

Wage trends in Indonesia

Indonesia has sustained over a decade of economic growth and growth in wages and regular wage employment continue to outperform most other countries in the world. To illustrate, growth trends continue for regular employees,¹ with 42.4 million people or 37.0 per cent of those employed working as regular employees (see Table 1). Growth in nominal wages has been constant, while gains in real terms are still being realized. Labour productivity has been increasing gradually. Gains in labour productivity and constructive dialogue on gains sharing are important for Indonesia, as they can translate into better quality jobs, including better wages and working conditions that are critical for raising living standards.

Table: Key labour market indicators

Variable	2011	2012	2013	2014
Employment (millions)	108.2	113.0	112.8	114.6
Regular employees (millions)	37.8	40.9	41.1	42.4
Casual employees (millions)	11.1	11.7	11.3	11.5
Simple average minimum wage (IDR thousands) ¹	988.8	1,088.9	1,288.4	1,494.1
Average wage for employees (IDR thousands)	1,552.5	1,636.0	1,917.2	1,925.6
GDP (constant 2000 prices, trillions)	2,456.7	2,618.9	2,770.3	NA
GDP per employed person ²	22.7	23.2	24.6	NA
Consumer price index (average annual, 2007=100)	127.4	132.9	142.2	113.2

Source: BPS (2014) Labourer situation August 2014, Badan Pusat Statistik, Jakarta. 1 Simple national average of provincial minimum wages in nominal prices. 2 Trillions, IDR constant 2000 prices.

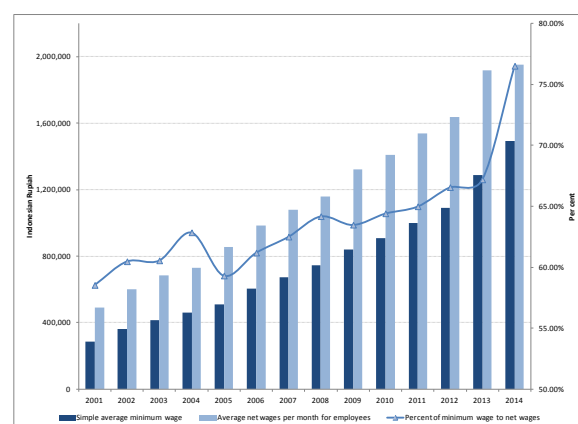
While minimum wages noticeably increased between 2012 and 2014, average wages have not maintained the same pace of growth.² This trend highlights that the minimum wage fixing

1 According to BPS an "employee is a person who works permanently for another person or institution/office/company and gains some money/cash or goods as wage/salary. Workers who have no permanent employer are not categorized as an employee but casual labourer. A casual laborer can be considered to have a permanent employer if he/she has the same employer during the past month or 3 months for the construction sector."

2 In August 2014 the simple average national minimum wage was estimated at IDR 1,494,134, while the average wage for regular employees was estimated at IDR 1,952,589. In January 2015 the UN conversation rate was USD 1 = IDR 12,441. Therefore, the simple average national minimum wage was equivalent to USD 120 and the average wage for regular employees was equivalent to USD 157. High inflation over the period has meant that gains observed in nominal wages have not always translated well in real terms.

mechanism is still the most predominant mechanism through which wage increases are achieved in Indonesia. This situation has led to a narrowing of the gap between average minimum wages and average wages over time. To further emphasize, in 2001 the simple average minimum wage for Indonesia was 58.5 per cent of the average wage for regular employees and by August 2014 this ratio had increased to 76.5 per cent (see Figure 1).

Figure 1: Trends in minimum and average wages for Indonesia, 2001-2014



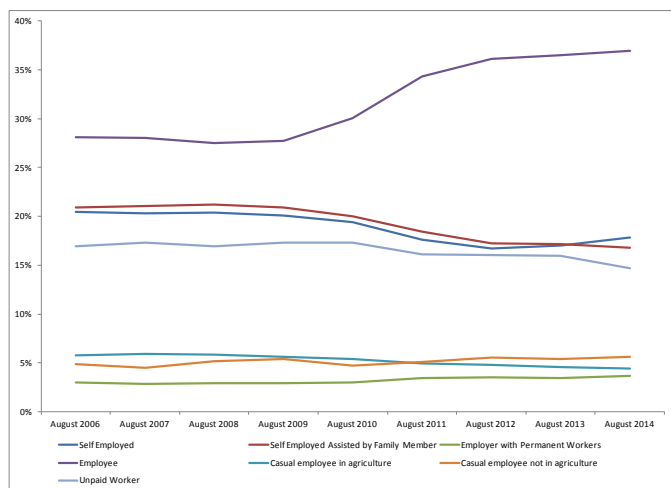
Source: BPS (2014) Labourer situation in Indonesia: August 2014, Badan Pusat Statistik, Jakarta. * ILO staff calculations based on revised population weights and backcast for 2011-2014.

Further analysis of wages shows that the situation of those employed in more vulnerable forms of employment, including casual work and own account work, has been mixed. In August 2014, the average earnings of casual workers and the self-employed was 51 per cent and 68 per cent of regular employees' average wage respectively. While in 2001 it had been 45 per cent and 75 per cent respectively.³ This trend indicates that casual workers have been able to improve their position over the period, mostly due to increases in the number casual workers employed outside the agricultural sector where wages are higher. However, the situation for own account workers has declined in comparative terms.

3 World Bank (2014) Indonesia Economic Quarterly, March 2014: Investment in flux, World Bank Country Office for Indonesia, Jakarta.

However, an important trend to note here is that the absolute number and share of people working as casual or self-employed workers (vulnerable employment) has decreased over time, as regular wage employment has expanded throughout the economy. Figure 2 depicts the trend over time. A related point is that the number of employers that hire permanent employees has also increased over time, from 3.0 per cent in August 2006 to 3.6 per cent in August 2014. Trends related to formal employers and regular employees therefore seem to be positively related.

Figure 2: Status in employment, 2006-2014



Source: BPS (2014) Labour force situation: August 2014, Badan Pusat Statistik, Jakarta

Trends in wage equality in Indonesia

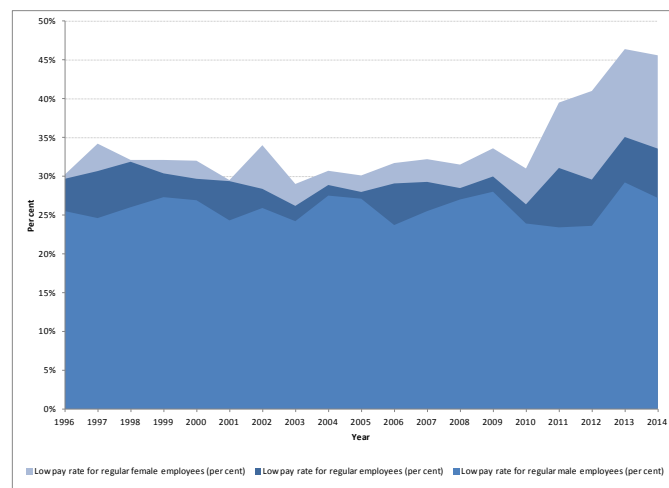
In addition to reviewing trends on wage growth and regular wage employment, it is important to understand the distributional characteristics of wage trends. For instance, in August 2014 the average wage for regular employees was IDR 1,952,589, and 66.4 per cent of regular employees earned below this wage. The median wage for regular employees was IDR 1,425,000 in the same period,⁴ which is substantially lower than the average wage - indeed it is closer to the prevailing levels of minimum wages. The discrepancy between the two figures indicates that the distribution of regular employees by wage level is highly skewed, with a high incidence of regular employees earning low pay.

Low pay is defined as the proportion of regular employees whose wage equals less than two-thirds of the median wage of regular employees. It is a measure that can help to gauge growth in income gaps. Two-thirds of the median wage, the benchmark for estimating low pay, was IDR 950,000 in August 2014. Analysis indicates that one in three regular employees (33.6 per cent) in Indonesia receive a low wage, with low wage employment accelerating in recent years, particularly

4 That is, half of regular employees earned below this level.

for women (see Figure 3). Low-wage workers also tend to be disproportionately female, with this trend likely reflecting the increasing number of women shifting out of unpaid family work onto part-time contract work as an employee. The low pay trend highlights that further efforts are needed to bridge the gender pay gap in Indonesia.

Figure 3: Percentage of regular employees with low pay, 1996-2014



Source: ILO staff calculations based on data from the labour force survey from Badan Pusat Statistik for selected years.

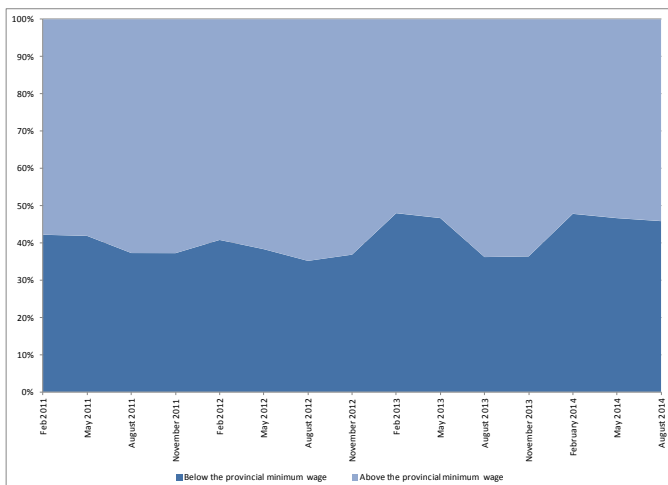
The high incidence of low pay in Indonesia is a concern as low pay increases the risk of vulnerability. In many countries low wage employment often acts as a stepping stone to entering into higher paying work, however for many Indonesian workers low wage employment tends to be the norm rather than a springboard. Analysis of low pay in Indonesia points to a situation where wage growth has been lagging, rather than a situation where minimum wage growth has been too high. In a situation where a large proportion of workers are receiving low pay, with little prospect of catching up to those in work with higher levels of remuneration, there is a greater risk of industrial conflict.

Specific policies are needed to address the high incidence of low wage work in Indonesia, as higher rates of economic growth do not alone guarantee progress in this area. Reducing the incidence of low pay is also important for strengthening the competitiveness and productivity of the Indonesian labour force, as low wage work can be associated with the deterioration of workers' skill and can also signal to employers that such workers have low productivity. Both of these factors reduce the likelihood that low wage workers will gain access to employment with higher levels of remuneration.

In addition, the high incidence of low pay in Indonesia may be related to the issue of minimum wage compliance, with 45.9 per cent of regular wage employees receiving wages below the lowest wage that is permissible by law in August 2014 (see Figure 4). Wage compliance displays a cyclical pattern throughout the year, with compliance at its lowest in

February and highest in August, suggesting a lag time in the application of adjustments in annual minimum wage increases within enterprises. Policies to address the issue of low pay and minimum wage compliance include strengthening labour market institutions, particularly labour inspection and wage bargaining institutions, to ensure compliance with minimum wage levels and other labour regulations.

Figure 4: Percentage of employees below and above the provincial minimum wage, 2011-2014



Source: BPS (2014) Labourer situation in Indonesia: August 2014, Badan Pusat Statistik, Jakarta.

Due to the nature of the labour market in Indonesia, which is characterized by a high incidence of low pay, persistent vulnerable employment, as well as limited capacities for labour inspection, the minimum wage falls short of fulfilling its role as a safety net wage. This means that the benefits of economic growth and formal wage setting systems do not necessarily trickle down to the working poor, who often work in the informal economy in rural areas where it is difficult to enforce labour regulations. Box 1 further discusses minimum wages in Indonesia.

Box 1. Minimum wages in Indonesia

Minimum wages in Indonesia are determined through an annual process led by decentralized wage boards that consist of workers, employers and government, which estimate the amount needed for workers to achieve a “minimum decent standard of living” or the “kebutuhan hidup layak” (KHL) for a particular province or district. The important role that the KHL plays in minimum wage determination in Indonesia creates a tense environment for industrial relations. Workers and employers often have varying views in regard to the number of items,⁵ and the prices of the items, that should be included in the assessment of minimum decent living standards. However, the final decision on the annual minimum wage for particular

5 The number of items included in the assessment for decent minimum living standards increased from 45 to 60 items in 2012.

provinces or districts is political and is the responsibility of the Governor or Mayor.

As the regulatory environment for minimum wage setting in Indonesia is decentralized and allows for the establishment of minimum wages by province and district, as well as minimum wages for sectors and occupations within districts or provinces, discrepancies have emerged. For example, there is considerable disparity in the level of minimum wages across Indonesia, with Central Java having the lowest minimum wage (IDR 910,000) and DKI Jakarta having the highest minimum wage (IDR 2,441,301) in 2014 - 2.7 times higher even though the provinces are only 300km apart in distance. Strengthening coordination mechanisms may therefore be useful for supporting equitable growth between provinces in Indonesia.

The focus on minimum wage setting has also seen some exceptional cases emerge. To illustrate, in one district in West Java province a minimum wage has been set for the manufacturing of zippers within the textile and garment industry. In this situation, it may have been more efficient for workers and the employer to directly negotiate over wages, rather than using the minimum wage fixing machinery. However, limited experience in wage bargaining means that the more familiar and legal binding tool of minimum wage setting is often preferred. This leads to a situation where a multitude of minimum wages may exist for specific contexts where it may be more efficient to develop collective bargaining agreements. Hence the importance of encouraging wage bargaining between workers and employers, in order to allow the minimum wage to fulfilled its function as a safety net wage.

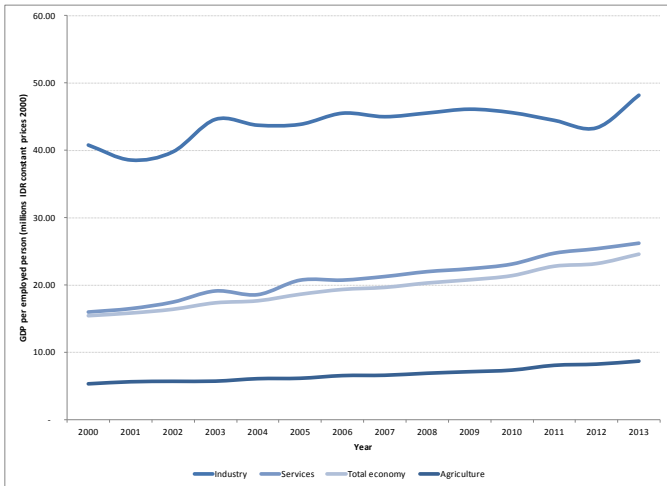
Trends in labour productivity

Gains in labour productivity are essential for the economy as a whole to maintain competitiveness. With the majority of those employed in Indonesia working long hours in jobs with low wages, improving productivity is an essential ingredient for moving towards a more competitive and prosperous economy. Labour productivity, defined as GDP per employed person, has been increasing gradually over time in Indonesia, with productivity in the industrial sectors nearly double that of the services sector and quadruple that of the agricultural sectors (see figure below).⁶

6 Labour productivity defined as GDP per employed person is not an ideal measure. It is preferable to use economic data on value added and compensation of workers, however this is only available for selected years. The latter measure provides a more robust assessment as it takes into consideration factors such as unpaid family workers, which comprise 16 per cent of employed persons in Indonesia.

For example, between 2005 and 2009 productivity expanded at an average annual rate of 3.3 per cent. Between 2010 and 2013 productivity expanded by average annual rate of 4.3 per cent. This trend has been supported in part through investments in infrastructure, as well as structural changes that have seen the expansion of employment in higher value-added industrial sectors and the contraction of employment in lower value-added agricultural sectors.

Figure 5: GDP per employed person 2000-2013⁷



Source: ILO staff calculations based on data from the labour force survey and national accounts from Badan Pusat Statistik for selected years.

As the manufacturing sector is a strong engine for both economic and employment growth in Indonesia, it is important to understand factors that are driving trends within the sector. Box 2 therefore further discusses productivity trends in manufacturing in Indonesia.

Box 2. Labour productivity - the case of manufacturing in Indonesia

The manufacturing sector is an important sector for the Indonesian economy. It is highly diverse, with significant differences between the performance of large and medium (LM) establishments and the micro and small (MS) enterprises, particularly in regard to employment growth, job quality and labour productivity.

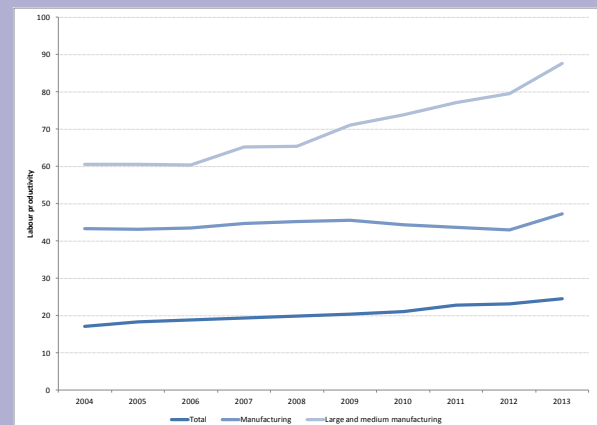
The manufacturing sector is the second largest contributor, after the service sector, to regular wage employment. This regular wage employment is concentrated in the large and medium sized establishments.² Regular wage employees in the such establishments are likely to receive higher wages, have terms of employment that comply with labour regulations, have better access to social security, and have higher chances of being involved in labour unions.

Moreover, large and medium sized establishments are likely to innovate, attract foreign direct investment and embark on technology transfers. These characteristics are critical to the dynamism of the economy and provide an essential source of growth. By contrast, the micro and small establishments suffer the opposite characteristics, with much lower productivity and their workers receiving far lower wages.

To further emphasize, while the overall average real earnings of workers in the manufacturing sector only mimic the real average earning of workers in the overall economy, the level of average real wage received by workers employed in the large and medium establishments is much higher, approximately twice average real wage in the overall economy. In addition, while employment growth has been picking up in the overall manufacturing sector, large and medium firms have had comparatively lower rates of employment growth.

In regard to labour productivity, it is observed that despite the wage level in manufacturing being similar to that of in the overall economy, labour productivity within the manufacturing sector is double that of the overall economy (see figure below). Building on this, labour productivity in large and medium establishments is approximately twice of that productivity in the general manufacturing sector and around three times higher than labour productivity in the overall economy. Here it is important to note that workers in large and medium establishments receive wages approximately twice as high as workers in the overall economy. This signals that higher productivity can lead to higher wages.

Figure 6: Labour productivity (Value added per worker, IDR million, 2000 constant prices)



Source: Calculated from BPS data (National Accounts and manufacturing Statistics)

Given the fact that large and medium establishments have low employment growth while enjoying much higher productivity and wages level, the opposite must be true for micro and small establishments.

⁷ Defined as GDP (constant prices 2000) per employed person. Agriculture includes the Agriculture, Forestry, Hunting and Fishery sector. Industry includes i) Mining and Quarrying, ii) Manufacturing, iii) Electricity, Gas and Water, and iv) Construction. Services includes i) Wholesale Trade, Retail Trade, Restaurant and Hotels, ii) Transportation, Storage and Communication, iii) Financing, Insurance, Real Estate and Business Services, and iv) Community, Social, and Personal Services.

This situation highlights several challenges for policy makers. **First** is how to increase employment growth in large and medium establishments, in order to open greater access to more quality jobs and in doing so allow workers to move out of lower wage and lower productivity sectors. For this, the overall expansion of the large and medium establishments is critical. **Second** is how to increase productivity of the micro and small establishments, in hope that the productivity gains would positively influence wage levels.

To emphasize, the manufacturing sector remains an important economic sector for the dynamism of the economy and is a source of quality employment. Within the sector, large and medium establishments play an important role as they are better situated in terms of achieving productivity growth and wage growth, attracting skills investment and technology transfers, providing social protection and fostering social dialogue. The challenge is on creating sufficient employment growth in these establishments. On the other hand, while micro and small establishments have higher employment growth, they are disadvantaged on the other characteristics. Strategies strengthening micro and small enterprises, particularly “home based industries”, will be highly important for strengthening competitiveness and productivity of the manufacturing sector in the future.

- ◆ Labour productivity has been increasing gradually over time and it is important that gains in labour productivity are shared between workers and employers. **Productivity gains sharing** can be implemented through mechanisms such as wage increases, improving working conditions, shorter working hours and/or investment in human resources. For employers, linking real wage growth to productivity gains implies stable real unit labour costs (and profit growth in line with productivity).
- ◆ With the large share of people working in low-paid jobs that have non-standard work arrangements, greater focus needs to be given to addressing the **challenge of employment quality** as progress in this area is likely to have significant development dividends, including gains on gender equality.
- ◆ Labour productivity increases can be optimized through **building the capacity of tripartite constituents** for engaging with wage-setting institutions. Building capacity can help to ensure that gains are shared, therefore reinforcing equitable growth while supporting enterprises to upgrade and enhance productivity.
- ◆ It will also be important to support **coordination** on wage setting, along with strengthening the **implementation** of regulations, in order to improve compliance and promote equitable growth across provinces.

In summary, to sustain economic and labour market momentum, a focus on employment creation, job quality and labour productivity is needed.

Policy implications

The pattern of economic growth since 2010, coupled with growth in wages and growth in regular wage employment, has played an important role in the shift towards a formal economy for Indonesia. However, it is clear that the recent gains made in wages have not translated for all workers. To illustrate, one in three regular employees in Indonesia still earns a low wage. Specific policies are needed to address the high incidence of low wage work, particularly as low compliance may be linked to low pay.

A number of implications arise from review of wages and productivity in Indonesia, including:

- ◆ Growth trends in wages reflect the strong reliance on minimum wage fixing and highlights the need to **strengthen collective wage bargaining** in order to promote the growth of average wages.

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Annex I: Statistical appendix - Wage indicators 2006-2013

Variable	2006	2007	2008	2009	2010	2011	2012	2013	2014	Five year average
National simple average minimum wage (nominal)	602,700	673,300	743,200	839,400	908,800	988,800	1,088,903	1,288,400	1,494,134	NA
Average net wages per month for regular employees (nominal)	985,028	1,077,312	1,158,085	1,319,930	1,410,982	1,536,960	1,635,965	1,917,152	1,952,589	NA
National simple average minimum wage (real)	641,170	673,300	674,410	729,279	751,074	776,138	819,340	906,048	1,319,673	NA
Average net wages per month for regular employees (real)	1,047,902	1,077,312	1,050,894	1,146,768	1,166,101	1,206,405	1,230,974	1,348,208	1,724,597	NA
Growth in average real minimum wages	NA	5.01%	0.16%	8.14%	2.99%	3.34%	5.57%	10.58%	45.65%	13.61%
Growth in average real wages for regular employees	NA	2.81%	-2.45%	9.12%	1.69%	3.46%	2.04%	9.52%	27.92%	8.92%
Consumer Price Index	94	100	110.2	115.1	121	127.4	132.9	142.2	113.22	NA

Annex II: Labour productivity growth 2006-2013 (per cent)

Sector	2005	2006	2007	2008	2009	2010	2011	2012	2013	Average
Total	7.5	2.6	2.3	3.2	2.3	3.8	7.9	1.7	6.0	4.1
Manufacturing	-0.2	0.7	2.6	1.4	0.7	-2.7	-1.6	-1.6	10.2	1.1
Large and medium manufacturing	0.2	-0.3	7.7	0.4	8.7	4.0	4.4	3.0	10.2	4.3

Annex III: Employment and employment shares, 2001-13

Sector	2005	2006	2007	2008	2009	2010	2011	2012	2013
Total	95,356,277	98,018,099	101,853,665	104,642,625	107,070,256	109,589,715	108,165,761	113,011,621	112,761,072
Manufacturing	11,380,551	11,815,089	12,052,112	12,325,295	12,512,148	13,474,059	14,540,124	15,618,481	14,959,804
LM Manufacturing	4,226,572	4,755,703	4,624,937	4,457,932	4,345,174	4,501,145	4,629,369	4,928,839	4,382,908
Employment shares (%)									
Total	100	100	100	100	100	100	100	100	100
Manufacturing	11.9	12.1	11.8	11.8	11.7	12.3	13.4	13.8	13.3
LM Manufacturing	4.4	4.9	4.5	4.3	4.1	4.1	4.3	4.4	3.9

Source: BPS (2014) Labourer situation in Indonesia: August 2014, Badan Pusat Statistik, Jakarta.