the provisions that are outlined in the labor law. Research on severance payments indicates that compliance tends to be low, with only one third of workers entitled to severance payments receiving it.<sup>20</sup> Moreover, payments tend to be lower than that which is specified in the entitlements and vulnerable workers are also less likely to receive payments. To emphasize, in a workforce of over 100 million persons, it is noteworthy that just 48,843 people received severance pay in 2015.<sup>21</sup> One reason why provisions on severance pay are comparatively high relates to the limited social assistance or social insurance programs for unemployed workers. When a worker becomes unemployed, they rely on severance payments to support themselves when they are between jobs.

## **D Earnings and governance trends<sup>22</sup>**

40. **Rising minimum wages.** Increases in minimum wages together with the growing strength of organized labor have been pushing up production costs. From 2000 to 2012, unit labor costs in Indonesia’s manufacturing sector more than doubled, outstripping gains in labor productivity.<sup>23</sup> This led to widening wage gaps between laborers in agriculture (and the informal sector) and those in the manufacturing sector. Between 2011 to 2015 real agriculture and construction sector wages grew by 12% while real manufacturing sector wages grew by 19%. The supply of labor is increasing by some 3 million workers a year, but in the year to August 2014 only 1.8 million jobs were added to the formal economy and in the year to August 2015

---

<sup>20</sup> Brusentsev, V., Newhouse, D., and Vroman, W. (2012) Severance Pay Compliance in Indonesia, Policy research working paper no. 5933, World Bank, Washington D.C.

<sup>21</sup> Directorate General of PHI and Jamsostek, Processed by Pusdatinaker.

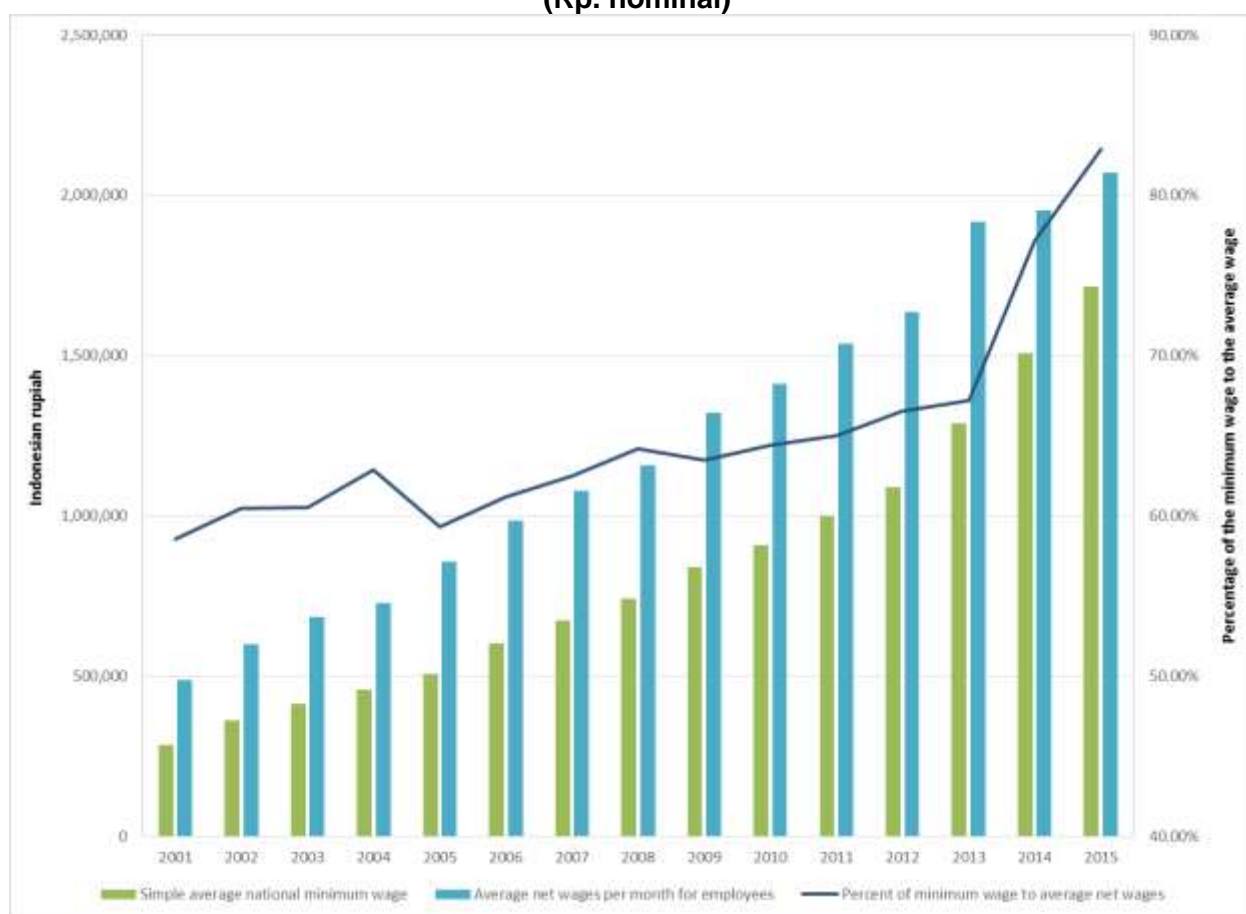
<sup>22</sup> The deflation of wages by CPI is useful when estimating the purchasing power of wages, while the GDP deflator is more relevant for examining issues related to economic competitiveness. However, the use of different deflators for the deflation of value added and wages can distort analysis. The problem of different deflators can be avoided by using nominal prices. Therefore, wage trends are considered in nominal prices in this section, unless otherwise specified.

<sup>23</sup> H. Aswichahyono et al. 2014. Competitiveness Issues in Indonesia. Jakarta (draft).

this was down to 191,000. With labor supply exceeding labor demand, wages in the informal economy have been falling.

41. **Growth in minimum wages has been outpacing growth in average wages.** A review of wage trends in recent years reveals that minimum wages have been growing at a faster pace than average wages in nominal terms. Figure 10 illustrates that in 2001 the simple average national minimum wage for Indonesia was 58.5% of the national average wage and by August 2015 this ratio had increased to 82.9%. This trend reflects the predominance of the minimum wage fixing mechanism in wage policy in Indonesia. Increases in minimum wages are the main mechanism through which wage gains are achieved for many workers across the country. This may also be one reason for the weak demand for low skill workers, and an increased use of short-term contracting and churning in the labor force.

**Figure 10: Trends in nominal minimum and average wages for Indonesia, 2001-2015 (Rp. nominal)**



Source: BPS (2015) SAKERNAS, BPS, Jakarta. \* 2011-2015 based on revised population weights and backcast.

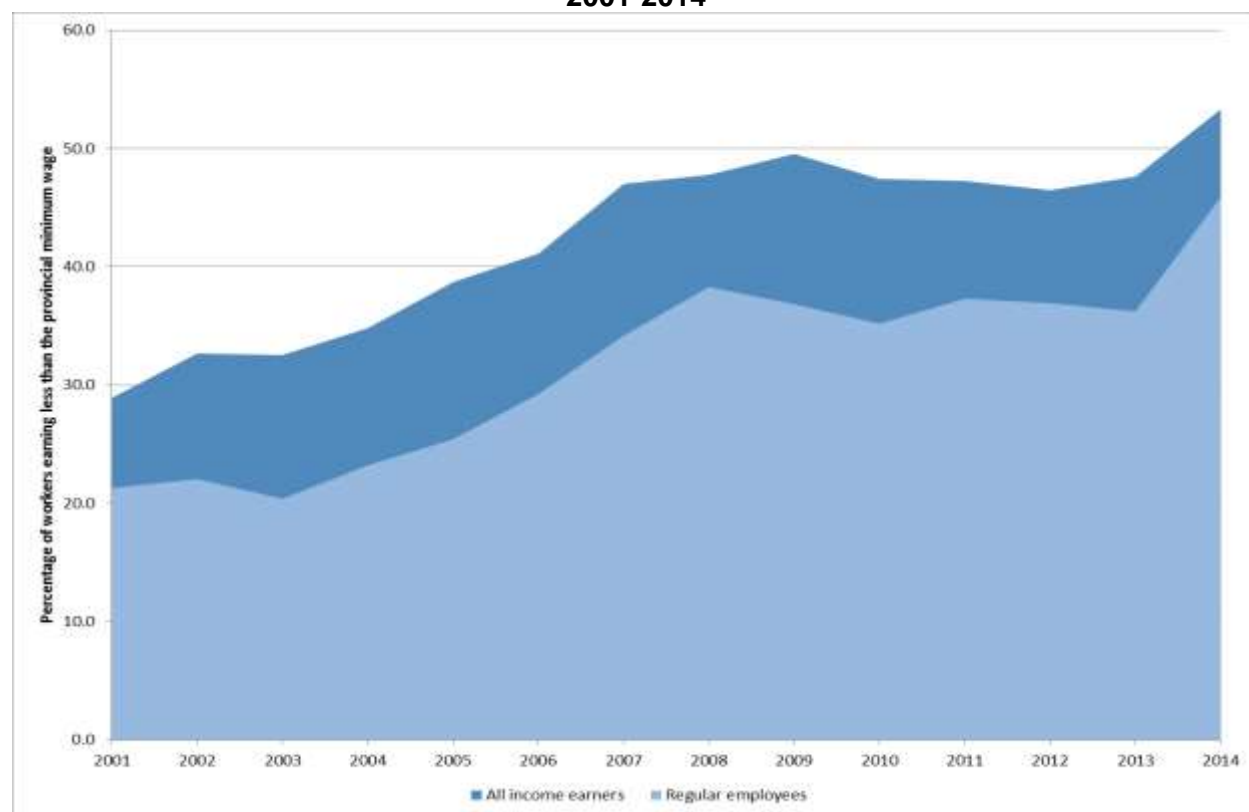
42. **Collective bargaining is limited in Indonesia.** Analysis of trends in collective bargaining in recent years indicates that while the number of collective agreements registered has been increasing in recent years, the overall number of collective agreements and associated coverage of workers remains quite limited. For example in 2010 there were 10,959 registered collective agreements, and this increased to 12,113 in 2013.<sup>24</sup> In addition,

<sup>24</sup> Directorate General of Industrial Relations (2014) Industrial relations statistics, Ministry of Manpower, Jakarta.

specifications in collective agreements tend to reiterate provisions that exist in the labor regulations, such as overtime rates, rather than offer additional incentives to employees. The limited scope and scale of collective bargaining in Indonesia often results in workers organizations using minimum wage mechanisms as the primary mechanisms for improving wages and working conditions.

43. **Minimum wage non-compliance is high and rising.** In August 2001 approximately 21.0% of regular wage employees received wages that were below the applicable provincial minimum wage. By August 2015 non-compliance among regular employees had increased to 47.2% (Figure 11). Non-compliance escalated rapidly between 2003 and 2008, when minimum wage adjustments were more moderate and average wages stagnated. Non-compliance hovered at close to 40% between 2008 and 2013, and then began increasing again in 2014. A broader analysis of trends in earnings that includes informal economy workers<sup>25</sup> illustrates that many more workers have earnings that are below the minimum wage. The high level of non-compliance among regular employees and low level of earnings among informal workers means that minimum wages do not provide an effective floor for wages. Steady increases in minimum wages may be contributing to weak employment growth while segmenting labor demand.

**Figure 11: Percentage of workers earning less than the provincial minimum wage, 2001-2014**



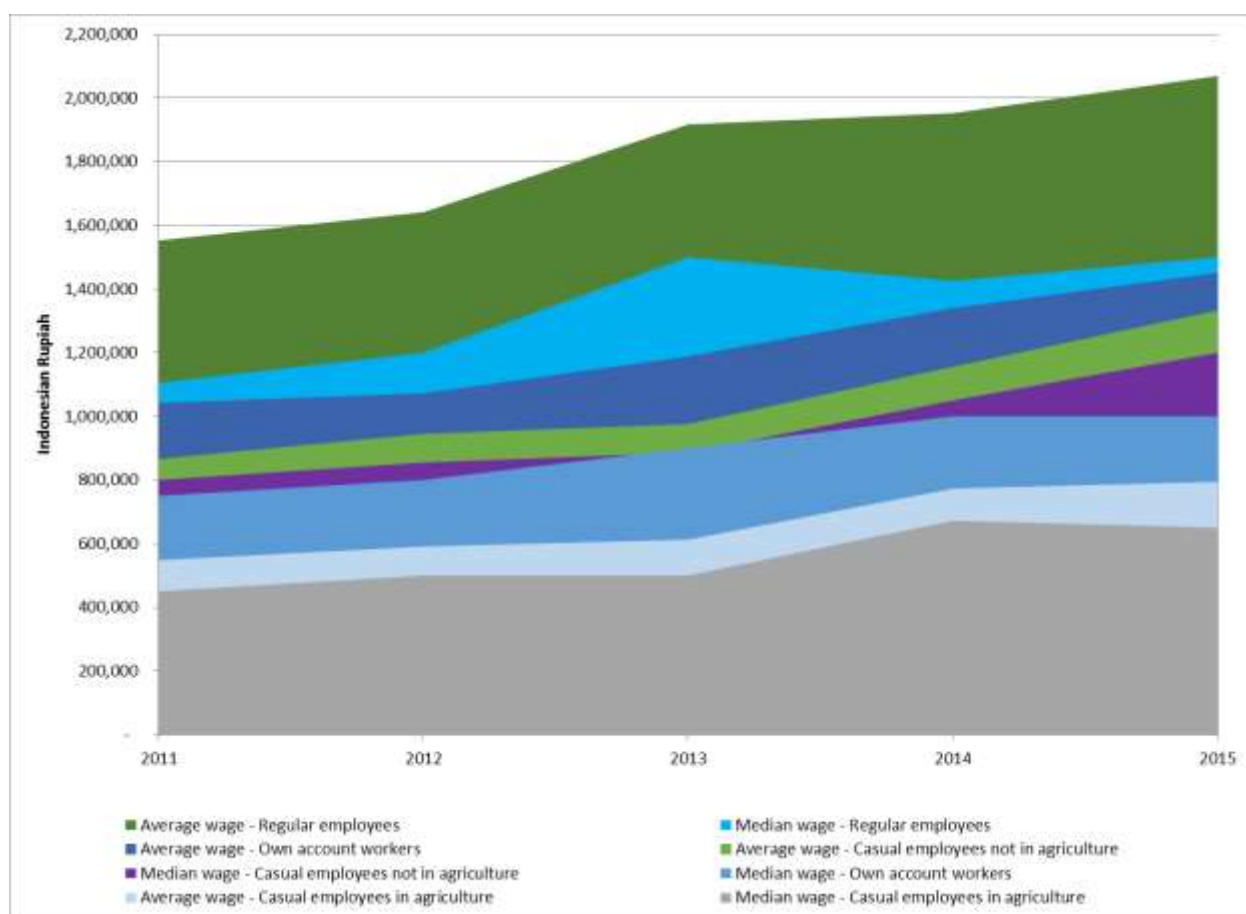
Source: BPS (2015) SAKERNAS, BPS, Jakarta. \* 2011-2015 based on revised population weights and backcast.

<sup>25</sup> Indonesia's labor force survey collects data on the incomes of own account workers, regular employees, and casual employees in agriculture and non-agriculture. When summed these four types of workers account for approximately 65% of total employment. The labor force survey does not collect data on the earnings of employers or unpaid family workers.



44. **Informal economy workers have lower earnings than regular employees.** Further analysis of wages indicates that those employed in the informal economy, including casual employees and own account workers, have lower earnings than regular employees (see figure 12). In 2015, the average monthly wage of casual employees in agriculture was Rp.0.8 million, casual employees not in agriculture was Rp.1.3 million and own account workers was Rp.1.4 million, while regular employees earned Rp.2.1 million on average. To emphasize, the average wage of regular employees was 2.6 times higher than that of casual employees in agriculture. In terms of median wages, the median monthly wage for casual employees in agriculture was Rp.0.7 million, casual employees not in agriculture was Rp.1.2 million and own account workers was Rp.1.0 million, while median earnings for regular employees was Rp.1.5 million. Figure 12 also depicts that earnings for casual employees in agriculture have been relatively stagnant over the period, while earnings for regular employees have increased.

**Figure 12: Nominal average and median earnings by status in employment, 2011-2015**

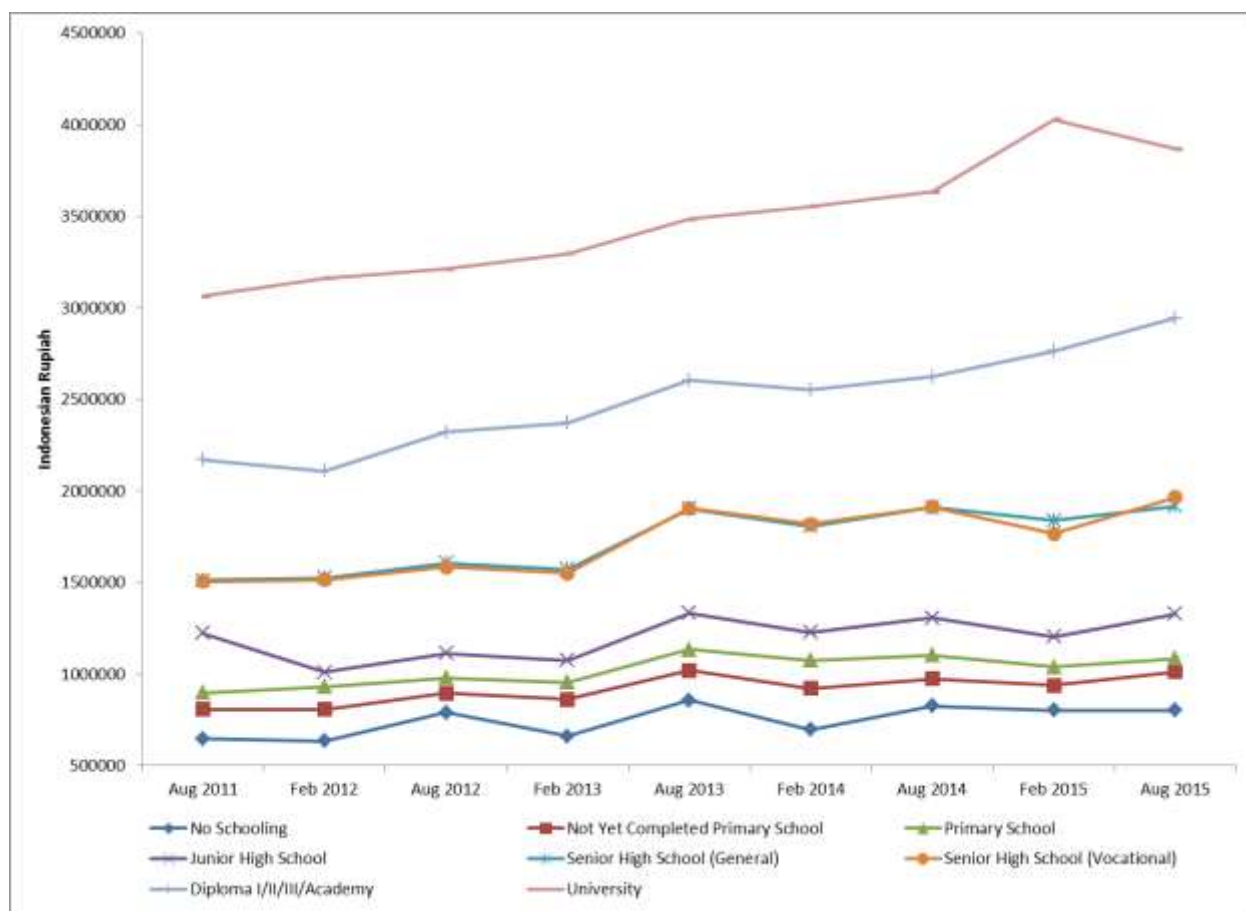


Source: BPS (2015) SAKERNAS, BPS, Jakarta. \* 2011-2015 based on revised population weights and backcast.  
\* ADB staff calculations.

45. **The distribution of earnings is highly skewed.** Median wages for regular employees tend to be substantially lower than average wages for these workers. The average wage was 1.4 times higher than the median for wage regular employees in August 2015, which indicates that the distribution of regular employees by wage level is highly skewed, with many regular employees having lower earnings than the average wage. The situation is similar for own account workers.

46. **Workers with tertiary education have higher wages and higher wage growth rates than less educated workers.** Figure 13 illustrates that average wages for employees with tertiary qualifications have had gains in nominal terms in recent years, while the wages of those with education levels of junior high school or less have been stagnant over the same period. To further illustrate, employees with a university degree have the highest average wages, at Rp.3.9 million in August 2015, while employees that have only completed junior high school have an average wage of Rp.1.3 million. Wage gains are increasingly associated with returns to education, while those with limited education are being left behind.

**Figure 13: Average nominal wages by education attainment for regular employees, 2011-2015**



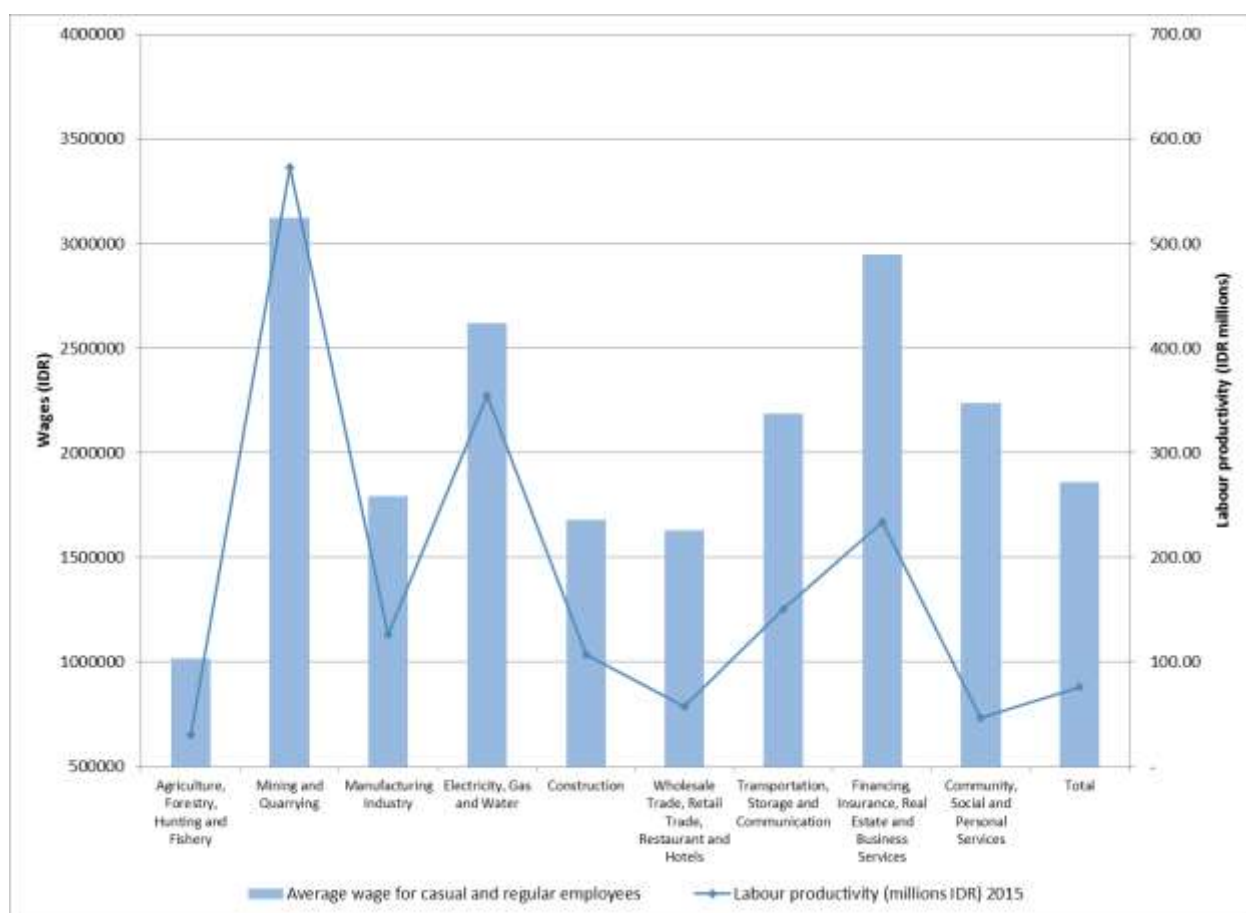
Source: BPS (2015) Laborer situation in Indonesia: August 2015, Badan Pusat Statistik, Jakarta. \* 2011-2015 based on revised population weights and backcast.

47. In particular, over the last decade economic development in Indonesia has been associated with industries that require higher skill levels than in previous periods. Thus, as the economy has developed, its demand for a more highly skilled labor force has continued. This may provide some explanation as to why educated workers have wage premiums, despite the increasing supply of such workers. In contrast, a worker with a low level of skill is becoming less likely to meet the prerequisites for the new jobs that are being created and less likely to meet the expectations of employers. Subsequently, these workers have faced downward pressure on

their wages. Without substantial investments in education, the chance of workers with low skills gaining quality employment becomes less likely as the economy further develops.<sup>26</sup>

48. **Sectors with higher wages have higher productivity.** Labor productivity and wages are interlinked, with the wage being the price of a worker's productivity. Figure 14 depicts trends in averages wages and labor productivity by economic sector in 2015. It illustrates that sectors with higher wages also tend to have higher productivity. The major challenge is accelerating the pace of gains in labor productivity across the economy, which will require policies that provide incentives and address disincentives for investment in education and workplace training.

**Figure 14: Average wages and labor productivity by economic sector, 2015**



Source: BPS (2015) Labor force situation: August 2015, Badan Pusat Statistik, Jakarta. \* ADB staff calculations.

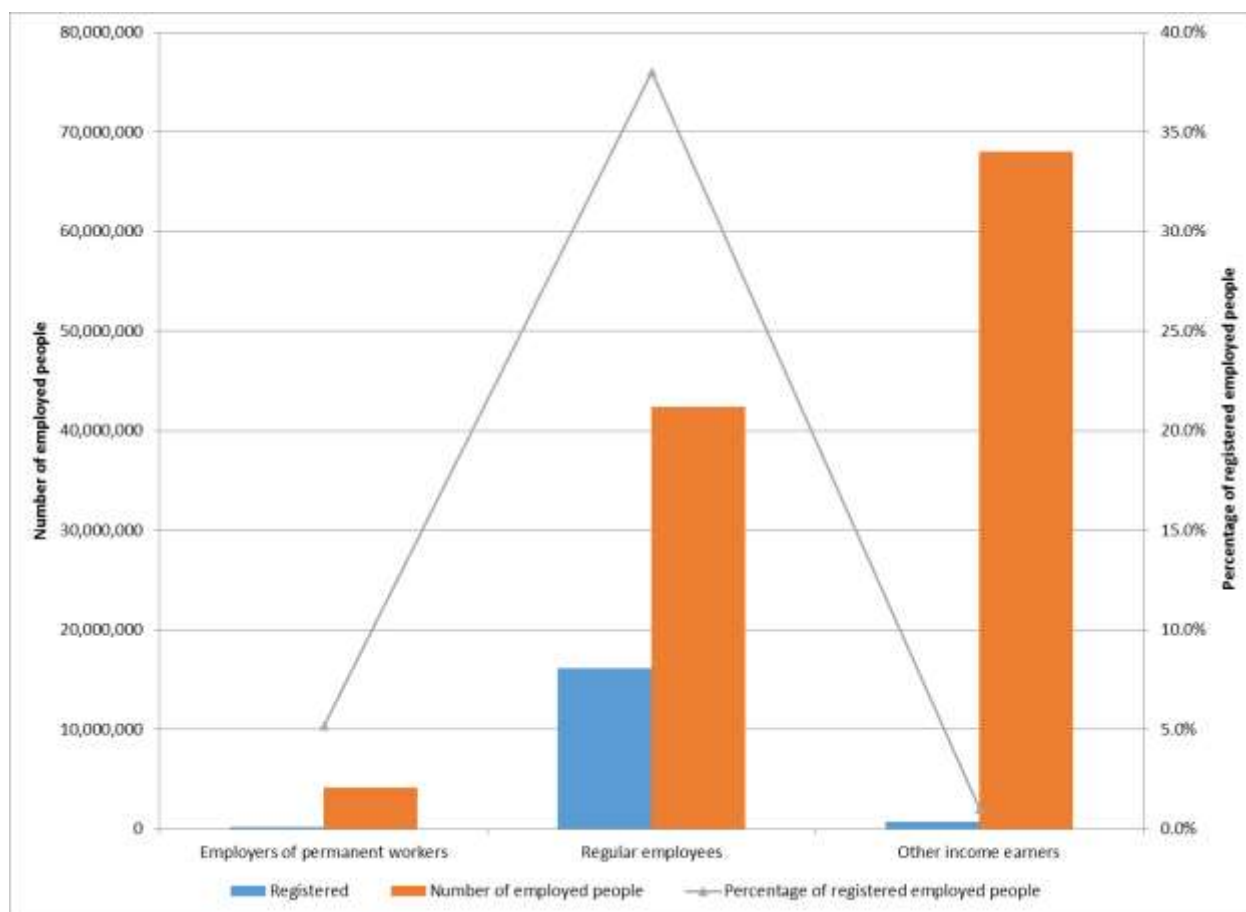
49. **Non-wage labor costs have risen, while compliance remains low.** Indonesia has a range of compulsory social security programs that provide protection against occupational injuries, death and a provident fund, as well as a new health insurance programme introduced in 2014 and a new pension programme introduced in 2015. The non-wage labor costs associated with social security require an employer contribution ranging between 10.24% and 11.74% and an employee contribution of 4%. From July 2015 there were five social security schemes in Indonesia that were obligatory, namely:

<sup>26</sup> ILO (2015) Homeworker mapping study, ILO Country Office for Indonesia and Timor-Leste, Jakarta.

- a) Occupational accidents, with an employer contribution ranging between 0.24% and 1.74%.
- b) Death benefit, with an employer contribution of 0.3%.
- c) Provident fund, with an employer contribution of 3.7% and an employee contribution of 2%.
- d) Health insurance, with an employer contribution of 4% and an employee contribution of 1%.
- e) Pension scheme, with an employer contribution of 2% and an employee contribution of 1%.

50. In addition, to these programs there are further provisions on severance pay and tenure bonuses, which further increase non-wage labor costs. However, compliance across the range of social security programs is limited. As figure 15 illustrates, in 2014 5.2% of employers of permanent workers were active members of these schemes, while 38.0% of regular employees were active members, and only 1.0% of other income earners were active members. This indicates that there are high levels of contribution evasion. By 2019 the government intends to have 62.4 million employees and 3.5 million informal workers participating in employment related social security programs. This would require a considerable increase in compliance.<sup>27</sup>

**Figure 15: Active membership of the employed population in social security programs, 2014**



Source: BPJS (2014) and BPS (2014)

<sup>27</sup> GOI (2015) RPJMN 2015-2019,

### III. GOVERNMENT FRAMEWORK FOR PROMOTING EMPLOYMENT

51. **Indonesia's employment goals are linked with overarching macroeconomic goals.** The medium term development plan postulates that an economic growth rate of between 6% and 8% per annum should see the unemployment rate reduce to between 5% and 5.5% by 2019.<sup>28</sup> In addition, the medium term development plan seeks to improve the human development index, reduce the Gini coefficient, increase the share of the population with access to health care, and increase the share of the population with access to employment related social security programs. Improvements are also sought in the area of education attainment and literacy levels. In order to achieve the employment goals that are outlined in this broad framework, two clear strategies are identified, including:<sup>29</sup>

- Improving productivity by accelerating the reallocation of workers to sectors that have higher added value and high productivity.
- Improving the living standards of workers, including the working poor, through the provision of productive employment.

52. **The regulatory context for employment is provided by the Law on Manpower No. 13, 2003.** This provides guidance on issues such as minimum wages, social security, worker dismissal, severance pay, the use of temporary employment and production outsourcing contracts, and freedom of association, among others. There are also specific laws on trade unions, (No. 21, 2000), industrial relations dispute settles (No. 2, 2004), and social security (No. 40, 2004). The medium term development plan for 2015-2019 identifies several areas for further development of employment regulations, including arrangements for training funding, linking wages and productivity, competency standards, labor market flexibility, and the harmonization of severance payments with social security provisions. In addition to laws and regulations, labor market interventions are informed by data from the labor force survey on the current employment situation, as well as by employment projections that forecast estimations for workforce supply and demand in the medium term.<sup>30</sup> This information is combined and used to plan the associated interventions and institutional support mechanisms that are needed to achieve the target of reducing the unemployment rate to between 5% and 5.5% by 2019.

53. **Technical vocational training seeks to improve labor productivity.** To improve the productivity of workers, a range of classroom and on-the-job training programs are provided with support from the government (further details in table 8). Training is provided based on competency standards and such standards are monitored and revised over time. Interventions that seek to optimize the productivity of the labor force use a combination of labor market information and institutional services. In particular, training policies rely on data from labor market information systems, as well as dialogue with employers and workers, in order to ensure that supply side interventions are well matched with the skills and competencies being demanded by employers. There a number of institutions that provide training services, including the National Professional Certification Authority (BNSP), professional certification institutions, and competency assessment centres as well as public and private vocational training centres. However, the need for training typically outstrips the provision of training from training institutions. Therefore, both the optimization, as well as the expansion of training facilities and

---

<sup>28</sup> Government of Indonesia (2010) Regulation of the President of the Republic of Indonesia, Number 5 of 2010 regarding the national medium-term development plan (RPJMN) 2010-2014, Office of the President, Jakarta.

<sup>29</sup> GOI (2015) RPJMN 2015-2019.

<sup>30</sup> MOMT (2013) National manpower planning, 2013-2014, Secretariat General, Ministry of Manpower and Transmigration, Jakarta.

services, has been identified as critical to enhance the skills and competencies of the labor force.<sup>31</sup> Provision of training programs is currently supported through a training levy on foreign workers, which requires their employers to pay US\$ 100 per month per foreign worker.<sup>32</sup> This tax goes into a fund for training for Indonesian workers that is channeled into the vocational training system. Given the vast need for training, and the funding constraints that are faced by the government in regard to provision of training, more viable financing mechanisms are needed to improve and expand service provision in this area.

**Table 8: Government employment programs**

<b>Employment program</b>	<b>Program description</b>
Productivity and training	<ul style="list-style-type: none"> <li>• Strengthening productivity through the standardization of competencies for technical and entrepreneurship training programs and through promoting the independent operation of certification authorities. Improving training and instruction through setting standards for the skills and competencies of trainers in public and private training institutions.</li> <li>• Developing and improving technical vocational education and training facilities through investing in training infrastructure.</li> <li>• Supporting access to employment for young people through apprenticeship programs that provide a combination of classroom learning and on-the-job training.</li> <li>• Promoting entrepreneurship through providing support for improving productivity in enterprises, identifying best practices interventions, and through provision of entrepreneurship training.</li> </ul>
Employment placement	<ul style="list-style-type: none"> <li>• Provision of public and private employment services to provide job matching and employment counseling services, including job fairs and online job matching websites.</li> <li>• Promoting access to employment through the development of labor market information systems, including collecting and analyzing data on job seekers and job vacancies.</li> <li>• Expanding employment through public employment programs that provide short-term work opportunities for informal economy development for vulnerable groups - particularly the unemployed, underemployed, and the poor.</li> <li>• Expanding employment through supporting Indonesian migrant worker placements, including provision of pre-departure training, placement abroad, improvement of the procedures and protections for Indonesian migrant workers, international cooperation.</li> <li>• Regulating foreign workers through improving the efficiency of foreign worker licensing and associated regulation compliance, as well as utilization of the foreign workers' training levy fund to support Indonesian workers to increase their capacity.</li> </ul>
Labor inspection	<ul style="list-style-type: none"> <li>• Strengthening compliance through labor inspection of workplace norms, freedom of association and the right to organize, minimum wage compliance and the implementation of social security requirements.</li> <li>• Improving conditions at work through monitoring and inspecting standards related to occupational health and safety.</li> <li>• Strengthening worker protection through inspection of discrimination in the workplace and advocating for gender inclusiveness in the workplace and the elimination of the worst forms of child labor.</li> </ul>

<sup>31</sup> ADB, ILO, and IDB (2010) Indonesia: critical development constraints, Asian Development Bank, Mandaluyong City, Philippines.

<sup>32</sup> MOMT (2013) National manpower planning, 2013-2014, Secretariat General, Ministry of Manpower and Transmigration, Jakarta.

Employment program	Program description
Industrial relations	<ul style="list-style-type: none"> <li>• Strengthening compliance through grievance investigation and enforcement of employment laws and regulations.</li> <li>• Improving workers' remuneration through supporting collective labor agreements, the setting of wages, and the development of structures and pay scales for enterprises and sectors.</li> <li>• Supporting employment relations through developing regulations and guidelines on particular issues, such as outsourcing.</li> <li>• Strengthening labor market institutions, including workers' organizations, employers' organizations, bipartite institutions and tripartite institutions, including facilitating the development of workers' cooperatives, secondary enterprises, and the construction of housing for workers.</li> <li>• Supporting the functioning of social security services through the socialization of laws on social security, expanding the number of employers and workers registered by social security providers, coordinating contributions and grievance processes, and extending social security services to workers in the informal economy.</li> <li>• Supporting dispute resolution, including worker dismissal. Disputes can be settled through bipartite deliberation, mediation, conciliation, and arbitration.</li> </ul>

Source: MOMT (2013) National manpower planning, 2013-2014, Secretariat General, Ministry of Manpower and Transmigration, Jakarta.

#### 54. **Employment placement programs support the functioning of the labor market.**

Labor market information and employment services provide job matching services to facilitate the matching of supply and demand, particularly for the formal economy (see table 8). While such services can play a vital role in the functioning of the labor market, these institutions tend to be rather weak. The national budget provides local governments with allocations to support the functioning of these institutions; however, there is often insufficient budget to cover all districts. Private providers also operate employment services, however reporting and coordination between the private sector and the government is limited. In addition, to address wide spread labor underutilization, the government provides a range of direct employment creation measures through a number of community development programs. These programs seek to stimulate local development and provide short-term employment opportunities for marginalized groups, particularly in areas with high unemployment or high levels of poverty. Such programs are also intended to also support gains in the employability of workers through provision of short term training opportunities in technical areas and in enterprise development. However, the scope and scale of community development programs in Indonesia is also limited, which makes it difficult for these programs to be used to address unemployment and stimulate labor underutilization or to operate as a workfare safety net program. In addition, the quality of the assets created under these programs can be low, which limits their potential contribution to local economic development.

55. **Labor inspection supports the protection of workers' rights.** The effectiveness of the labor inspection in Indonesia is limited due to resource constraints. Current labor inspection services only reach between 200,000 and 250,000 firms per year.<sup>33</sup> This leaves a large gap in provision of services, with it being estimated that less than 1 % of enterprises are serviced by labor inspectors each year.<sup>34</sup> Moreover, compliance with existing labor regulations is low. The importance of labor inspection is being heightened, as international buyers, that subcontract

<sup>33</sup> MOMT (2013) National manpower planning, 2013-2014, Secretariat General, Ministry of Manpower and Transmigration, Jakarta.

<sup>34</sup> Authors' estimation based on data from the Ministry of Manpower and data from BPS SAKERNAS.

work to factories in Indonesia, are under increasing pressure from consumers to ensure decent working conditions throughout their supply chains. Therefore in recent years there has been a move to create private, voluntary mechanisms for monitoring compliance with established public (laws or regulations) and private labor standards.<sup>35</sup> These developments are termed “private compliance initiatives”.

**56. Industrial relations systems support worker-employer dialogue.** The industrial relations environment in Indonesia could be described as tense. Instruments of industrial relations include company regulations, collective labor agreements, employers' and workers' organizations, mediators, and bipartite and tripartite cooperation institutions (see table 8). These instruments provide systems for dispute resolution and the negotiation of various standards, such as minimum wages and specification in collective labor agreements. The capacity of these institutions is quite limited, with industrial disputes often resulting in strikes and a stalemate on critical issues for industrial dialogue persisting for long periods of time.

**57.** Wage policies have been a particular challenge. Each year the tripartite wage council was tasked with undertaking a survey of a basket of goods to determine the wage that is needed for a single worker to obtain a “minimum decent standard of living” or the “*kebutuhan hidup layak*” (KHL). Following the recommendations from the wage council, the governor or mayor was tasked with setting the provincial minimum wage annually. Ideally, the minimum wage should be equivalent to the KHL, however, over time a gap between the KHL assessment and the minimum wage emerged.<sup>36</sup> There are several reasons for this, including the failure of the wage council to reach a consensus on the KHL and political lobbying from employers and workers to influence the decision on the setting of the minimum wage. As a high proportion of workers receive a wage that is close to the minimum wage and since collective bargaining at the enterprise or sector level is limited, the minimum wage setting has become the main bargaining mechanism for increasing the wages of workers. This is in contradiction to the idea that the minimum wage should provide a safety net function. In previous advice to the wage councils, the Ministry of Manpower recommended that the annual increase in minimum wages should be 3% higher than the inflation rate in order to improve workers' purchasing power and support enterprise sustainability.<sup>37</sup> In 2015 a new regulation on wage settings was introduced, which specifies that the annual minimum wage adjustment is to be equivalent to the national inflation rate plus national GDP growth rate.<sup>38</sup> However, the new regulation has been criticized from both employers and workers.

**58. Multiple minimum wages.** Indonesia has a complex system of district and provincial level minimum wages that are annually revised. As the regulatory environment for minimum wage setting in Indonesia is decentralized, discrepancies have emerged between regions. For example, in 2016 Gunung Kidul district in Yogyakarta had the lowest minimum wage (Rp.1,235,700) in Indonesia and DKI Jakarta had the highest minimum wage (Rp.3.1 million) in Indonesia - 2.5 times higher even though the provinces are on the same island. An advantage of these large differentials is that it provides space for wage policy to complement the industrial and economic policies of local economies. In addition to district and provincial level minimum

---

<sup>35</sup> Allen, E. (2015) Labor and social trends in Indonesia: Strengthening competitiveness and productivity through decent work, ILO Country Office for Indonesia and Timor-Leste, Jakarta.

<sup>36</sup> Allen, E. (2013) Labor and social trends in Indonesia 2013: Reinforcing the role of decent work in equitable growth, ILO Country Office for Indonesia and Timor-Leste, Jakarta.

<sup>37</sup> MOMT (2013) National manpower planning, 2013-2014, Secretariat General, Ministry of Manpower and Transmigration, Jakarta.

<sup>38</sup> Government Regulation Number 78 of 2015 on wages



wages, sector level minimum wages exist in many areas throughout Indonesia. The system for sector minimum wages has largely developed through a bottom up process, where workers in various industries have organized and bargained for wages higher than the district or province minimum wage over time. While there are exceptions, sector wage bargaining has generally involved developing specific minimum wage awards for workers in labor intensive, capital intensive and resource intensive manufacturing industries. The framework for setting the sector minimum wage uses the KHL as a base, and bargaining based on factors such as productivity, skills, and investment, among others. Sector minimum wages can be more than 30% higher than the district minimum wage or they can be up to 15% lower than the district minimum wage. In this regard, sector minimum wages may be seen as a “substitute” for limited collective bargaining, but they could also be used to provide a base for moving towards collective bargaining.

59. **Social security programs promote workers’ welfare.** Contributory social security programs are available in areas of accident insurance, death, old-age lump sum, health insurance and pensions. Unemployment insurance and unemployment assistance is currently not available. The costs associated with provision of social security require an employer contribution ranging between 10.24% and 11.74% and an employee contribution of 4%. The currently social security system seeks to provide basic protection for fulfilling the minimum needs of workers and their families, while also compensating workers for their efforts over the course of their career. Social security coverage is quite limited, covering approximately 5.2% of employers with permanent workers and approximately 38.0% of regular employees.<sup>39</sup> The number of workers on employee contracts has been rapidly increasing since 2010, which has seen a greater number of workers gain access to social security services, however, coverage is still limited and not all members are actively contributing to the social security programs.<sup>40</sup>

#### IV. KEY CHALLENGES FOR THE LABOR MARKET

60. Improvements in public policies and institutional arrangements are needed to stimulate employment, facilitate structural change, boost labor productivity, combat labor market segmentation and lower youth unemployment. Reforms will be also needed to improve labor relations and to better link wage setting to productivity improvements.

##### **A. Expanding productive employment**

61. **The top priority is to expand quality jobs for inclusive growth.** In recent years, the economy has experienced jobless growth. With a large share of workers employed in the informal economy in low-paid jobs that have intermittent and insecure work arrangements, a greater focus needs to be given to addressing the challenge of vulnerable employment and informal employment as progress in this area is likely to pay significant development dividends. Ensuring that labor is able to shift from low-paying agriculture jobs to higher paying jobs in the industrial and services sector is also critical to boosting incomes and labor productivity.

62. **The employment elasticity of growth.** A growth process that creates more and better jobs is needed. The projected fast growth of the working-age population highlights the importance of having productive employment as a core component of the national development strategy. A key challenge is how to promote a more employment intensive growth model and how to ensure that the jobs that are created are quality jobs. The Indonesian labor market will

---

<sup>39</sup> Authors' estimation based on PT Jamsostek data and data from BPS SAKERNAS.

<sup>40</sup> BPJS (2014) Annual report

need to evolve, with structural transformations, urbanization, and new engines of growth playing a role herein. Structural change can carry significant adjustment costs, highlighting the need to ensure that vulnerable groups are supported to access better quality jobs, in order to prevent further labor market segmentation. Fluctuations, associated with labor market churning, are likely to continue, unless incentives for full-time employment are improved.

## **B. Incentivizing skills and training for productivity improvements**

63. **Training policies in support of structural transition are needed.** There is evidence of structural transformations occurring, with shifts away from agriculture and shifts towards services. This trend is being reinforced by increasing urbanization. The changes in the sector composition of the economy and the labor force have altered demand for skills, with demand for workers with higher levels of educational attainment increasing. It is expected that these structural changes will continue, with employment expanding for skilled workers and contracting for low and unskilled workers. Given pervasive skill shortages, it appears that workers with insufficient qualifications will continue to fill many high skill vacancies in the future. This could lead to bottlenecks and it is therefore important that current skills and labor market policies focus on building a more productive and competent labor force.

64. **Incentives are needed to drive productivity gains.** Gains in productivity are needed to ensure that Indonesia continues to remain competitive in the global economy. Many workers in Indonesia have low levels of educational attainment and work in informal micro and small enterprises (MSEs) that are characterized by low levels of labor productivity and unregulated working conditions.<sup>41</sup> In addition, the government's capacity for improving and expanding training facilities is limited. Knowledge of workplace strategies for improving productivity, such as work-time management, ergonomics, and health and safety measures, is also limited. Policy interventions and the dissemination of best practices are urgently needed, including quality education and skills investment, as well as investment in improved organizational and managerial capacities, in order to promote productivity improvements. Building a culture of workplace training may need to be incentivized by subsidies or grants to drive a more rapid uptake.

65. **Strengthening vocational training and apprenticeship systems is essential.** Apprenticeships are public private partnerships between training institutions and employers that combine school-based learning and workplace training. While Indonesian term “*pemagangan*” can be translated into English as “internship” or “apprenticeship”, these two systems of training are very different. Apprenticeships provide workers with a certified trade qualification that will increase their employability and overall earning capacity in the future. The apprentice is mentored in the enterprise on a daily basis and attends classroom training in block periods. In exchange for this, they participate in the program for some years for a trainee wage and other standard social protection coverage. Apprenticeships are proven to reduce youth unemployment as they support the labor market attachment of youth and provide a bridge between school and the world of work. Given high levels of youth unemployment and skills gaps in Indonesia, investment in such a system is warranted. However, it is noted that there are barriers that need to be addressed, and such a program may need to be incentivized by a skills development fund while it is being revitalized.

---

<sup>41</sup> Allen, E. (2015) Labor and social trends in Indonesia: Strengthening competitiveness and productivity through decent work, ILO Country Office for Indonesia and Timor-Leste, Jakarta.

66. **Industry partnerships and information systems to address asymmetries.** High rates of skill mismatch are associated with lower labor productivity through a less efficient allocation of resources, with productive firms finding it more difficult to attract skilled labor. At the same time, a higher share of under-qualified workers is associated with both lower efficiency and lower productivity. Issues related to skills shortages and skills mismatches are in part related to limited dialogue and limited partnerships between training institutions and employers. This has resulted in many labor market entrants failing to meet the expectations of employers. Better links between industry, higher and vocational education institutions are needed to overcome the issue of skills mismatch and to begin to address the problem of skills shortages. Strengthening labor market information systems and job matching services can also play a role herein.

### **C. Making the labor market more flexible**

67. **Reliance on short-term contracting effects skills investment.** High severance or high worker dismissal requirements are important reasons for using temporary contracts. However, an over reliance on short-term contracting tends to expose the labor force to insecure work conditions and weakens incentives for on-the-job training and skills formation. Investments in human resources for strengthening productivity, operations, management and skills to enhance competitiveness are needed, but have not been forthcoming. Efforts need to be made to address disincentives for engaging workers on regular contracts and to incentivize skills investment and provision of workplace training. In particular, progress towards national goals of productivity improvement and poverty reduction will require better incentives for skills development at the firm level. Therefore, provisions on worker dismissal and severance payment, along with provisions on short-term contracting, and their implications on skills formation should be reviewed in the light of national development objectives.

68. **Promoting flexibility and addressing segmentation in the labor market.** A more flexible labor market is needed that ensures that structural transformation, and the associated reallocation processes, strengthen economic growth and create quality jobs. Increasing flexibility in the labor market is essential for promoting innovation and productivity gains in this regard, and should need to the creation of better business opportunities and better jobs while forcing inefficient production activities to reform. There are beneficial and detrimental aspects of labor market fluidity and ensuring that the regulatory framework provides the right combination of flexibility for enterprises and security for workers is critical. However, the current incentive structures in the Indonesian labor market for getting people into stable employment and promoting career progression are inadequate to stimulate the desired outcomes. Trends in short-term contracting and worker reallocation suggest that the current regulatory framework may be reinforcing segmentation in the labor market. Advancement in this area will require review of worker termination and severance policy to improve enterprise flexibility and workers' protection.

69. **Unemployment insurance for addressing gaps in social protection.** While several social protection programs are in effect, there are gaps in Indonesia's social safety net. In particular, Indonesia does not have an unemployment insurance program for the working age population. This creates an over-reliance on provision of severance payments and to early withdrawals from the provident fund for the small proportion of workers that have access to these funds. Contract employees are not entitled to severance, and many permanent employees also don't receive the full severance entitlement when they are dismissed from their jobs. This exposes unemployed workers to income loss and hardship.

#### **D. Sustainable wage policies**

70. **The minimum wage is becoming the average wage.** For many workers in Indonesia, minimum wage has become the default wage, rather than the fall back wage. They receive annual wage increases due to the growth of minimum wages. However, the general purpose of minimum wages is to provide protection against low pay. The over reliance on minimum wages is evident in the Indonesian labor market, with the median wage in Indonesia close to the level of the minimum wage and many workers being paid the minimum wage despite years of experience. The culture of collective bargaining and compliance with labor regulations are both limited. This situation combines to create due pressure on the minimum wage fixing machinery. Ideally, minimum wages should be set to ensure that entry level workers earn a sufficient amount to meet their basic needs. Greater efforts are needed to return the minimum wage to its original function and to promote collective dialogue on wage setting in particular industries and sectors, as well as at the enterprise level.

71. **Reforms to wage policies.** In October 2015 the government introduced reforms to minimum wage setting processes, along with compulsory steps and scales requirements for non-entry level workers. In particular, the government adopted a formula based approach to minimum wage setting involving adjusting minimum wages annually by the percentage increase in real national GDP in the previous year plus the percentage increase in national inflation from the previous year.<sup>42</sup> The reform limits the role of the wage councils and the governors in determining the minimum wage. The formula provides a solution that increases the predictability of annual minimum wage adjustments. However, adjusting all minimum wages by GDP growth and inflation each year, regardless of general economic circumstances, may be problematic given that different regions grow at different rates, have differing inflation rates, and very different living costs. A large increase in the minimum wage may have adverse effects on a region's competitiveness, particularly if economic activity in that region is slowing. In addition, automatic adjustments of minimum wages may limit the room for wage increases based on individual or sector performance. It may also mean that wages negotiated in collective agreements increase at a faster pace than productivity growth, which will likely adversely affect enterprise performance and industrial relations. Compulsory steps and scales for non-entry level workers may also be problematic, and lead to increasing labor turnover in compliant firms.

72. **Strengthening alternative avenues for wage negotiation.** A particular challenge for Indonesia is that collective bargaining is weak and minimum wages are the main avenue for wage negotiations. The challenge for Indonesian wage policy is to ensure that wages increase in line with labor productivity growth and that there is a fair distribution of value added between employers and workers. Wage policies should support the purchasing power of workers and the competitiveness of enterprises. Collective bargaining should be used as a tool for setting wages above the minimum, in order to promote wage increases that are broadly in line with labor productivity and contribute to a fair labor income share in GDP. Moreover, the regulatory environment for wage policy should foster a culture of dialogue and bargaining between employers and workers, and encourage bipartite processes for wage setting above the minimum.

73. **Expanding collective bargaining.** In Indonesia collective bargaining is often about the implementation of existing rights or the extent to which these rights may be infringed. Collective bargaining agreements also often refer to issues such as overtime payments and premiums for working on Sunday which are specified in laws and regulations. A wage system that allows

---

<sup>42</sup> Regulation 78/2015 on wages

workers to establish different awards with benefits beyond the legal minimum can help to reduce pressure on the minimum wage fixing system and offer workers in more productive industries a premium for their skills and productivity. Collective bargaining can be established at the sector level or at the enterprise level. For example, workers in the electronics and automotive sector, who typically have higher levels of skills and productivity than workers other sectors such as textiles, may engage in multi-employer or industry level collective bargaining to set standards for the sub-sector. Links between wages and productivity can also be established at the enterprise level. Enterprise level agreements may negotiate working conditions as well as workplace modifications that increase productivity.

74. **Promoting sound industrial relations.** The process of minimum wage fixing lacks tripartite consensus and has contributed to tensions between employers and workers. In addition, the over reliance on minimum wage fixing and tensions on outsourcing and social security have fueled industrial conflict, with strikes and demonstrations a persistent feature of industrial relations in Indonesia. The challenge is how to create a culture of good faith bargaining about wages and conditions of employment. It is important to get industrial relations back on track and find ways to balance workers' and employers' conflicting demands in dealing with matters of job security, welfare and social protections. A sound industrial relations environment is an important consideration for investors; therefore improving the quality of dialogue that takes place between employers, workers and the government will be an important part of the fabric for strengthening the competitiveness of the Indonesian economy.

#### **E. Strengthening labor market governance**

75. **Strengthening coordination in the context of decentralization.** Improved compliance efforts across minimum wages, social security, and income taxation, may help to drive forward gains in government revenues as well as help to reduce inequality. Gains in compliance would need to be supported by simultaneous investments in management information systems that collect information for monitoring, auditing, inspection, and grievance resolution. Cross ministerial and interregional cooperation would need to be strengthened incrementally over time to support a more coherent system of labor market governance. However, Indonesia's decentralized mode of governance poses certain challenges. Local governments suffer from a lack of human and financial resources, and from poor coordination within and between regions. There has been a chronic underinvestment in training and employment services as well as labor market institutions by many regional governments. Moreover, policies related to staff rotation have adversely affected the capacities and development of these services and institutions. A government wide solution is required to make progress on this challenge.

76. **Promoting good faith bargaining.** It is widely acknowledged that a piecemeal approach to the reform of individual labor market regulations represents difficulties, due to the perceived zero-sum nature of any change in industrial relations.<sup>43</sup> For this reason an overall grand bargain may be needed in order to create a thorough set of reforms that are perceived to be beneficial to the government, employers, investors, labor unions, and job seekers. The scope of a "grand bargain" could potentially encompass the many challenges that have been outlined in the previous sections. Particular focus may be on wage policies and labor market flexibility vis-a-vis workers' protection. The negotiation of a grand bargain provides the opportunity for building a culture of "good faith bargaining" between employers, workers and the government in order to be able to make progress towards a development model that fosters inclusive growth.

---

<sup>43</sup> World Bank (2010) Indonesia jobs report: Towards better jobs and security for all, World Bank, Washington D.C.

Holding forums that provide space for dialogue on these issues is a way of building this culture and moving forward.

77. **Evidence based research for supporting industrial dialogue.** Industrial dialogue should be supported through evidence based research that is undertaken by bodies that are recognized as neutral by the government, employers and workers. For example, there is a need to understand the effectiveness of the strategies that are implemented to support labor market outcomes and for reforms to be identified that can help to increase the efficiency of government spending and improve employment outcomes. Understanding the overall effectiveness of the various labor market institutions and programs is an integral part of bureaucracy reform and is needed to optimize inclusive growth outcomes.

78. **Labor inspection and private compliance initiatives.** Compliance with labor and other regulations is limited in Indonesia; however, international trading partners are increasingly placing demands on contracted Indonesian companies to meet standards. If companies are able to fulfill requirements, compliance with standards can help to increase market share and reliability in international product markets. Given the limited capacity of the government to administer such service, supporting private sector involvement in compliance initiatives may be the most feasible option to expand such services, along with market share.

\*\*\*