ASIA-PACIFIC DECENT WORK DECADE 2006 2015

Indonesia:

Wages and productivity for sustainable development

International Labour Organization

A decade of sustained growth…[1]

Indonesia has sustained over a decade of economic growth, and this has provided an environment that has allowed growth in wages and regular wage employment to outperform most other countries in the world. Table 1 provides key economic indicators for 2011-2014. Trends highlight that economic growth has been maintained, labour productivity has been improving and that inflation has been comparatively lower. Economic performance during the first quarter of 2015 slowed to 4.71 per cent (yoy), largely attributed to a weakening of government consumption, the slowing of investment in construction sector and poor export performance. In 2015 it is expected that GDP growth will remain close to 5.0 per cent.

Table 1: Key economic indicators, 2011-14

Variable	2011	2012	2013	2014
GDP (constant 2010 prices, IDR trillions)[1]	7,142.6	7,560.3	7,954.5	8,354.0
GDP growth rate (constant 2010 prices)	6.2	6.0	5.6	5.0
GDP per employed person (constant 2010 prices, IDR million)[2]	66.0	66.9	70.5	72.9
Consumer price index (average annual, 2007=100)[3]	127.4	132.9	142.2	151.4

Source: BPS (2015) GDP data: Base Year 2010, Badan Pusat Statistik, Jakarta. 1 From January 2014, the CPI is calculated from 82 cities based on 2012 = 100. Official linkage factors applied to connect the data series.

… has seen wage employment expand…

The positive economic growth trends have provided a climate that has seen wage employment grow and allowed both average wages and minimum wages to increase in nominal terms. To illustrate, in February 2015, 46.6 million people or 38.6 per cent of those employed working as regular employees[2] (see Table 2).

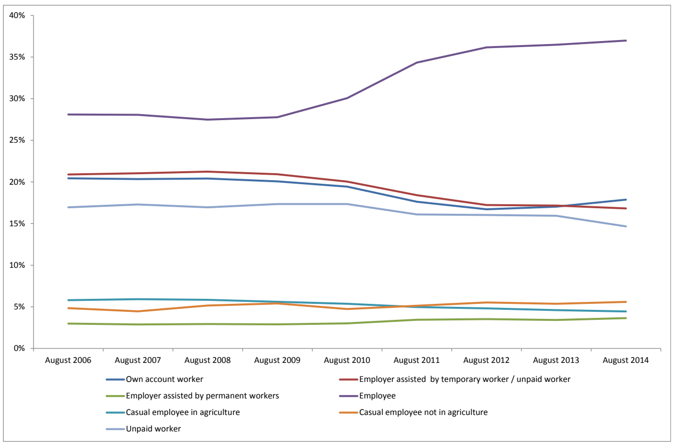
Table 2: Key labour market indicators, 2011-15

Variable	2011	2012	2013	2014	2015
Employment (millions)1	108.2	113.0	112.8	114.6	120.8
Regular employees (millions)	37.8	40.9	41.1	42.4	46.6
Casual employees (millions)	11.1	11.7	11.3	11.5	11.9
Simple average monthly minimum wage (nominal, IDR thousands)2	988.8	1,088.9	1,288.4	1,494.1	NA
Average monthly wage for regular employees (nominal, IDR thousands)	1,552.5	1,636.0	1,917.2	1,925.6	1,981.7

Source: BPS (2015) GDP data: Base Year 2010, Badan Pusat Statistik, Jakarta. 1 From January 2014, the CPI is calculated from 82 cities based on 2012 = 100. Official linkage factors applied to connect the data series.

Two important trends to note in the area of wage employment are that the absolute number and share of people working as casual employees or own account workers (vulnerable employment)[3] has decreased over time, as regular wage employment has expanded throughout the economy. Figure 1 depicts the trend over time. Second, the share of employers that hire permanent employees as a percentage of all employed persons 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 1: Status in employment, 2006-2014



Source: BPS (2014) Labour force situation: August 2014, Badan Pusat Statistik, Jakarta. Note: The status in employment reflects an Indonesian adaptation of the International Classification by Status in Employment (ICSE-93).

1 This brief provides a summary of the discussions that took place at the Indonesia country-level consultation of the UN ECOSOC 2015 Integration Segment on the theme of "Mind the gap: Economic and social limits to income inequality", Jakarta 24-25 February 2015. The ILO is grateful to the panelists who contributed to this session, including Malte Luebker, Chris Manning, Zulfan Tadjoeddin and Ninasapti Triaswati.

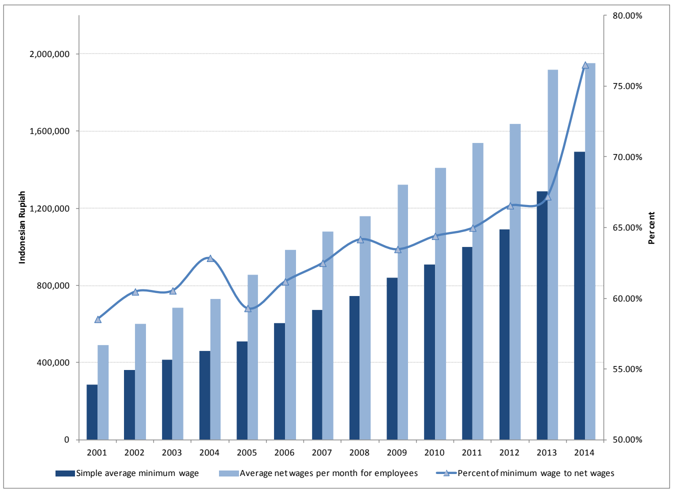
2 According to BPS an "employee is a person who works permanently for another person or institution/office/company and gains some money/cash or goods as wage/salary. Workers who have no permanent employer are not categorized as an employee but casual labourer. A casual laborer can be considered to have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

3 The Indonesian definition of vulnerable employment and the ILO definition of vulnerable employment varies somewhat. ILO defines vulnerable employment as the sum of own-account workers and contributing family workers, while Indonesia also includes casual workers and employers assisted by temporary worker/unpaid worker in their definition of vulnerable employment.

... and growth in minimum and average wages

A careful review of wage trends in recent years reveals that the relative level of minimum wages (in relation to average wages) has increased steadily, indicating a narrowing of the gap between minimum wages and average wages over time (Figure 2).[4] 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. This trend is partly thanks to the strong growth in minimum wages but also highlights that there is a need for strengthening wage bargaining by sector and occupational structures to promote the growth of average wages.

Figure 2: Trends in minimum and average wages for Indonesia, 2001-2014 (IDR, nominal)



*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 employees and own account workers, has been mixed. In August 2014, the average earnings of casual workers and own account workers 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.[5] This trend indicates that casual workers have been able to improve their relative 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.

4 In August 2014 the simple average nominal minimum wage was estimated at IDR 1,494,134, while the average wage for regular employees was estimated at IDR 1,952,589. In August 2014 the UN conversation rate was USD 1 = IDR 11,578. Therefore, the simple average national minimum wage was equivalent to USD 129 and the average wage for regular employees was equivalent to USD 167. High inflation over the period has meant that gains observed in nominal wages have not always translated well in real terms.

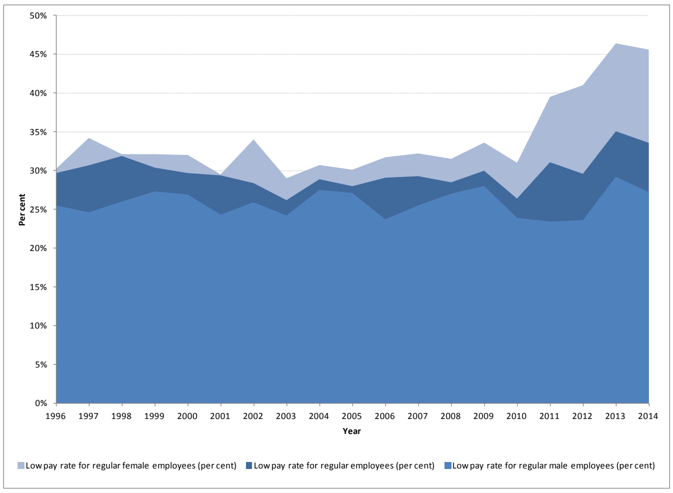
5 World Bank (2014) Indonesia Economic Quarterly, March 2014: Investment in flux, World Bank Country Office for Indonesia, Jakarta.

However, many workers receive low pay...

While growth trends in wages and wage employment are largely positive, 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,[6] which is substantially lower than the average wage - indeed it is closer to the prevailing levels of minimum wages. To further emphasize, the ratio of the mean to median wage for August 2014 was 1.37, which is high in comparison to global trends and indicates that the distribution of regular employees by wage level is highly skewed, with a high incidence of regular employees earning low pay.

In this brief 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 (see Figure 3). Low-wage workers tend to be disproportionately female, with this trend likely reflecting the increasing number of women shifting out of unpaid family work onto contract work. The low pay trend highlights that further efforts are needed to bridge the gender pay gap and address earnings inequality 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.

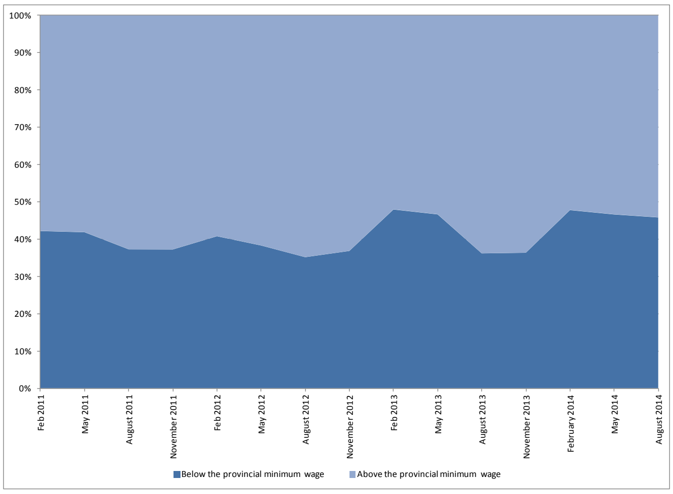
In some situations low wage employment can acts as a stepping stone to entering into higher paying work, however for many workers low wage employment tends to be a norm rather than a springboard. The situation in Indonesia highlights that a combination of efforts on both wages and skills policies are needed to support workers to move out of low wage employment and access opportunities that are more productive and offer higher levels of remuneration.

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

… highlighting the need for further efforts on wages and skills policies

Part of the problem also appears to be related to non-compliance with minimum wages. In terms of overall coverage of the minimum wage, however, a number of concerns remain given that as of August 2014, approximately 45.9 per cent of regular wage employees receive less than what is permissible by law (figure 4).[7] Moreover, coverage is typically lower in February which may point to a lag in the application of adjustments in annual minimum wage increases within enterprises.[8] The challenge of compliances is also exacerbated by the fact that many workers are concentrated in the informal economy, often in rural areas where it is difficult to enforce labour regulations (see Box 1).

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.
** Based on regular employees and provincial minimum wages, Kementerian Ketenagakerjaan.*

Due to the nature of the labour market in Indonesia, which is characterized by a high incidence of low pay and a large informal economy, as well as limited capacities for labour inspection, the minimum wage falls short of fulfilling its role as a safety net wage. In a sense, the minimum wage has become an entry-level wage that applies in medium and large formal enterprises, with non-compliance in the informal economy. 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 and 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 representatives, 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 focus on the KHL means that minimum wage increases are tied to inflation. Therefore, gains in real terms are not forthcoming, unless the number of items[9] is increased, or price data are artificially inflated. To emphasize, workers and employers often have varying views in regard to the number of items, 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 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: In 2014, the lowest minimum wages were found in districts within Central Java (IDR 910,000) and the highest in DKI Jakarta wage (IDR 2,441,301) – a 2.7-fold difference, even though the provinces are only 300 km 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 curious cases emerge. To illustrate, in the District of Bekasi in West Java Province, textile enterprises that specialize on making narrow ribbons for the use in zippers have to pay a higher minimum wage than the remainder of the 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.

Labour productivity has been increasing…

Gains in labour productivity are essential for the economy as a whole to maintain competitiveness and increase living standards. 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 at a solid pace. From 2005 to 2009 productivity expanded at an average annual rate of 3.3 per cent. From 2010

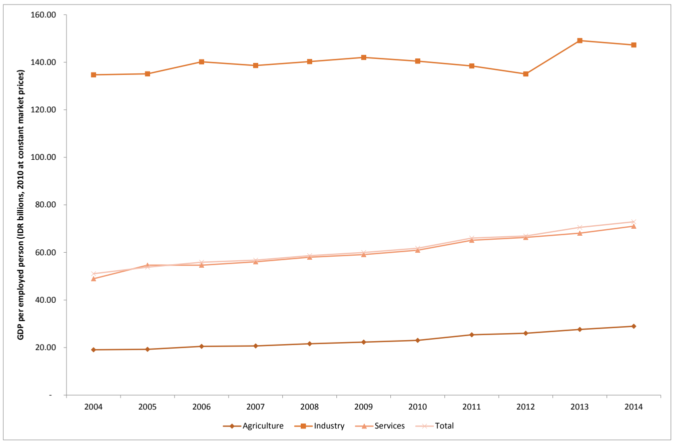
7 It is important to note that minimum wages are wage rates for full-time work, while workers many work less or more than full-time. Therefore, this indicator is a proxy for compliance.

8 Employers may apply for exceptions if they are able to illustrate a lack of viability.

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

to 2014 productivity growth accelerated to average annual rate of 5.1 per cent.[10] 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 2004-2014[11]



Source: ILO staff calculations based on data from the labour force survey and national accounts (2015 revision) from Badan Pusat Statistik for selected years.

Productivity in the industrial sectors nearly double that of the services sector and quadruple that of the agricultural sectors. 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 further discusses this issue.

Box 2. Labour productivity in manufacturing

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.[12] Regular wage employees in 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 in recent years, large and medium firms have had comparatively lower rates of employment growth recently.

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 more than double that of the overall economy (see figure 5). 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.

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. 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. For example, strategies strengthening micro and small enterprises, particularly “home based industries”, will be highly important for strengthening competitiveness and productivity in the manufacturing sector in the future.

... and a better linking of wage and productivity increases...

Given the trend of increasing labour productivity, it is important to understand how such benefits are being shared across the economy, as sharing gains is critical for raising living standards and promoting equitable growth. In simple terms, higher productivity should be associated with higher returns from production processes, with the sharing of such gains between employers and workers. One way of assessing this is through an analysis of the labour share, i.e. the share of the total income in an economy allocated to workers (as opposed to capital).

10 Based on compound annual growth rate (CAGR).

11 Defined as GDP (constant prices 2010) 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.

12 Large and medium sized establishments are defined to employ 20 employees or more.

Relevant statistics are, however, only available up to 2008. Yet, based on Indonesia's input-output tables, the labour share has been relatively constant in the second half of 2000s (table 3) – consistent with the finding that wages have grown in line with productivity during this period. However, the developments in wages and labour productivity since 2010 – discussed above – may have put some downward pressure on the labour share. This is an important issue which deserves further analysis and more recent data.

Table 3: Distribution of income, 1971-2008 (per cent)[13]

Variable	1975	1985	1995	2005	2008
Compensation of employees	24.9	27.7	30.5	30.7	30.9
Gross operating surplus and gross mixed income	73.1	70.2	64.9	67.7	69.1
Net taxes and subsidies on production	2.0	2.1	4.6	1.6	0.0
Gross value added (in market prices)	100	100	100	100	100

Source: BPS, Input Output Table, various years.

Another way of assessing the inclusiveness of growth is through analysis of trends in wage growth and productivity growth. As mentioned, higher labour productivity should lead to higher earnings. In many countries the link is broken. At first, the link appears intact in Indonesia. However, if the GDP deflator is used for estimating in real terms, a gap is evident (see figure 6). Moreover, the wage-to-productivity ratio of the overall economy has declined over time, from 34.8 per cent in 2004 to 23.3 per cent in 2013.

Figure 6: Labour productivity and real wages in Indonesia, 2005-2014 (Index, 2005 = 100)

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. ILO staff calculations based on BPS, National Accounts (February 2015).

… is needed to promote equitable growth

In recent years Indonesia has experienced strong economic growth, gains in regular wage employment, and wage growth that has been broadly consistent with productivity growth. Part of the success lies in the increases in minimum wages that have taken place over this period.

Yet, a number of workers still earn below the minimum wage and many more have difficulty accessing regular employment, especially in the highly sought after manufacturing jobs. It will be important to continue to monitor developments in employment, wages and labour productivity closely, in order to anticipate any consequences that trends may have on the inclusiveness of growth. A number of implications arise from review of wages and productivity in Indonesia, including:

- Trends in wages reflect the simultaneous strong reliance on minimum wage fixing and a high incidence of low pay. This highlights the need to strengthen collective wage bargaining in order to promote the growth of average wages. In addition, it would be important to strengthen labour market institutions in order to address the issue of low pay and minimum wage compliance, particularly the labour inspectorate and bipartite cooperation institutions.
- 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.
- 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.
- It is important to better link wage and productivity increases, so that gains from labour productivity are shared between workers and employers. Gains in labour productivity and constructive dialogue on gains sharing are important, as such dialogue can translate into better quality jobs, including better wages and working conditions that are critical for raising living standards. For employers, linking real wage growth to productivity gains implies stable real unit labour costs (and profit growth in line with productivity growth).
- 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 and may therefore reinforce equitable growth while supporting enterprises to upgrade and enhance productivity.

In summary, a focus on quality job creation and a greater emphasis on equitable growth – by strengthening labour market institutions, social dialogue and accommodative macroeconomic policies – will be needed to sustain the current momentum.

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13 Compensation of workers refers to the wages and salaries of workers (including imputation for unpaid workers and own account workers).

Annex I: Statistical appendix - Wage indicators 2006-2014

Variable	2006	2007	2008	2009	2010	2011	2012	2013	2014
National simple average minimum wage (nominal, IDR)	602,700	673,300	743,200	841,529	908,800	988,829	1,088,903	1,288,424	1,494,134
Average net wages per month for regular employees (nominal. IDR)	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
National simple average minimum wage (real, IDR, in constant 2007 prices)	641,170	673,300	674,410	731,129	751,074	776,161	819,340	906,065	986,878
Average net wages per month for regular employees (real, IDR, in constant 2007 prices)	1,047,902	1,077,312	1,050,894	1,146,768	1,166,101	1,206,405	1,230,974	1,348,208	1,289,689
Growth in average real minimum wages	NA	5.01%	0.16%	8.41%	2.73%	3.34%	5.56%	10.58%	8.92%
Growth in average real wages for regular employees	NA	2.81%	-2.45%	9.12%	1.69%	3.46%	2.04%	9.52%	-4.34%
Consumer Price Index (2007=100)	94	100	110.2	115.1	121	127.4	132.9	142.2	151.4

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

Annex II: Employment and employment shares by economic sector, 2005-2013

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