



ASEAN Community 2015: Managing integration for better jobs and shared prosperity



International
Labour
Organization

Avoiding the middle income trap in Indonesia through a more inclusive labour market and deeper ASEAN integration

Indonesia Country Brief | August 2014

The Association of Southeast Asian Nations (ASEAN) is a dynamic and diverse region.¹ It enjoyed remarkable economic growth in recent decades but also witnessed rising inequality and the persistence of poor quality jobs. By 2015, the ASEAN Economic Community (AEC), envisioned as a single common market and production base, will become a reality. Trade and investment liberalization will impact the structure of economies, jobs, skills, wages, and labour mobility.

Indonesia accounts for more than one-third of the ASEAN economy and nearly two-fifths of the region's workforce.² Deeper integration under the AEC could help the country avoid the middle income trap by unlocking new opportunities for growth and prosperity and catalyzing the transition to a higher-value economy. However, the benefits of the AEC will be distributed unevenly, which has the potential to exacerbate existing inequalities between regions and sectors and between women and men.

This is of particular concern for Indonesia given growing income disparity over the past two decades. Between 1991 and 2011, inequality, as measured by the Gini coefficient, increased from 29.2 to 38.1. Uneven regional economic growth has led to an expanding gap between provinces and regions, especially between West and East Indonesia. In addition, significant gender inequality persists as evidenced by the 33-percentage point gap in labour force participation rates between women and men (see Table 1). Young jobseekers are also at a distinct disadvantage in the labour market, and high youth unemployment could squander Indonesia's looming demographic dividend.

To realize the benefits of deeper ASEAN integration, Indonesia must ensure a more inclusive labour market. Coordinated and coherent policies must be enacted to invest in rural infrastructure, support more productive jobs in key sectors, improve the quality of education and training systems, link wages to productivity, and enhance the coverage and depth of social protection.

Table 1: Selected economic and labour market indicators in Indonesia

	2011	2012	2013
GDP growth rate (%)	6.5	6.3	5.8
Merchandise trade (% of GDP)	56.1	54.8	41.5
Output per employed person, PPP (constant 2005 international \$)	9 130	9 486	9 848
	Total	Male	Female
Total employment (thousand)	112 760	70 330	42 430
Labour force participation rate (%)	66.9	83.6	50.3
Unemployment rate (%)	6.2	6.1	6.5
Agriculture share of total employment (%)	34.8	35.6	33.4
Vulnerable employment rate (%)	50.1	45.1	58.5
Average monthly wages (US\$)	174

Note: "..." indicates data are not available; all labour market indicators cover the population ages 15 and above and reflect 2013 data except average monthly wages (2012); vulnerable employment defined as own account and contributing family workers.

Source: ADB and ILO: *ASEAN Community 2015: Managing integration for better jobs and shared prosperity* (Bangkok, ILO, 2014), Annex F.

The AEC could create an additional 1.9 million jobs in Indonesia and accelerate structural change to higher productivity sectors

Model simulations suggest that deepened trade integration under the AEC could lead to considerable economic and job gains in Indonesia (see Figure 1).³

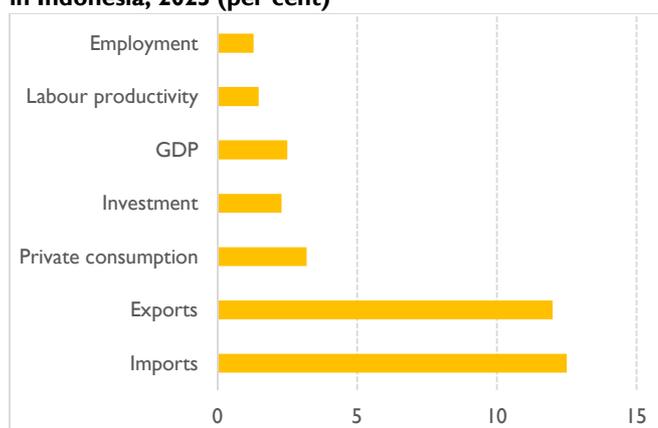
¹ This research brief is based on ADB and ILO: *ASEAN Community 2015: Managing integration for better jobs and shared prosperity* (Bangkok, ILO, 2014).

² Source: IMF: World Economic Outlook Database (Apr. 2014) and ADB and ILO, op. cit., table F1-I.

³ See ADB and ILO, op. cit., chapter 3.

The model projects that the AEC policy measures could expand Indonesia's GDP by 2.5 per cent by 2025, compared to a baseline scenario without deeper integration. In addition, simulations show a net increase of 1.9 million jobs over the baseline, however this represents only 1.3 per cent of total employment. Women account for just 27 per cent of expected job gains – a disparity that threatens to worsen the current gender gap. This highlights the need for careful management and monitoring of the gender impacts of ASEAN integration in Indonesia.

Figure 1: Change in various economic and labour market indicators under the AEC scenario relative to the baseline in Indonesia, 2025 (per cent)



Source: ADB and ILO, op. cit.

In the past twenty years, the labour market has undergone significant structural shifts. There has been a substantial decline in the significance of agriculture which has been overtaken by services. Between 2003 and 2013, 71.9 per cent of additional jobs created have been in wholesale and retail trade, hotels and restaurants and in community, social, personal and other services. A key challenge is that labour productivity in these particular service sectors is lower than in manufacturing and only 1.6 to 1.7 times higher than in agriculture.

The AEC could accentuate these sectoral patterns of employment. Increases in employment under the AEC relative to the baseline are accompanied by the expansion of the trade and transportation, construction, metals, chemicals, and textiles sectors and the decline of the food processing sector. Absolute gains in agriculture are also expected; however, the relative share of employment in agriculture will decline as job gains in industry and services will be greater. Although the structural transformation will occur towards sectors with higher levels of productivity relative to agriculture, these sectors are often prone to vulnerable employment and informality. The prospect of large gains in such

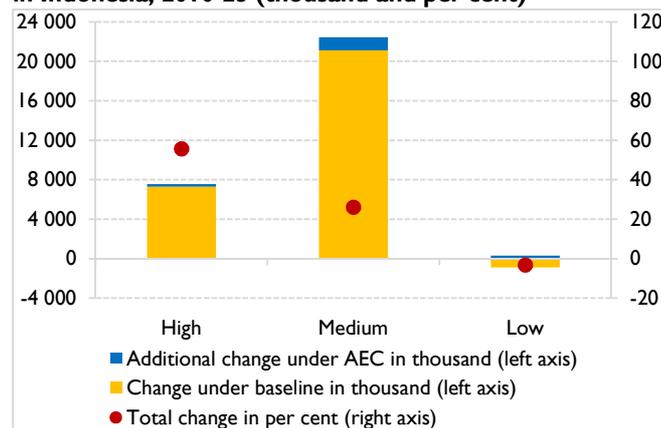
jobs calls for coordinated labour market policies to improve working conditions and reduce vulnerability.

Structural change inevitably causes a churning in the labour market – creating increases in demand for some jobs while decreasing demand for others. There is a risk that displaced workers will be unable to gain employment in more productive sectors. This could worsen inequality and trap such workers in vulnerable employment. Mitigating the adjustment costs and inequalities associated with structural transformation requires the implementation of well-designed industrial and sectoral policies, robust social protection floors, policies to support smaller enterprises, and further investments in skills and training.

Skills mismatches could worsen

Structural change under the AEC can help move Indonesia up the competitiveness ladder towards more skill-intensive production and exports, reflecting higher labour productivity.⁴ Projections indicate that between 2010 and 2025, high-skill employment in the country could increase by an additional 55.7 per cent, approximately half of the potential high-skill employment growth in the ASEAN region (see Figure 2). Growth in demand for medium-skill employment is lower at 26.1, while the demand for low-skilled jobs will contract by 3.2 per cent.

Figure 2: Estimated change in employment by skill level in Indonesia, 2010-25 (thousand and per cent)



Source: ADB and ILO, op. cit.

Meeting the demand for high-skilled workers will not happen automatically. Realizing these opportunities requires strengthening the access, quality, and relevance of education and training systems, addressing skill mismatches, and ensuring that the

⁴ See ADB and ILO, op. cit., chapter 4.

most vulnerable have the competencies needed to compete for jobs.

In many of these aspects Indonesia faces some notable challenges. More than 900,000 Indonesian children of primary school age are not in school. These children risk becoming child labourers and are unlikely to secure decent employment in the future. However, Indonesia has made progress in boosting lower secondary education, primarily for girls in poor rural areas. This has occurred as a result of initiatives to provide scholarship grants, supplementary feeding, assistance with transportation, and separate sanitation facilities.

In addition to access, improvements in the quality and relevance of education would help to meet the demands of the fast-changing labour market and address skills gaps. Model estimates suggest that workers with insufficient qualifications will fill 63 per cent of all high-skill employment (13.3 million positions) in Indonesia by 2025. In addition, a 2013 ILO survey of ASEAN enterprises and business associations concluded that only 35.3 per cent of respondents agreed that secondary school graduates and 41.2 per cent of tertiary education graduates in Indonesia were equipped with the relevant skills needed by their enterprises.

Skills development policies can not only correct skill mismatches but also provide a pathway for the most vulnerable segments of the labour market to access better quality jobs. In this regard, too many young women and men in Indonesia face a difficult transition from the classroom to the workplace. Youth unemployment is 21.6 per cent, the highest in the region and more than three times the overall unemployment rate in the country. Indonesia is currently in a demographic transition where it has a high working-age population relative to the ageing, dependent population. To optimize this demographic dividend, it is essential that youth have the appropriate skills required by the labour market, as well as support in school-to-work transition. If young people are unable to secure decent work, the demographic dividend could turn into a demographic liability.

Stronger collective bargaining can ensure workers benefit from higher productivity

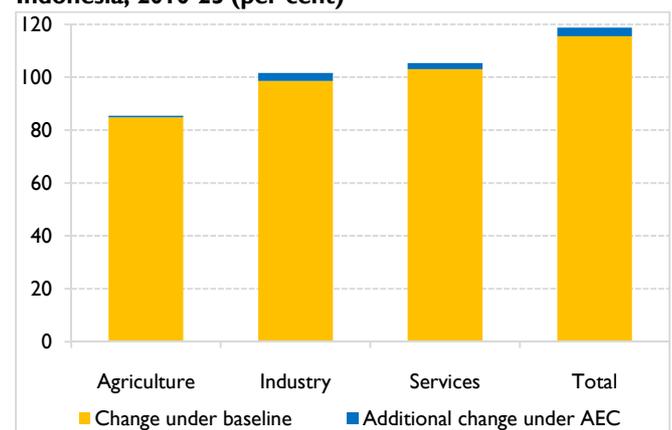
As workers move towards higher levels of skills and drive gains in productivity, they should benefit through

higher wages.⁵ Owing to their large contribution to household income, wages are the key mechanism to ensure growth translates into shared prosperity and equitable development. In Indonesia, the share of wage employees has been growing rapidly, from 31 per cent of total employment in 1993 to 47 per cent in 2013.⁶

Real wages have risen in recent years, in large part due to increases in minimum wages. Despite these trends, average monthly wage levels in 2012 were low in Indonesia at \$174 (or 1.6 million IDR). This contrasts with average monthly wages of \$3,547 in Singapore, \$609 in Malaysia, and \$357 in Thailand. Furthermore, large differentials in wage levels exist in Indonesia and are continuing to grow between wage earners, including across skill levels. One way to measure wage inequality is to compare the monthly earnings of those near the top (90th percentile) to those near the bottom (10th percentile). In 2010, this ratio reached 7.0 in Indonesia. In comparison, values in the Philippines and Thailand were 6.4 and 6.7, respectively.

Wage differences between countries and within Indonesia partly reflect differences in labour productivity. Model simulations indicate that labour productivity in Indonesia could increase by almost 120 per cent by 2025 under the AEC (see Figure 3). This creates significant potential for sustainable wage growth. However, in some past instances productivity gains have by-passed workers altogether.

Figure 3: Change in labour productivity under the AEC in Indonesia, 2010-25 (per cent)



Source: ADB and ILO, op. cit.

The twin objectives of containing inequality and linking wages to productivity call for stronger wage setting institutions. One key component is setting minimum wages, which are critical for protecting low-paid

⁵ See ADB and ILO, op. cit., chapter 5.

⁶ Includes regular employees and casual workers

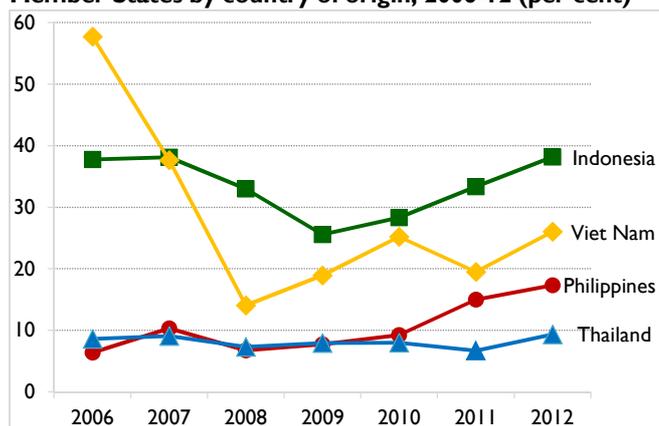
workers. However, the decentralization of wage-setting institutions in Indonesia has led to large differences in minimum wages, ranging from \$74 in the Purworejo regency to \$199 in Jakarta.

In addition, collective bargaining can be an effective method of wage negotiation between employers and workers. It can standardize employment conditions across enterprises and reduce the potential for a downward spiral of wage competition between enterprises. In Indonesia, however, limited ability of workers and employers to bargain collectively creates a strong incentive for unions to try to achieve all wage gains through the minimum wage-fixing system. Strengthening collective bargaining is crucial to avoid excessive reliance on minimum wage-setting and improve industrial relations.

Economic and demographic factors point to continued outward migration

Economic and demographic disparities are driving labour migration in the region.⁷ Indonesia is ASEAN's second largest country of origin for migrant workers. Each year, two million workers leave the country, predominantly to the Gulf States and parts of China. However, over the past five years the share of migrant workers from Indonesia going to other ASEAN Member States has increased (see Figure 4). Within the ASEAN region, the overwhelming majority of Indonesian migrants go to Malaysia.

Figure 4: Share of migrant workers in other ASEAN Member States by country of origin, 2006-12 (per cent)



Source: ADB and ILO, op. cit.

Structural factors point to a continued outflow of low- and medium-skilled migrant workers. Between 2010 and 2025, Indonesia's labour force is anticipated to grow by 29.5 million, almost half of the estimated growth for ASEAN as a whole. In a country with high

youth unemployment, the continued expansion of the youth labour force will place pressure on the labour market to create decent jobs, which may lead to further outmigration of young women and men. Other structural factors behind changing migration patterns are economic – notably the large differences in wages between ASEAN Member States. Wages in Malaysia, for example, are approximately three and a half times those in Indonesia.

Current AEC policies for managing migration are confined to a few high-skill occupations that account for less than one per cent of total employment in Indonesia. This suggests the AEC's provisions on labour mobility may have limited short-term impacts. If Indonesia and other ASEAN Member States are to reap the benefits of labour mobility, they will need to collectively prioritize skills recognition, extend the coverage and portability of social security, and safeguard the rights of migrant workers. National policies can play an important role in protecting and regulating migration especially for the large number of low- and medium-skilled migrant workers confined to informal employment (see Box 1).

Policies for better jobs and shared prosperity in an integrated Indonesia

The AEC has the potential to generate higher output, trade, employment, and productivity and could help steer Indonesia away from the middle income trap towards a higher value economy – with positive spillover effects on wages and incomes. However, if not managed appropriately, deeper integration could exacerbate inequalities. Therefore, policies must be put in place to ensure the equitable distribution of economic benefits. In Indonesia, five priority actions are particularly relevant given the opportunities and challenges of the AEC.

(i) Invest in rural infrastructure to bridge the development gap in remote areas and reduce regional disparities

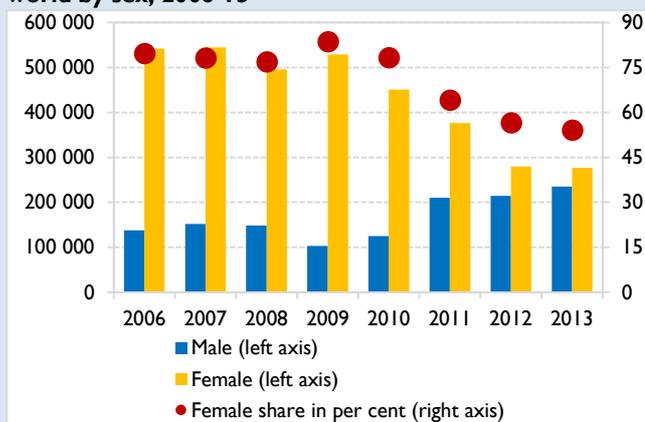
Minimum service standards provided by local governments have not delivered the requisite investment in public services needed to curb regional disparities. Institutional constraints further hinder rural-urban connectivity placing remote areas and small islands at a significant disadvantage. To ensure equity in regional development, connectivity and infrastructure should be strengthened and basic service systems should be put in place. To achieve this, efforts should be made on completing projects prioritized in the 2015-19 National Medium Term Development Plan (RPJMN). In addition, the right

⁷ See ADB and ILO, op. cit., chapter 6.

Box I. Rising formal employment for migrant workers in Indonesia

During each year between 2006 and 2009 more than half a million women registered to work abroad, making up around 80 per cent of total flows. Since 2009, however, the share of women migrants has fallen as the Government began introducing tighter regulations to protect migrant workers. This has included a moratorium against sending migrant workers without a formal employment contract from a registered employer, and additional regulations for ensuring employment is properly defined and remunerated. As a result, between 2010 and 2013, the share of workers entering employment abroad without a formal contract decreased from 73.0 per cent to 44.0 per cent.

Figure B1: Flow of workers from Indonesia to the rest of the world by sex, 2006-13



Source: ADB and ILO, op. cit.

Many of the remaining difficulties for protecting women migrant workers relate to the regulation of brokerage services and the capacity to respond to complaints – particularly for those in informal employment. This will require better coordination among countries and more responsive services.

incentives are needed to stimulate private sector infrastructure investment. Greater focus needs to be given to building quality infrastructure from the outset – durability and sustainability are key concepts herein for increasing the efficiency of spending in the long term. Furthermore, renewed effort should be made to implement prioritized projects set forth in the Master Plan on ASEAN Connectivity, such as the Melaka Pekan Baru Interconnection and the West Kalimantan-Sarawak Interconnection.⁸

(ii) Support the growth of productive employment in key sectors

Rapid economic structural change calls for more active policies to support productive job growth in key dynamic and higher-valued added sectors. The Government's Masterplan for the Acceleration and Expansion of Economic Development of Indonesia 2011-2025 (MP3EI) articulates a strategy to accelerate and expand economic development in Indonesia and transform the country into one of the ten major economies in the world by 2025. Under the plan, the development of six economic corridors based on the potential and advantages inherent in each region is envisaged. The development of such economic corridors provides opportunities for the creation of more productive jobs. Efforts will also be required to help current and future jobseekers find these opportunities, including by strengthening public employment services and providing labour market information to future jobseekers on sectors and occupations with high growth potential. Such

investments can support the school-to-work transition of the youth entering the labour market in the future.

(iii) Strengthen systems of social protection

Policy reforms in 2013, especially those related to the cutting of the fuel subsidy, are expected to reduce pressure on the national budget, creating an opportunity to extend social protection programmes. The National Social Security System Law of 2004 legislates the universal coverage of social security in Indonesia; however, large gaps in protection currently exist for informal workers and migrant workers. Steps should be taken to expand the state owned social insurance fund, PT Jamsostek, to include work accident, survivors, retirement, and health benefits to those outside formal employment. An unemployment insurance scheme is currently lacking and could help mitigate the adjustment costs of structural change by easing the vulnerability of displaced workers.

(iv) Reduce skill gaps by improving education and training systems

Improvements in education and training systems would help Indonesia equip its workforce with the requisite technical skills to meet the current and future demands of the labour market. These measures should include, providing a responsive technical and vocational training system to help fill gaps in skills and competencies not developed by tertiary education; fostering collaborations between training providers and employers to develop practical curricula and apprenticeship systems; engaging in public-private dialogue to anticipate future skill demands; and

⁸ Master Plan on ASEAN Connectivity, Hanoi, Oct. 2010.

improving the accessibility and relevance of tertiary institutions. To reduce gender gaps, extra emphasis must be placed on supporting young rural women to develop the skills need to compete in the labour market. Moreover, fully operationalizing the Indonesia Qualifications Framework and benchmarking it to the ASEAN Qualifications Reference Framework, which is currently under development, would improve the recognition of skills of Indonesian migrant workers.

(v) Strengthen wage-setting institutions

The Manpower Act of 2003 bestows workers the right to collective bargaining and declares the validity of collective labour agreements between registered trade unions and employers. Despite this legislated right, low union density in Indonesia and the high degree of informality suggest that the number of workers covered under collective agreements remains low. Better mechanisms for collective bargaining can help counter rising inequality and translate the benefits of closer integration into shared prosperity. As such, more action is needed to offer training activities for workers and employers on collective bargaining and provide a common bargaining platform for informal and contract workers. Minimum wage setting should be seen as complementary to collective bargaining and is appropriate for low-paid workers who lack bargaining power. Care should be given to adjust minimum wages regularly based on sound evidence and tripartite dialogue.

The full report “ASEAN Community 2015: Managing integration for better jobs and shared prosperity” can be accessed at: www.ilo.org/asia.

Contact Information:

*ILO Regional Office for Asia and the Pacific
United Nations Building
Rajdamnern Nok Avenue, Bangkok 10200, Thailand
Tel.: +66 2 288 1234 | Fax: +66 2 288 3062
Email: BANGKOK@ilo.org*