



International
Labour
Organization
Jakarta

Indonesia:
Working out
of Poverty



**Promoting good governance
in the labour market by
strengthening tripartism
and social dialogue**

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In Preparation for the ILO's submission to the Poverty Alleviation Committee in Indonesia, a series of 12 (twelve) Technical Briefing Notes (TBNs) have been prepared which serve two purposes; first, as background documents, on issues and policy choices critical to poverty reduction and secondly, as building blocks towards a comprehensive report: "*Working Out of Poverty: an ILO submission for the Indonesia PRSP*".

This briefing note address ***Promoting good governance in the labour market by strengthening tripartism and social dialogue***. Other themes in series include the following:

- Employment dimensions of macro and sectoral policies;
- Decentralization and decent work: making the connection to the MDGs;
- Job creation and enterprise development (SMEs and local economic development);
- Youth employment: pathways from school to work
- Rural development: access, employment and income opportunities;
- Skills development for economic growth and sustainable livelihoods;
- Promoting the declaration on fundamental principles and rights at work;
- Eliminating the worst forms of child labour;
- Social protection for all;
- Migration: opportunities and challenges for poverty reduction;
- Gender and poverty.

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First published 2004

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ILO

*A Series of Policy Recommendations
Decent Work and Poverty Reduction in Indonesia, 2004*

ISBN 92 2 015540 0

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Printed in Jakarta, Indonesia

PROMOTING GOOD GOVERNANCE IN THE LABOUR MARKET BY STRENGTHENING TRIPARTISM AND SOCIAL DIALOGUE

“We urge(d) the government to prioritise good governance as a critical element of Indonesia’s poverty strategy. Unresolved governance issues stand in the way of ordinary people obtaining opportunities, justice and access to livelihood resources. These barriers create and perpetuate poverty. Better governance is the key to conflict resolution, growth and poverty reduction”¹.

After an especially deep financial crisis, Indonesia has succeeded in restoring macro stability – inflation is down, the exchange rate has strengthened and interest rates have declined sharply. In addition, the country’s fiscal position is on a sustainable path, the banking system has been stabilised and some progress has been made on structural reforms. Now that the basic groundwork for recovery is in place, Indonesia must accelerate growth in order to address the challenge of reducing the incidence of poverty and achieving the Millennium Development Goals. Creating a stronger investment climate is essential for achieving this growth. Policies that affect the investment climate – for foreign and domestic investors – will enable Indonesia to both compete with and develop policies to benefit from the growth of other countries (especially major competitor nations like China, Vietnam, the Philippines and Thailand).

Good governance is needed for improving competitiveness and investment in Indonesia

¹ Consultative Group on Indonesia, Mid Year Review June 2002, Report by the Working Group on Poverty Reduction.

Notwithstanding progress to date, the investment climate remains weak. Although financial market conditions have improved considerably, several high-profile legal cases focused observers' attention on the slow pace of reform in the legal and judicial sphere. The recent establishment of the Anti-Corruption Commission is welcome, but much will depend on its implementation and operation (similarly for the Supervisory Commission for Business Competition). Decentralization, which on the whole has proceeded relatively well, has also raised problems for both existing businesses and prospective investors, in the form of new and conflicting regulations and taxes. Investors have also expressed increasing concern about the framework for labour regulations and the trend of increasing minimum wages². Recent terrorist attacks have heightened concerns related to internal security. All this means that the Government must do all it can to improve the investment climate, enhance Indonesia's competitiveness and build growth prospects in the period ahead.

Historically, Indonesia's considerable economic strengths have made it an attractive destination for foreign investment: a large domestic market and labour force, abundant natural resources, a solid infrastructure, and a strategic location among some of the world's major trade routes. However, foreign direct investment flows into Indonesia remain at less than half their pre-crisis peak. Investment by Indonesians also remains weak, with the result that gross fixed capital formation in 2003 was still running significantly below its pace in 1997 (FDI stocks as a percentage of GDP have been on a downward trend since 2000 having fallen from 40.4% in 2000 to 32.2% in 2002³). According to the latest UNCTAD Inward FDI Performance Index,⁴ Indonesia lies in 138th place (out of 196 economies). In terms of competitiveness, Indonesia has dropped from 25th in 2002 to 28th in 2003 (out of 30 economies with populations greater than 20 million) in the IMD

2 A recent study by SMERU, a research institute, suggests that unemployment has been worsened by increases in the minimum wage, with every 10% increase in the minimum wage resulting in a 1% fall in formal sector employment. Minimum wages for workers in the formal sector have increased by 20% in real terms compared with their levels before the 1997-98 crisis (reported in the Economist Intelligence Unit Indonesia Country Report September 2003)

3 UNCTAD World Investment Report 2003

4 Ibid, ranked for 1999-2001: the ratio of a country's share in global FDI flows to its share in global GDP

World Competitiveness league table (China is 12th, South Korea is 15th and the Philippines is 22nd) and in terms of business efficiency (which includes a composite index of labour market variables) Indonesia was ranked the least efficient of all 59 economies surveyed⁵.

What then is most needed to restore market confidence, promote greater competition and support investment in Indonesia? Legal and judicial sector reform must be a critical element of any strategy to produce sustained improvement in the investment climate. Ensuring the effective operation of the newly-created Anti-Corruption Commission, passage of amendments to the bankruptcy law, and continued efforts to strengthen the commercial court are specific priorities. Continued care will need to be taken to ensure that decentralization does not lead to an unduly complex and unstable regulatory framework that discourages investors. Customs and tax administration, which are often reported to have deteriorated in terms of transparency, predictability, and fairness, are also frequently cited as disincentives for investment. A sensible labour market policy that strikes a balance between protecting workers' rights and preserving a flexible labour market in the context of a sound industrial relations policy is also important in light of recent concerns that have been expressed. These are some key areas where the Government will need to make a serious commitment to addressing problems if it is to have a significant impact on the overall investment climate: a sound industrial relations policy is an essential component of this and the focus of this TBN.

ELEMENTS OF GOOD GOVERNANCE

What is good governance?

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1. Participation

All men and women should have a voice in decision-making, either directly or through legitimate intermediate institutions that represent their interests. Such broad participation is built on freedom of association and speech – implying the need to fully implement ILO Convention 87 - as well as capacities to participate constructively.

5 See IMD World Competitiveness Yearbook 2003

2. Rule of law

Legal frameworks should be fair and enforced impartially, particularly the laws on human rights.

3. Transparency

Transparency is built on the free flow of information. Processes, institutions and information are directly accessible to those concerned with them, and enough information is provided to understand and monitor them. This is crucial for success in PRSP processes: information must be made available in a timely manner so that stakeholders can participate and contribute properly.

4. Responsiveness

Institutions and processes try to serve all stakeholders.

5. Consensus orientation

Good governance mediates differing interests to reach a broad consensus on what is in the best interests of the group and, where possible, on policies and procedures. This is a key objective of social dialogue and an especially important challenge for the social partners given their heterogeneous membership base.

6. Equity

All men and women have opportunities to improve or maintain their well-being and are given voice through their membership of representative organisations, like trade unions and employers' organisations.

7. Effectiveness and efficiency

Processes and institutions produce results that meet needs while making the best use of resources.

8. Accountability

Decision-makers in government, the private sector and civil society organizations – including trade unions and employers' organisations - are accountable to the public, as well as to institutional stakeholders. This accountability differs depending on the organization and whether the decision is internal or external to an organization.

9. Strategic vision

Leaders and the public have a broad and long-term perspective on good governance and human development, along with a sense of what is needed for such development. There is also an understanding of the historical, cultural and social complexities in which that perspective is grounded.

Source: Adapted from "Good Governance for the People Involving the People: Partnership for Governance Reform", Partnership for Governance Reform Secretariat, UNDP Indonesia.

Social dialogue plays a key role in achieving the ILO's objective of promoting opportunities for women and men to obtain decent and productive work in conditions of freedom, equality, security and human dignity. Social dialogue is defined by the ILO to include all types of negotiation, consultation or simply exchange of information between, or among, representatives of governments, employers and workers, on issues of common interest relating to economic and social policy. It can exist as a tripartite process, with the government as an official party to the dialogue or it may consist of bipartite relations only between labour and management (or trade unions and employers' organisations), with or without indirect government involvement. Consultation can be informal or institutionalised, and often it is a combination of the two. It can take place at the national, regional or at enterprise level. It can be inter-professional, sectoral or a combination of all of these. In each case, social dialogue is about building trust between parties with different interests who pursue common economic activities in the presence of asymmetric information.

Why social dialogue is a vital instrument for promoting good governance in the labour market

Typically, the principal vehicles for social dialogue are bipartite and tripartite committees. The new Manpower Act 13/2003 states that all companies with more than 50 employees are obliged to establish a bipartite cooperation committee which should function as a forum for communication, consultation and deliberation aimed at solving manpower problems at the enterprise level. In reality, however, most companies do not have these committees and in most of those that do, they do not appear to function very effectively⁶. Similarly, the

National Tripartite Council needs to be strengthened and (perhaps more significantly, given the decentralisation process) so do the regional tripartite committees.

The enabling conditions for social dialogue are as follows:

- ◆ Strong, independent workers' and employers' organisations with the technical capacity and access to the relevant information to participate in social dialogue;
- ◆ Political will and commitment to engage in social dialogue on the part of all the parties;
- ◆ Respect for the fundamental rights of freedom of association and collective bargaining.

*Appropriate
institutional
support*

Social dialogue institutions are often defined by their composition. They can be bipartite, tripartite or "tripartite plus". The key tripartite actors are the representatives of government, employers and workers. At times, and depending on specific national contexts, the tripartite partners may choose to open the dialogue to other relevant actors in society in an effort to gain a wider perspective, to incorporate the diverse views of other social actors and to build a wider consensus.

Social dialogue can take a variety of forms, ranging from the simple act of exchanging information to the more developed forms of consultation. The following is intended as a short list of the most usual forms of social dialogue.

Information-sharing is one of the most basic and indispensable elements for effective social dialogue. In itself, it implies no real discussion or action on the issues but it is nevertheless an essential part of those processes by which dialogue and decisions take place.

Consultation goes beyond the mere sharing of information and requires an engagement by the parties through an exchange of views which in turn can lead to more in-depth dialogue.

Tripartite or bipartite bodies can engage in negotiations and the conclusion of agreements.

While many of these institutions make use of consultation and information-sharing, some are empowered to reach agreements that can be binding. Those social dialogue institutions which do not have such a mandate normally serve in an advisory capacity to ministries, legislators and other policy-makers and decision-makers.

Collective bargaining is not only an integral – and one of the most widespread – forms of social dialogue, it can be seen as a useful indicator of the capacity within a country to engage in national level tripartism. Parties can engage in collective bargaining at the enterprise, sectoral, regional, national and even multinational level.

The main goal of social dialogue itself is to promote consensus building and democratic involvement among the main stakeholders in the world of work. Successful social dialogue structures and processes have the potential to resolve important economic and social issues, encourage good governance, advance social and industrial peace and stability and boost economic progress. Social dialogue is, therefore, both a means and an end in the quest for poverty reduction. It is an essential component of participatory processes inherent to the drafting of inclusive and meaningful PRSPs and the bedrock on which the foundations for an open, transparent and democratic society are laid.

The effectiveness of the ILO's tripartite structure is dependent on the strengths and capacities of the constituents. the Ministry of Manpower and Transmigration (DEPNAKERTRANS), the employers' organisation (APINDO) and the various workers organisations (trade union federations). The relative strengths and weaknesses of these organisations are well documented⁷ and it is not the purpose of this TBN to reflect on this. However, it is safe to say that both social partners face similar organisational and institutional challenges as a result of the democratisation and decentralisation processes which have transformed Indonesia over the recent

The social dialogue challenge in Indonesia and what it means for promoting investment and competition and reducing poverty

7 See, for example, Peggy Kelly, "Promoting Democracy and Peace through Social Dialogue", Infocus Programme on Strengthening Social Dialogue, ILO January 2002.

past. It is also safe to conclude that the Manpower Act 13/2003 and the Trade Union/Labour Union Act 21/2000 present great opportunities for strengthening the framework for industrial relations in Indonesia. The later gives effect to Indonesia's obligations under Convention 87 and the former provides a legal framework in relation to wages, social security, occupational health and safety, hours of work and holidays. It regulates industrial relations and details procedures for how to deal with collective work agreements and enterprise regulations.

Despite notional adherence to a *pancasila* industrial relations policy, the actual basis on which industrial relations policy was grounded pre-1998 was more centred on bureaucratic edict, a lack of transparency and openness and a tendency towards autocratic and sometimes coercive policies. In recent years there has been great improvement and the fact that Indonesia has ratified all eight ILO Core Conventions (the first country in Asia to do so) provides a sound basis for strengthening social dialogue and good governance in the labour market. However, there has been considerable negative publicity in Indonesia, with numerous media reports over recent years suggesting companies are pulling out of the country or threatening to do so because the country is no longer perceived as being a good place to do business.

These media reports have suggested that increased labour costs, problems with disputes and the uncertainty of the industrial relations environment combine to give investors real concern about doing business in Indonesia⁸. However, the reality and what is perceived to be reality is not necessarily the same thing. For example, overall, there is no evidence to substantiate the impression that labour disputes are on the increase (official data suggests that in the five year period 1998-2002 there were less strikes than in the five year period 1993-1997⁹). Nor is it clear that the increases in minimum wages levels are making Indonesia uncompetitive relative to her neighbours. Notwithstanding the fact that minimum wages still remain below those of the Philippines and Thailand

8 Patrick Quinn, "Freedom of Association and Collective Bargaining: A Study of Indonesia Experience 1998-2003", ILO Declaration Working Paper 2003

9 Ibid

and barely higher than those of Vietnam, when compared to GNP per capita – a rough indicator of productivity – Indonesia's minimum wage does not seem out of line with some of its competitors¹⁰. It should also be remembered that it is a bit difficult to talk of a single minimum wage in Indonesia because as part of the decentralisation process responsibility for fixing the minimum wage has been passed to the provincial and district levels. Rather than "labour market issues", what is probably of greater concern to most companies and investors is political uncertainty, security concerns and corruption.

Official statistics suggest that 27.3 million Indonesians are employed in the formal sector (out of a labour force of about 98 million) but it would be wrong to suggest that sound social dialogue benefits only the relatively small number of formally employed because – amongst other reasons - the formally employed are likely to support a large number of dependents, implying significant "multiplier effects" of any policies affecting the formal labour market. The amorphous nature of labour markets in low income countries imply that monetary benefits accruing to organised workers are likely to be passed on to others through, for example, remittances to rural areas, capital for micro enterprise activities, subsidisation of other members of the extended family, investments in social capital etc. When the broader impacts like these are taken into account, it can be argued that a frequent missing component in poverty reduction strategies is the governance of the labour market. Indeed a major factor that distinguishes those countries that are successful in reducing poverty and those that are not is the quality of governance in the labour market. Investing in social dialogue, then, is a key element in promoting a process of institutional change to improve the performance of labour markets and thus bring about pro-poor growth.

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The "conventional wisdom" that social dialogue (and, by extension, the Core Labour Standards) tend to raise labour costs (by more than productivity) and therefore reduce competitiveness is not born out by the evidence. With respect to the Core Labour Standards, a recent study concluded that there was no solid evidence in support of what has been

10 World Bank Brief for the Consultative Group on Indonesia: "Maintaining Stability, Deepening Reforms", Jan 2003.

referred to as the “conventional wisdom” that foreign investors favour countries with lower labour standards, with all evidence of statistical significance pointing in the opposite direction¹¹.

Rather, it is argued that the Indonesian PRSP should stress the importance of promoting investment and competition through sound industrial relations because by strengthening social dialogue and tripartism the Government will:

- ◆ Help promote social and economic stability (foreign investors put a high premium on predictability and stability because it reduces risk);
- ◆ Make markets work better by fostering transparency, information flows and institutional checks and balances;
- ◆ Reduce the waste of skills and capabilities which comes from disruption, high labour- turnover and discrimination at the workplace;
- ◆ Promote human capital formation by eliminating coercive forms of labour (child labour, forced labour, etc.)

Furthermore, if sound industrial relations help eliminate discrimination at the workplace, this may create new opportunities for marginalised groups – including women and indigenous peoples – so raising overall labour market participation rates.

Policy recommendations

The Government of Indonesia has promoted an inclusive and participatory process underpinning the development of the PRSP and it is expected that this will be continued into the final phases of drafting the PRSP and, thereafter into its implementation. The trades unions, the employers’ association (APINDO) and the Chamber of Commerce (KADIN) together with the Ministry of Manpower and Transmigration all have a crucial role to play.

The Government of Indonesia has made great strides in passing the legislation to underpin a sound industrial relations policy and has ratified all the core labour standards and Convention 144 on Tripartite Consultation. A strong basis exists to integrate social

11 David Kucera, “Core Labour Standards and Foreign Direct Investment,” *International Labour Review*, 141 (1-2).

dialogue into poverty reduction strategies and thereby to foster a sound enabling environment for attracting investment and promoting competition in the economy.

In the context of the PRSP, the ILO urges the Government to:

1. Strengthen the National Tripartite Council by ensuring that it is both representative (in line with the formula agreed upon in late 2002 under which representation would be extended to unions other than KSPSI/FSPSI) and operates on a regular basis with a defined mandate. Tripartite committees also function at the provincial and district levels and in line with Indonesia's decentralisation policy it is very important that sub national tripartite structures are also strengthened;
2. Implement recent and proposed labour law reform. The Manpower Act 13/2003 requires the development of many enabling decrees and regulations. More work is needed to develop an infrastructure for mediation, conciliation and arbitration as envisaged in the Industrial Relations Disputes Settlement Bill. Monitoring the application and impact of the new laws will be important in order to assess the extent to which they support the extension of the Core Labour Standards and improve the industrial relations environment;
3. Include indicators to measure the breadth and depth of participation in the preparation of the PRSP and in its implementation. They should be integral to the mechanisms/methodologies established to monitor and evaluate the overall implementation process.