

# THE EFFECTS OF TRADE ON EMPLOYMENT IN INDONESIA

**Carunia Mulya Firdausy**

**Professor of Economics**

**Centre for Economic Research-Indonesian Institute  
of Sciences (P2E-LIPI)**

# Outline of Presentation

- ❑ The Significance of the study, Objectives and Data sources
- ❑ Results and Discussion :
- ❑ National Development Strategies and Policies related to Trade Sector
- ❑ Employment Policies
- ❑ Effects of Trade on Employment
  - Macroeconomic and social performances
  - Trade Performance
  - Employment performance
- ❑ Views toward the Effects of Trade Reforms on Employment by constituents interviewed
- ❑ Conclusions and Policy Implications

# The Significance of the study

- Development strategies and trade policies in Indonesia started since the late 1960s.
- Tariff adjustment and investment policies as the main instruments.
- Are there studies on the effects of trade liberalization on employment?
- There is a big body of literature; but, not too many of them analysing the impact of free trade on the labour market; not in the sense of providing evidences of causality.
- This is understandable as it is difficult to find a good 'counterfactual' for a trade policy.
- Thus, further studies on the impacts of these trade reform policies on employment are significant

# WHY EMPLOYMENT MATTERS ?

- Waste of resources if unemployment and underemployed
- Great individual able to give benefits and social benefits
- A right (Human Right)
- MDGs
- Political stability

# Objectives of the study

- To assess and discuss the effects of trade reforms on employment;
- To support the analysis of effective and coherent trade and labor market policies that address the adjustment challenges that workers and employers face and expand opportunities for the creation of decent employment in developing countries.

# DATA SOURCES

- Literature review
- Published Data (BPS, ADB, WB, ILO, UNDP, and the Central Bank)
- Interview through meetings with individual stakeholders (constituents) related to employment sectors:
  - National Planning Board (Director of Employment Creation-Bappenas).
  - Ministry of Trade
  - Ministry of Manpower and Transmigration
  - Confederation of Technical Unions (SPSI, SBSI, SPI
  - National Chambers of Commerce (KADIN)
  - Indonesian Trade Association (APINDO)

# Results and Discussion

- National Development Strategies and Trade Policies
- Employment Policies
- Effects of Trade on Employment
  - Macroeconomic and social performances
  - Trade Performance
  - Employment performance
- Views toward Trade Reforms on Employment by constituents interviewed

# National Development Strategies and Policies Related to Trade

- The basis of development : pro-poor, pro jobs, pro-poor and pro environment (the Act of No.17/2007)
- Strategies to promote trade are conducted through:
  - (1) *Inward supportive approach*, a strategy that aims to strengthen domestic market
  - (2) *Outward friendly approach*, a strategy aims to promote exports.



Trade policies and strategies to increase and maintain trade balance were by:

- (1) promoting the competitiveness of non-oil/gas exports products;
- (2) improving the business climate for external trade by improving services in licensing and non-licensing related to external trade;
- (3) improving distribution networks to support the development of the national logistics system, strengthening the internal market and the effectiveness of the goods market

**Thus, Indonesia's trade policies have been considered more progressive especially from the perspective of tariff liberalization on the vast majority of its products.**

## 6 ways to strengthen exports promotion

- by taking optimum advantage of ASEAN and China market's potentials;
- By strengthening Indonesia's trade representatives abroad; tourism, trade, and investment (TTI);
- managing export issues;
- monitoring Indonesia's certificate;
- promoting Indonesia's role in the export funding institution (*LPEI*) in supporting export facilitation;
- Strengthening Indonesia's trade position through diplomatic and trade negotiations (multi tracks: bilateral, regional, and multilateral).

## On Investment and business Climate

- Triple L (legal, Local regulations and Labor Regulation) through inter alia:
  - a. simplification of procedures
  - b. improving the information system
  - c. development of Special Economic Zones (KEK)
  - d. Public Private Partnership (PPP)
  - e. synchronization of policies on manpower-business climate
- Other policies :
  - a) implementation of the development of industries (Presidential Regulation No: 28/2008 on National Industrial Policy)
  - b) increasing the role and capability of international trade diplomacy
  - c) increasing services to protection of Indonesian migrant workers abroad.

# Employment policies

- Employment creation across all economic sectors and development programs (e.g. Investment and Business friendly environment)
- Export promotion zone (the greater Jakarta area and Batam)
- Enhancing physical infrastructure for production, transport and logistics
- Export oriented industrialization
- Active labor market policies (e.g. training, job search assistance and career guidance)
- The promotion of social dialogue

- Issuance of the Act no. 13/2003 on Manpower calls for the formation of tripartite cooperation Institutions.
- Advocating decent work agenda
  - Establishment of various institution (wage council, productivity council, training council and national skills certificate system-BNSP)
  - Provisions of loans to industry at lower interest rate
- Social assistance for the vulnerable population, but no employment insurance scheme
- The National social security system Law (law no. 40/2004)

# Effects of Trade Reforms on Employment

# Macroeconomic and social performances

- Macro economic performance: Rapid Growth at the average 7 % before 1997 (a miracle economy)
  - Economic Transition from A to M and S
  - Due to robust private consumption, stronger investment, Remittances and expansion of net export
  - However, net exports fell, acting as a drag on GDP growth (from 1.5 % of total growth in 2011 to 1.1 % in 2012).

## **Supply side performance**

- Service and manufacturing sector were key drivers
- Services expanded by 7.7 %
- Manufacturing decelerated 5.7 % due to weaker export markets
- Agriculture increased to 4 % due to good harvest of food crops

## Social performance

- HDI had increased overtime from 0.390 in 1980 to 0.617 in 2011
- Categorized in the medium human development group, but still low in comparison with the world and East Asia Pacific levels
- The incidence of poverty declined from 40.1 per cent in 1976 to 11.7 per cent in 2012
- The emergence of middle income group of 135 million
- A better educational attainment for the population over time since 2000



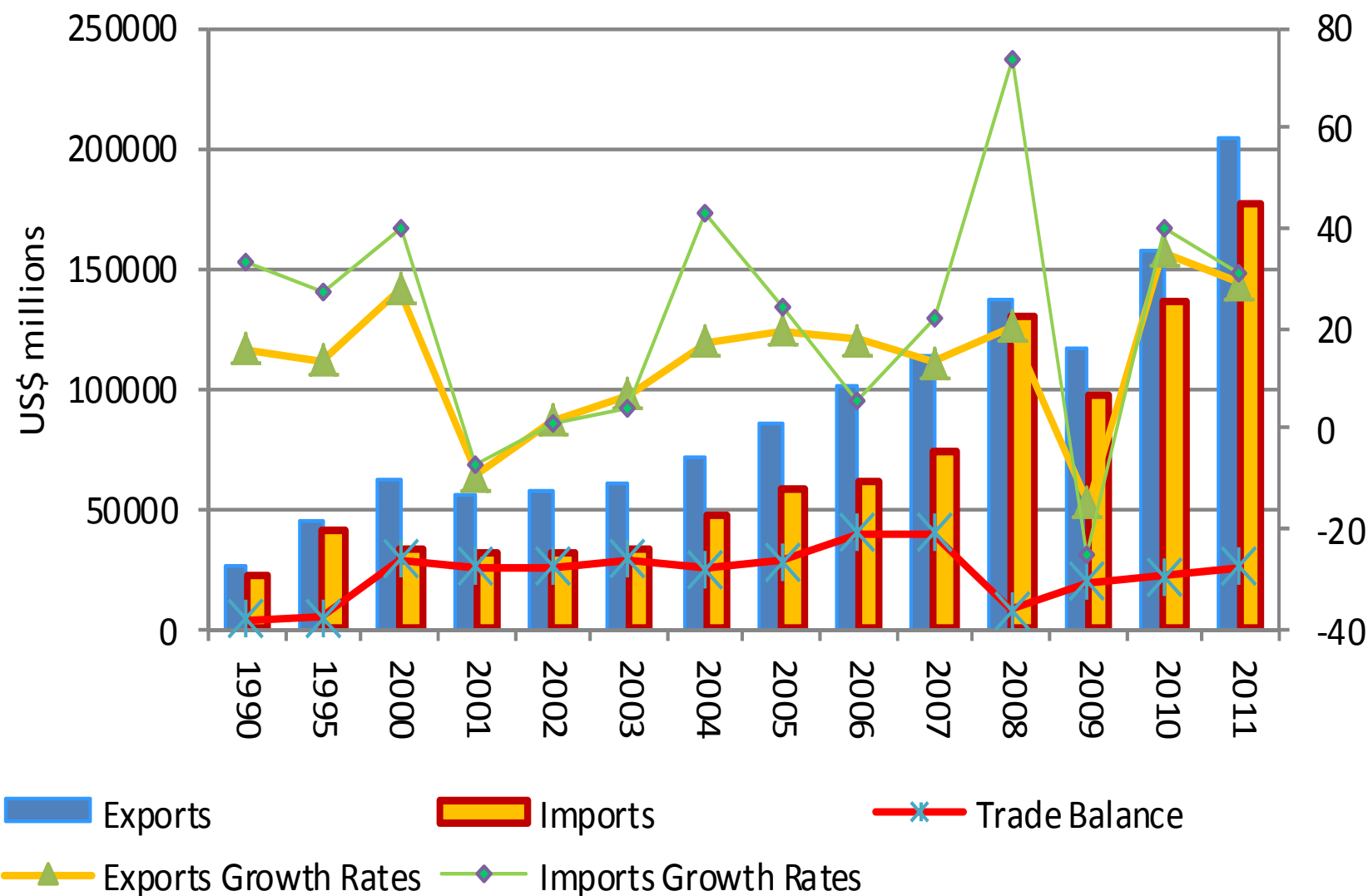
## Trade Performance

- Indonesia's exports are still mainly resource-based commodities (including human resources).
- In the post-crisis era, the export growth was poor largely driven by supply-side constraints, among others was the country's poorer business-facilitating environment (including infrastructures)
- The global trade recovered slightly and gave the positive impacts on indonesia's trade, after declined in 2009 mainly due to the decreasing global world.

## Trade structure

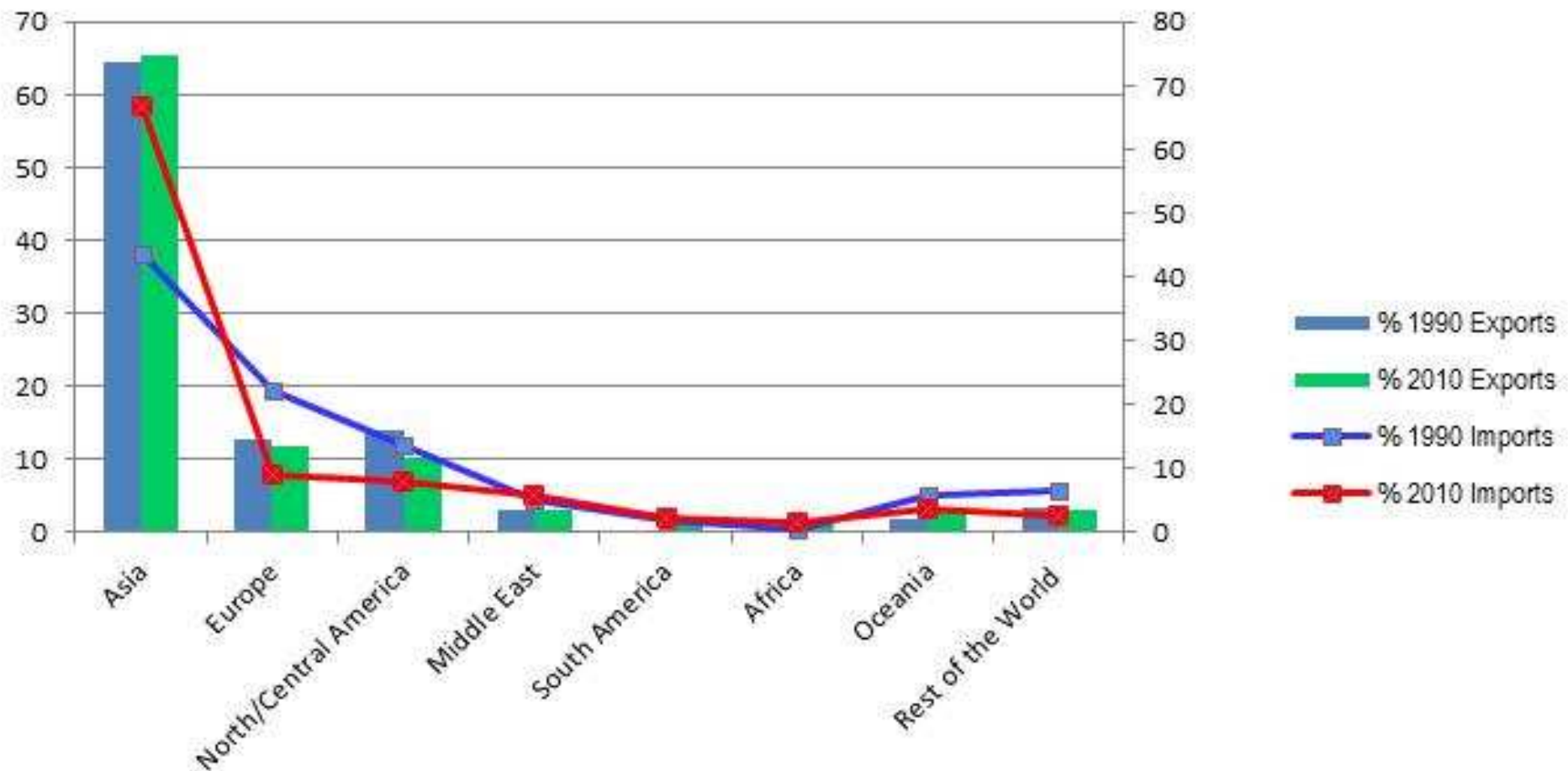
- A substantial fraction of Indonesia's exports was made up by non-oil/gas,
- Equally, the imports were comprised of a considerable share of non-oil and gas

## Indonesia's Merchandise Exports and Imports, Growth and Trade Balance, 2000-2010



The trade partners have been changing to the closer neighbourhood trading partners. The regionalism has emerged.

Direction of Merchandise Exports (% of total exports) and Merchandise Imports (% to total imports) by continents, 1990 and 2010



# Employment Performance

Unemployment tend to decline, but generating sufficient jobs remain major challenge

- The unemployment rate only fell from 6.6 % to 6.1 % (2011-2012)
- Due to the strong employment growth in manufacturing and community and social services
- But, the underemployment remains relatively high at 14 per cent in 2010
- LFPR remained at 67 per cent. This means around 67 per cent of people aged 15+ were either employed or unemployed

Type of Activity	2007	2008	2009	2010	2011	2012
Population 15+	164.1	166.6	169.3	172.1	171.8	173.9
Labour Force	109.9	112	113.8	116.5	117.4	118.1
Employed	99.9	102.6	104.9	108.2	109.7	110.8
Labour Force Participation Rate (%)	67	67.2	67.2	67.7	68.3	67.9
Unemployment Rate (%)	9.1	8.4	7.9	7.1	6.6	6.1

## Youth employment

Youth employment decline, but it contributed to the total unemployment.

- Ratio of youth to adult unemployment rate was 10 times, but declining since 2008. This is surely alarming problem.

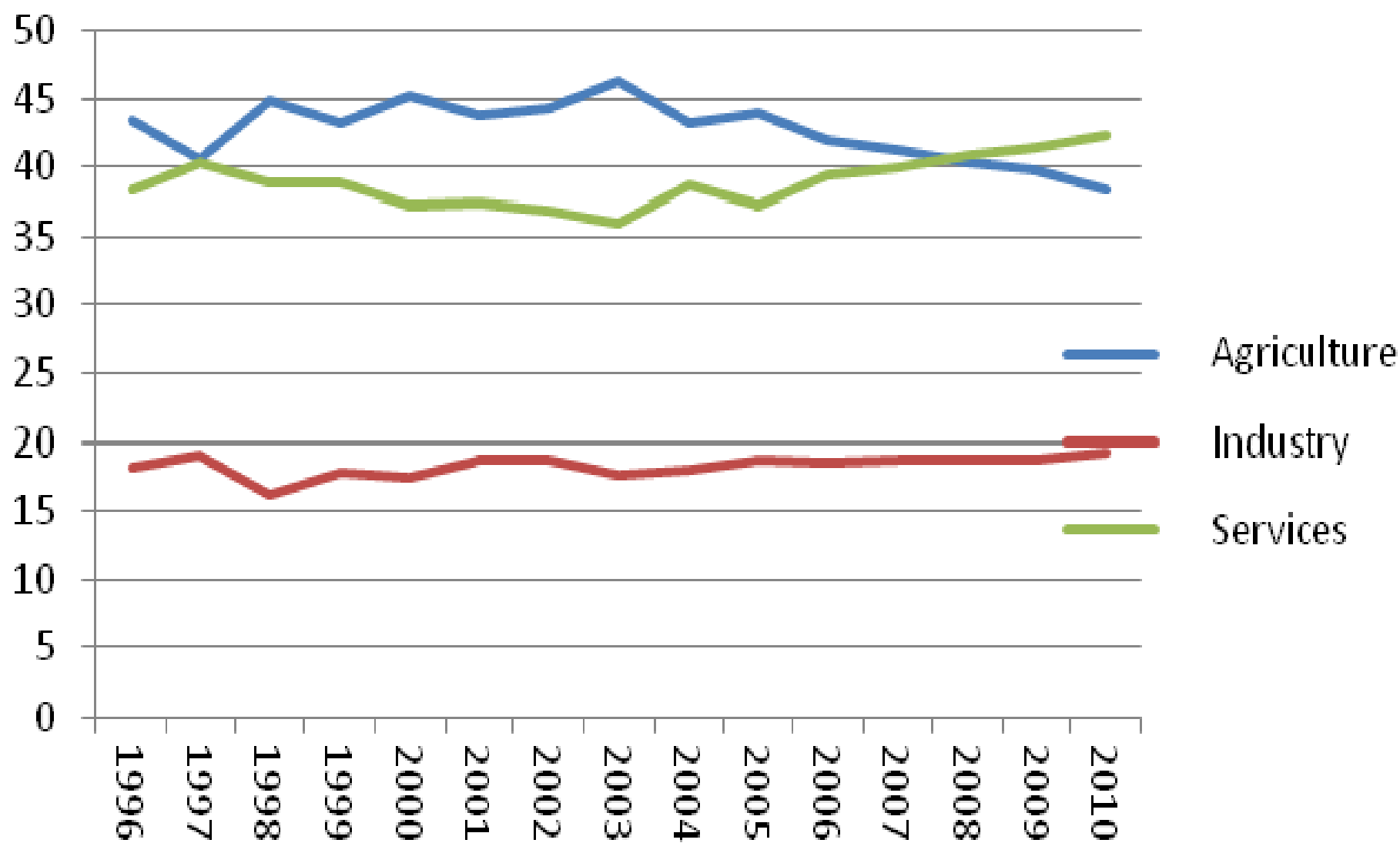
## **The quality of employed population by educational attainment**

- Dominated by those workers with low educational level (more than 50 per cent has educational level less than primary school)
- Substantial share of employed have junior and senior high educational level
- the share of vocational education and university level was so small.

## **Patterns of sectoral employment**

- Structural change
- Dominated by A sector, though decreasing significantly to less than 40 per cent
- M sector declined to less than 15 per cent in 2010. This indicated the dominance of capital intensive establishment and other factors (bureaucracy, education, infrastructures, etc.)
- The rest of employment is in S sector indicating this sector as the safety valve of unemployment problems for the unskilled.

Figure 3.4. Employment share by main economic sector,  
Indonesia 1996-2010



## Status in employment

- Formal sector absorbed 30 per cent of the total employment (increased by 2.8 annually since 1996)
- This indicates that the formal sector employment is sensitive to globalization and policy reforms
- informal sector has been the dominant factors, but should be cautious with this condition as it will lead to ***the informal sector trap*** due to inter alia globalization, trade liberalization.
- it will increase the unemployment rate, increasing income inequality, the incidence of poverty and migrant workers (during the last ten years, the Gini coefficient increasing to 0.41)
- The poverty reduction trend declined slowly, while proportion of migrants workers increased significantly annually.



# Views toward Trade Reform on Employment by Constituents Interviewed

## **Box 1. Trade and Employment: Stakeholders in the Services Sector and Policy Dialogue**

- The services sector is expanding fast, but the involvement of the overall stakeholders is still limited especially between the governments, company owners and workers.
- Academics are expected to bridge the existing gaps between the workers, company owners as well as the governments, in which their relationships are not equal.
- Technical assistance programs for the stakeholders through conferences or seminars supported by international institutions are also expected to enhance participation and discussion of policy issues.

## **Box 2. The Services Sector and Employment**

- The services sector is important and expanding fast, but policy discussions on it are slow to involve its stakeholders.
- As the service sector expands, investment may follow. This will increase the flow of capital, best practices of management and professionals.
- Indonesia has to adapt and improve the skills profile of the country's workers.
- The backbone of the services sector is finance, transportation and communication.
- Liberalization of these services subsectors may result in a positive employment impact.

### **Box 3. Indonesia Services Dialogue**

- Indonesia Services Dialogue (ISD) should be a forum to discuss and share views on various critical and emerging issues in services.
- The ISD should invite many stakeholders such as from the line ministries, business practitioners, entrepreneurs, academicians, and other stakeholders.
- The ISD should be a means to create a more inclusive forum for government, business and individual stakeholders.
- It also developed the understanding of the new regional and global dynamics in trade and investment.

**Thus, the ISD has not paid attention exclusively to trade- related labor issues. So, it is necessary to give more space to issues of trade and employment in the next agenda of the ISD.**

#### **Box 4. Indonesia and Trade Negotiations**

- The Ministry of Trade needs to coordinate with other stakeholders, private actors and academicians.
- The Ministry of Trade needs to build a mechanism to perform negotiations with other countries.
- The Ministry of Labor need to be involved in the process of coordination.
- Negotiations on services trade have been particularly challenging.
- Any agreement will have an impact on workers' welfare.  
(e.g. in the case of nurses, some may be sent overseas, but the stock of nurses in the domestic market must also be considered to meet domestic demand).
- Developed countries are reluctant to negotiate the movement of unskilled labor.

### **Box 5. Free Trade and Labor Movement: Government's Perspectives**

- Under FTA, the movement of natural persons (free movement of labor) is still risky for Indonesia.
- The position of Indonesia is weak due to the fact the labor quality, unskilled and low level-educated workers.
- In the FTA negotiations, there is a need to have special treatment for unskilled labor and efforts to develop their capacity.
- There should be a link between fiscal incentives and the use of domestic workers.

For instance, if a firm recruits all its workers domestically then this firm should be given some sort of fiscal incentive.

- A better competitiveness level will allow industries to absorb job seekers.
- The subcontracting system seems to be a common method for companies (including the ones producing exported products).
- Due to unskilled labors, Indonesia will have to bear the costs of upgrading their skills as well as the costs for skilled labors (increase/maintain professionalism).
- In-flows of capital and technology must be accompanied by increasing numbers of qualified human resources.
- The workers certification system must be developed. Mutual Recognition Arrangements (MRA) may be one way to increase the ability and skills of Indonesia's workers.

## **Box 6. Free Trade Agreements (FTA) and Employment: Trade Unions' Perspectives**

- Globalization and free trade have come together to affect Indonesia's economy.
- Indonesia has joined a number of FTA, such as ACFTA.
- These agreements have influenced employment in Indonesia.
- FTAs and the ASEAN Economic Community (AEC) in particular, will result in positive and negative impacts on labors.
- To minimize the negative impacts of FTAs and AEC, there is an increasing need for improving labor skills, by having a pool of certified labor (e.g. construction workers) to encourage labor mobility.
- Thus, the productivity may be raised through training for not only unskilled but also skilled labors.



Conditions in Indonesia show the country may not be ready yet to enter FTA due to:

- Uncertainty of implementation of the laws/rules and regulations, especially those related to the protection.
- The Implementation and enforcement of laws are weak.
- The regulators do not function well in applying the law.
- The low budget and lack of staff.
- Hidden cost is still also a common problem.
- Insufficient infrastructure
- Firms are reluctant to increase wages.
- With low skills and education, it seems that the country is not ready to have a free-trade regime
- High-income work opportunities may be filled by workers from other countries.

## **Box 7. Trade Unions on the Solutions to Employment under Free Trade Agreements (FTAs)**

- FTAs have positive and negative impacts on employment.
- It depends on whether the country has the necessary conditions to gain the potential benefits or not.
- In AFTA, e.g. Indonesia will, most probably, not gain due to weaker position in terms of competitiveness.
- For example, Indonesia and some other countries compete in exporting electronic goods and other competitive products.
- One way to increase the competitiveness is by reducing production costs.
- It was suggested that the opening-up of certain industries or sectors should be implemented gradually (step by step) and sector by sector.
- It would be ideal if countries could make agreements on production sharing and exports.

- For example, Indonesia may specialize in the production and exporting of certain products, while other countries produce and export different products.
- To gain from free-trade, the two most significant factors which need to be resolved are poor infrastructure and the low capacity of human resources.
- Labor costs are only around 10% of total costs. In a condition of abundant labor supply, the workers tend to have lower bargaining power on the level of wages.
- the lack of government support to domestic firms is a key reason for the lack of domestic competitiveness. This in turn could create unemployment.

## **Box 8. Notes on Labour Policy**

- Policy and regulations in Indonesia, basically, they are all well proposed.
- But, it seems no integration and coordination between the line ministries.
- Vocational education must be promoted as have been implemented by developed countries.
- The reason is that skills of workers are not well prepared and developed properly.
- Also, vocational schools are not promoted yet; the polytechnic is not so popular for students.

## **Box 9. The importance of Labor Intensive Industries**

- Indonesian government have agreed to the incoming 2015 of AEC and other FTA.
- We, basically, believe that we can compete in the 2015 of AEC.
- However, some (groups) are worry in entering the AEC.
- If the national government signed the FTA, we believe we can compete with other countries, especially skilled laborers.
- They could compete with others. So far, they spread out in many countries such as in Thailand and Japan.
- For the unskilled laborers, it seems that we are losing.

Hence, we must give serious and special attention, especially for migrant workers.

- Certification is important in global competition cause we cannot avoid the competition in globalization era.
- Our level of competitiveness depends on the quality of human resources.
- The awareness can be in the form of policy development. But, the implementation is still in the question mark.
- The intensive labor industries are the sectors which are most fragile to the free trade.
- How can we compete if, such as in the shoes industry, the material inputs and labors accounted for around 60% of total cost?
- Outsourcing is still controversial and some companies had been withdrawing from the outsourcing system in recruiting the workers.

- The minimum wage policy is still a nightmare for the companies to apply.
- Under this condition, it may be better to import than produce the products.
- It means that we have become a trader, not a producer, which is less in absorbing the labors.
- We acknowledged the big size of markets in Indonesia.
- If we cannot feed up or supply the domestic demand, then, we have to fulfill it with imports.
- This condition needs attention from all. All stakeholders must have responsibilities to solve these issues.  
The industrial relation must be well developed.

## **Box 10. Policy to Increase Skills, Competence and Productivity of Indonesian Workers**

- The government should pay attention on the new job seekers, not just pay attention on the current employed workers.
- Workers just insisted on the increasing minimum wage, but no attention on their productivity.
- Prosperity is important. But the national government must also encourage all stakeholders to increase skill, competence and productivity.
- The government should also do campaign on productivity and workers competency.
- The training center (e.g. *Balai Latihan Kerja* (BLK)) has been underdeveloped. It has not been promoted and integrated with the CSR of the companies.



- In fact, there are progressive business opportunities in outside java, but job seekers are reluctant to go outside.
- The government should develop the integrated system that creates employment.
- Other important thing, social control is important to sustain the productivity level.
- In case of migrant workers, they might have higher productivity when working in overseas, but not at home.
- Discipline and nation culture must be developed to increase productivity level.

# Conclusions and Policy Implications

- Trade reforms increased economic growth, but employment creation is still a big problem
- There are still problems with capital bias, spatial bias, and skill bias
- The movement of natural persons is still risky, due to the huge number of unskilled and low level-educated workers.

***Thus, Indonesia is still not yet ready to enter full competition under free trade inter alia under the reasons:***

1. the uncertainty of the implementation of the laws/rules, especially related to the protection of workers under the Labor Law No. 13/2003.

2. The Implementation and the enforcement of the Law are very weak and regulators do not function well
3. Decentralization has also add up the problems as the Ministry of Labor does not have authority over the district level - leading to difficulty in law enforcement.
4. The country's low levels of connectivity. Hence, this resulted poor logistics system.
5. Burdensome and unclear administrative procedures contribute to import delays and invite corruption, undermining the competitiveness of industries.
6. Indonesia has a very open economy in terms of tariffs, but its non-tariff barriers (NTBs) remain significant.

# Policy Implications

- Modernization of agriculture
- Magic duet: industrialization and investment in infrastructure
- Set specific employment creation targets
- Labor intensive policies
- There should be a link between fiscal incentives and the use of domestic workers.
- Some incentives must be given to industries to encourage them to employ more local workers.
- The country needs further investments to boost the economy - to create more employment.

- Promotion of export oriented industry is one way to generate employment, especially for labor intensive manufacturing sector.
- A special treatment for unskilled labor and efforts to develop their capacity.
- The In-flow of capital and technology from abroad must be accompanied by the increasing numbers of qualified human resources.
- The workers certification system must be developed as soon as possible to deal with AEC.
- Mutual Recognition Arrangement (MRA) is also one way to increase the ability and skills of Indonesia's workers.
- Outsourcing system seems to be a common method for companies.

THANK YOU