

#### Assessing and addressing the Effects of Trade on Employment (ETE)

Trade negotiations – bilateral, regional or multilateral – routinely lead to debates on the implications for employment. There are promises of new and better jobs as well as concerns over job losses and pressure on wages and labour rights. Factual assessments of the employment and distributional impacts of trade agreements are, however, rare. The EU-funded ILO-project ‘Assessing and addressing the Effects of Trade on Employment’ tries to address this.

## TRADE AND EMPLOYMENT IN SERVICES IN INDONESIA

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Services have played an increasingly influential role in the Indonesian economy and employment since the Asian Financial Crisis. On both counts services now dominates other sectors. While most of the jobs are linked to domestic rather than international sources of demand, jobs created through exports are also significant in both modern and traditional segments of the sector.

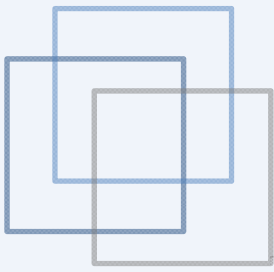
This study investigates the growth of services in Indonesia and linkages with other sectors in terms of value-added and employment, using statistics from the national accounts, trade and labour force data and input-output data. The authors analyse the following key propositions:

- Services are playing an increasingly major role in the Indonesian economy and employment.
- From the supply side, one crucial role of services in the economy and labour market is as inputs into tradable goods sectors.
- International migration is playing an important role in generating export earnings (remittances) in services, and improving the skill base at home.
- Increased productivity and competitiveness of services can be promoted through various modes of supply internationally.

► The study yields the following policy-related findings:

- First, benefits are predicted to flow from reforms that promote greater competition among domestic providers, by lifting more general regulatory restraints to trade.
- Second, both globally and within a regional framework, the main areas for reform is in regard to Mode 3. Greater engagement of foreign players would benefit Indonesia especially in distribution services.
- Third, less restrictive policies towards the deployment of skilled foreign manpower can have favourable effects on employment, as well as profiting business.
- Fourth, a regional set of common labour standards and rights for unskilled workers could be developed within an ASEAN or East Asian framework.



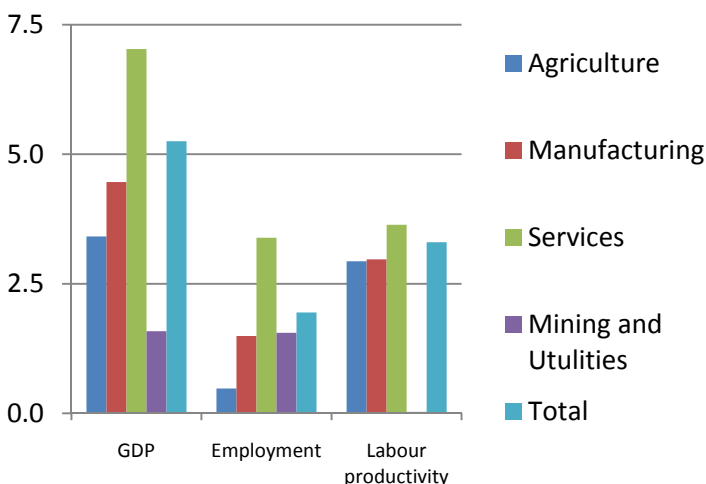


- What is the importance of the services sector and sub-sectors in Indonesia's economy?
- What characterizes recent service-sector employment in Indonesia?
- How does Indonesian services trade contribute to employment?
- What are the issues relating to Mode-4 services trade?
- Which service-sector reforms are predicted to benefit Indonesia and Indonesian workers?

## IMPORTANCE OF THE SERVICES SECTOR

The service sector largely carried the Indonesian economy during the recovery years after the Asian Financial Crisis (AFC). It is now the largest of the major sectors – bigger than agriculture and manufacturing combined. It provided more jobs than any other sector from the middle of the 2000s. The value of output in services grew almost twice as fast, and employment increased more than twice the rate recorded in agriculture, manufacturing and mining in the 2000s (Figure 1). In just one decade, the share of services to GDP rose from 44 to over 50 percent, and the employment share rose by a similar magnitude, to slightly less than 50 percent of all employment in 2010.

Figure 1: Annual Growth in GDP, Employment and Labour Productivity by Major Sector, Indonesia 2001-10 (% per annum)



Source: Statistics Indonesia, National Accounts and National Labour Force Survey (SAKERNAS) 2001 and 2010

The slower growth in manufacturing output after the AFC in 1997-98 has been a general phenomenon in Southeast Asia (Aswicahyono, Hill and Narjoko, 2008). Nevertheless, even from a regional perspective, one important

difference with several other Southeast Asian countries has been the slow recovery of industry in Indonesia after the AFC, relative to services. Services grew much faster than manufacturing in Indonesia in the 2000s, reversing the situation in the 1990s before the AFC. In contrast, industry continued to grow as fast as services in Thailand and Malaysia, even though both industries registered a much slower rate of growth than before the AFC.

It is important to bear in mind that overall labour productivity was lower in services than in manufacturing or mining, a feature of the sector that remained as true in 2010 as it did in 1990 (Manning, 1992). The sector is characterized by contrasting modes of production: low productivity, traditional segments – the ubiquitous street sellers, for example – coexist with modern segments that register much higher value added per worker.

In the transport sub-sector, the marked contrast between double digit annual growth rates in deregulated air transport contrasts with very slow expansion of over-regulated sea-transport and only moderate growth in road transport. The latter two activities feature prominently in the connectivity agenda in the Master Plan (MP3EI) for Indonesia's development 2011-2025 (Bappenas, 2011). However, institutional and regulatory reforms are necessary for these sectors to play a more dynamic role in linking regions and population centres.

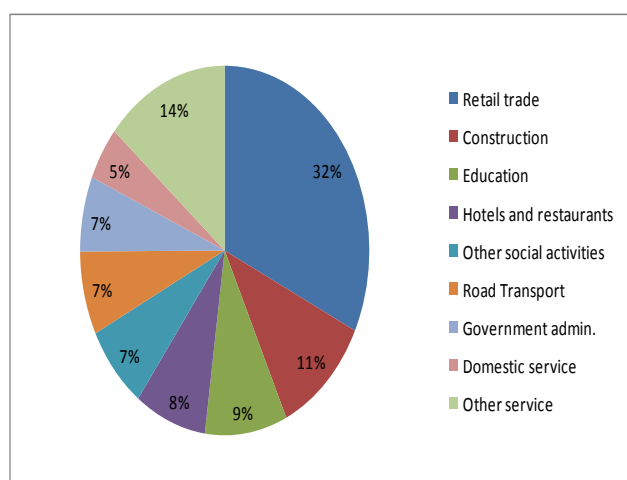
In the area of financial and business services, growth has been slow among banks that dominate the sector, whereas non-banking institutions have grown strongly. Rental markets and business services have also expanded quite quickly. While the former is symptomatic of a continuing boom in property markets, the latter supports a general picture of a quite dynamic business environment, despite a range of regulatory and institutional constraints.

The value of output from community, social and private services all grew quickly. The economy, diversified, and the middle class grew during the decade of the 2000s (World Bank, 2011). In contrast, government services grew quite slowly, especially from around the mid 2000s, as public revenue and spending struggled to keep up with an increasingly dynamic private sector.

## EMPLOYMENT IN SERVICES

Employees in service industries were marked by characteristics rather different from the stereotypes of the sector, which tend to focus on high levels of informality, and on services as an employer of last resort for rural 'surplus' labour. Compared with agriculture and manufacturing, service industries employed a higher percentage of white collar, formal sector and educated workers than the main tradable goods sectors. New private sector service activities engage well educated professionals, and coexist with traditional service activities in petty trade, transport and other services (especially domestic helpers). By far the largest sector of employment was trade, followed by construction, with education in third place (Figure 2).

Figure 2: Distribution of Employment in Main Service Sector Activities, Indonesia, 2010



Source: Statistics Indonesia, National Labour Force Survey (SAKERNAS) 2010

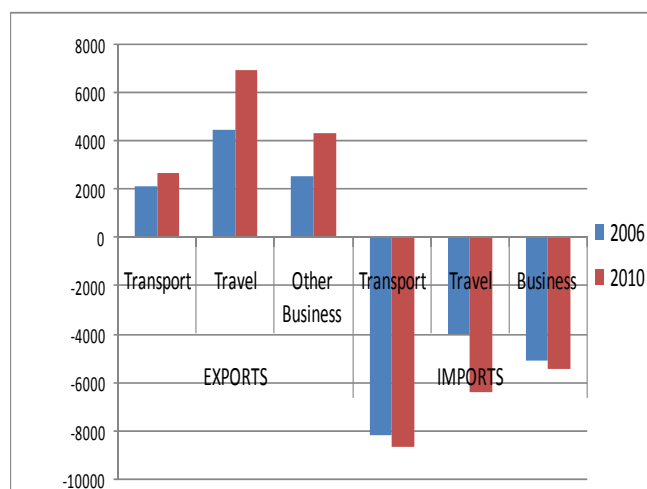
In the past five years, a period when employment in services has been growing quite strongly, overall, employment has shifted towards 'modern' services. At least senior high and often tertiary schooling is increasingly required for a 'regular' job. The number of professionals engaged in modern sector activities appears to have grown very strongly, by over 10 percent a year in 2005-10 after stagnating in the early 2000s. This is consistent with a significant expansion in the share of tertiary educated people employed over the same period from (2005-2010), from three to just under five percent, many of whom are working in the education and health sectors, as well as in trade.

However, in sectors where informal work is more pronounced, the share of informal workers has remained high and has risen in some sectors (e.g., construction) in the 2000s, as the demand for formal sector jobs has tended to stagnate (Manning and Purnagunawan, 2011). While the share of workers with only a primary level of schooling, or less, fell in the female dominated retail trade sector, it rose in construction and road transport, which are mainly the preserve of male workers.

## SERVICES TRADE AND EMPLOYMENT IMPACT

Services are an important part of Indonesia's global trade and thus have a significant impact on the domestic labour market and employment. This applies especially to employment generated through services exports, which grew at a moderate rate in the 2000s. Amounting to only slightly more than 10 percent of the value of total exports and imports, both exports and imports of services grew close to the same rate as commodity trade. Exports of services grew at close to ten percent per annum in nominal US\$ terms from 2000-2010. In contrast to commodity (goods) trade, Indonesia sustains a significant deficit in services trade. Imports at nearly US\$ 26 billion were almost twice the value of services exports in 2010. The absolute size of the deficit in services trade increased during the 2000s to just under \$10 billion in 2010 (nominal value). Both imports and exports mainly consisted of three groups of services: transport, travel and 'other' business services (Figure 3).

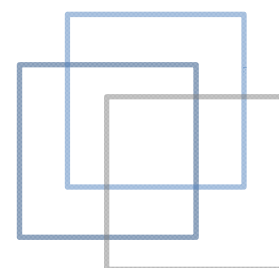
Figure 3: Exports and Imports of Services, Major Sectors, Indonesia 2006, 2010 (\$ million)



Source: Bank Indonesia, Balance of Payments Statistics, 2006 and 2010

Based on input-output tables, the share of exports from service activities was surprisingly high in 2005 at close to 20 percent of all the total (dollar) value of exports. Jobs in services accounted for slightly less than 20 percent of the total number of jobs created from export activities. **Perhaps surprisingly, the 7.1 million jobs supplied in services in relation to all exports (taking into account both direct and indirect linkages), was more than the total number of jobs created by all manufacturing exports (processed foods, light and heavy industry), which amounted to less than five million jobs.** The number of service jobs created through exports was only second to those generated in primary industries, and exceeded employment creation in manufacturing. Service sector jobs associated with exports dwarfed job creation in primary industries which accounted for only ten percent of all jobs created by exports in 2005.

Services play a significant role in the production of other sectors. Looking at exports, services inputs account for approximately 16 percent of the value of exported output. The large share of these costs come from domestically produced services, and a small part (less than two percent) from imports. Compared with their share in total employment, real estate and business services, and financial intermediaries account for a larger percentage of total costs. In contrast, trade costs only account for around a quarter of total costs. Road transport is also important in total costs in export industries. These are the areas where better (and often less) regulations and more competition have the potential to reduce the cost of exports, and have a positive flow-on effect on employment at home.



## MODE-4 SERVICES TRADE

In absolute terms, Indonesia has become a significant supplier of mainly unskilled, contract labour to East Asia and the Middle East in the past decade. It is also a destination country for skilled and professional temporary migrants mainly from Asia. Both flows make a significant contribution to welfare and growth, and help create jobs, even though both still account for a small share of the total work force.

Net movements of labour and international transfers are heavily in favour of labour exports (TKI). Remittances from out-migration are significant (Indonesia ranks among the top 20 countries in terms of the annual level of exchange earnings). Conversely, remittances of the earnings of foreign workers working in Indonesia amounted to smaller \$1.7 billion in 2010, although the average value of remittances are much higher for foreign labour (TKA) employed in Indonesia.

For TKI the two big, interrelated policy issues have been the low level of skills of workers going abroad and associated low levels of wages and poor working conditions that Indonesian workers experience overseas. Neither, it seems, can be solved overnight if Indonesia is bent on maintaining a high level of labour exports.

## SERVICES SECTOR REFORMS AND EMPLOYMENT

Regional trade agreements in ASEAN under the rubric of AFAS have promoted services trade through deregulation. The removal of some of the barriers to both foreign and domestic competition in services is likely to deliver significant gains in output and employment, for both domestic and overseas investors.

*First*, benefits are predicted to flow from reforms that promote greater competition among domestic providers, by lifting more general regulatory restraints to trade. Providing more access to foreign competition through liberalization of trade, capital and labour flows is only one aspect of deregulation. For example, in airlines and telecommunications, opening up of competition to domestic players have been behind both low prices and wider consumer choice.

*Second*, both globally and within a regional context, the main areas for reform are in Mode 3. Greater engagement of foreign players would benefit Indonesia especially in distribution services. But gains in employment can also be made through opening up

telecommunications, maritime transport and education services over the medium to longer term. Some of these reforms involve lifting restrictions on foreign participation. They would need to be introduced judiciously to avoid disruption of existing domestic players. A special strategy may be required for the opening up of vulnerable state enterprises to domestic as well as foreign competition.

*Third*, less restrictive policies towards the deployment of skilled foreign manpower can have favourable effects on employment, as well as profiting business. The engagement of foreign workers has risen in Indonesia in recent years, and this appears to have filled a gap in the supply of highly skilled manpower to meet growing and new demands. The rationale for a more liberal policy towards the deployment of foreign professionals lies in creation of more jobs domestically. Complementary policies, such as those designed to improve the quality of tertiary institutions, may be required to ensure that the necessary skilled and professional manpower are available to optimize the utilization of foreign manpower.

*Fourth*, an area of potential reform is to develop a regional set of common labour standards and rights for unskilled workers (currently not covered under AFAS) in the main industries of labour migration in ASEAN. From Indonesia's perspective, it would make good sense to extend the framework beyond ASEAN to all of East Asia, so that it also covers the main migrant receiving countries: Hong Kong, Taiwan and Japan. However, the government may need to develop a more consistent approach to labour rights' issues at home and abroad, if Indonesia is to champion a regional approach for better protection of unskilled migrant workers.

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