# Toward Inclusive Growth in Indonesia : Improving Trade and Employment


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*) The views expressed here are those of the author and do not necessarily reflect the views or policies of the ADB.

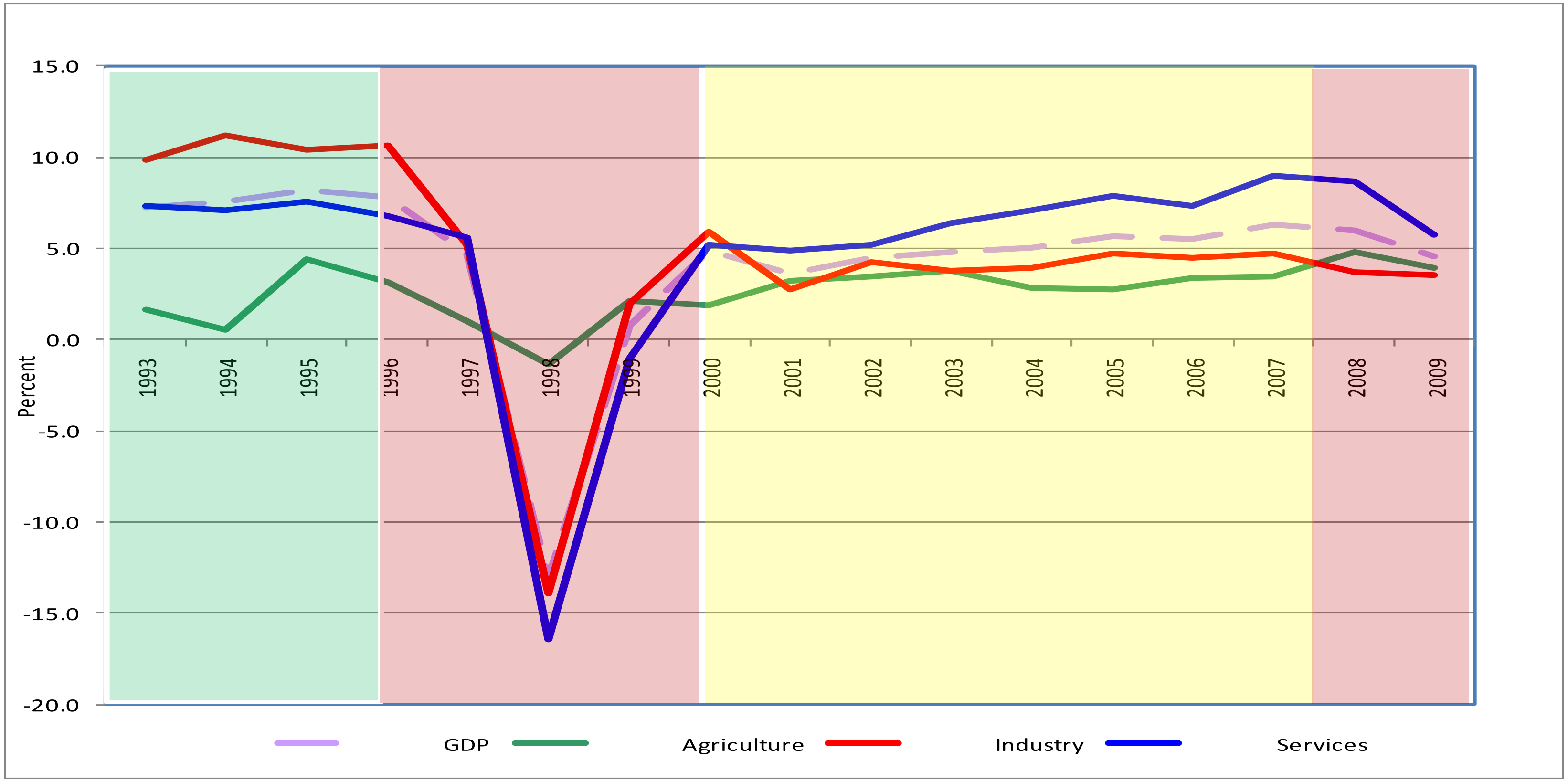
# Outline of Discussion

1. Key Outcomes:
   - Economy
   - Trade and Employment
   - Labor Market (LM) and Employment
2. Problems in LM and Employment
3. Key Issues on Trade and Industry
4. Government Interventions
5. Concluding Remarks

# Failed Structural Transformation

- Declining industry replaced by service sector since 2000
- Higher growth of Agriculture compare than industry lately
- Four different areas with two "red districts"

**Growth of GDP by Sector: Agriculture, Manufacturing and Services, 1993-2009 (%)**

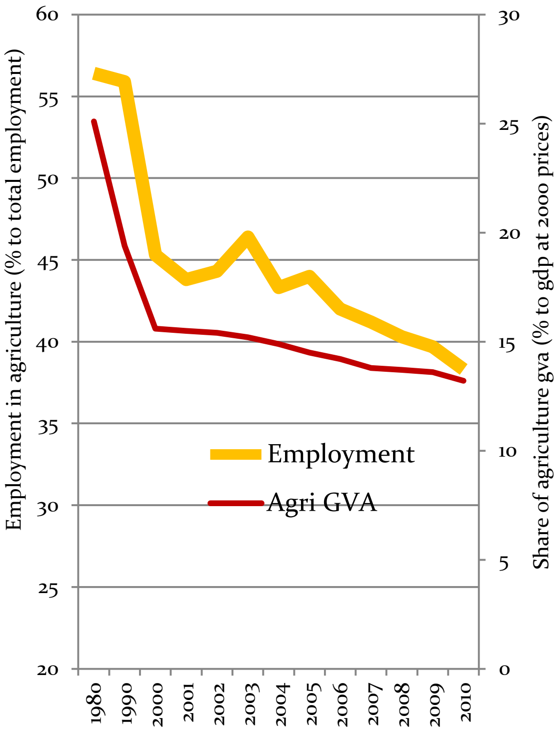



Source: Calculated from the Key Indicators for Asia and the Pacific

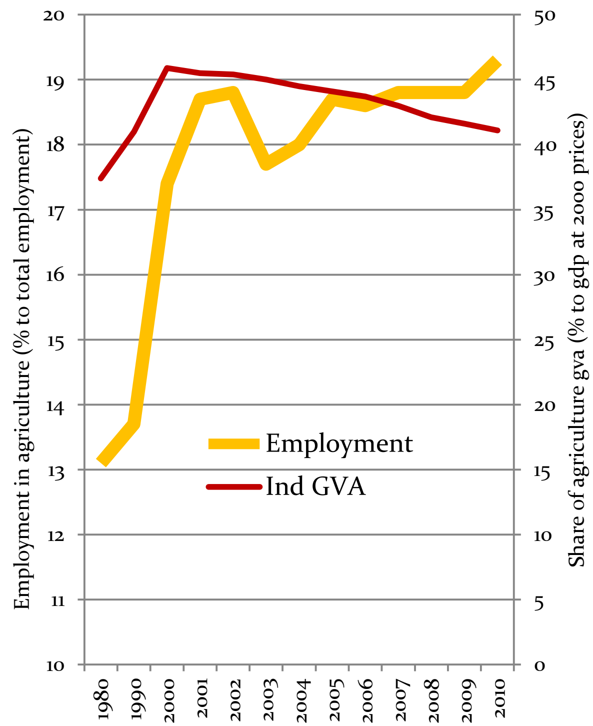
# Sectoral GVA and Employment

•Agr: Slowly declining and remain the main source of employment
•Industry: remain low and declining with increasing empl share. Hence decreasing productivity
•Services: relatively high and increasing

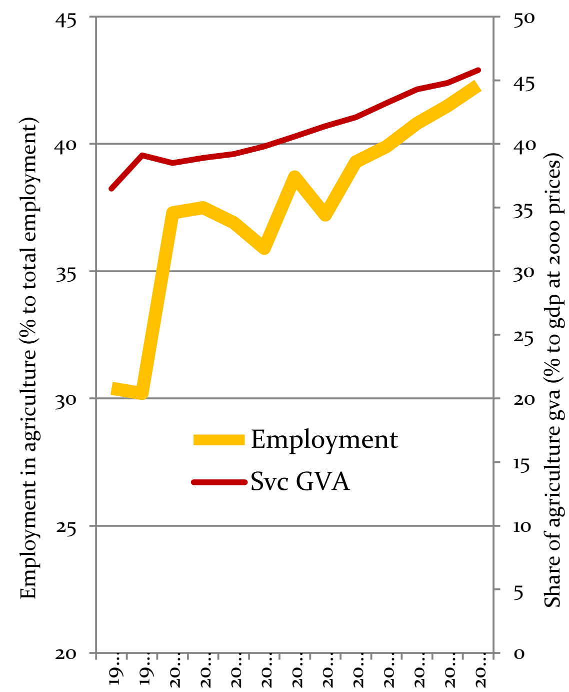
## Agriculture




## Industry



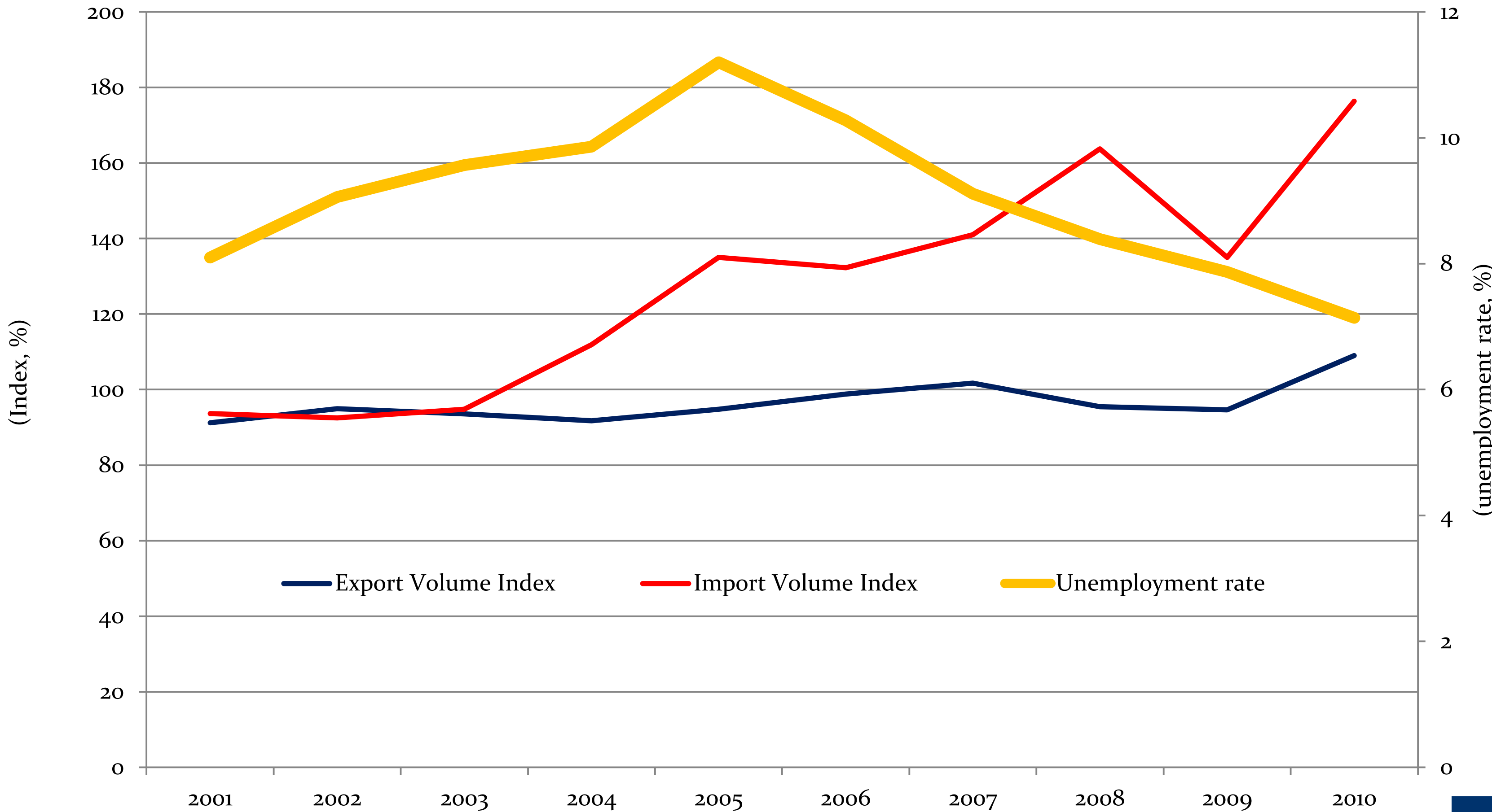

## Services




Source: World Development Indicator Online

# Trade and Employment

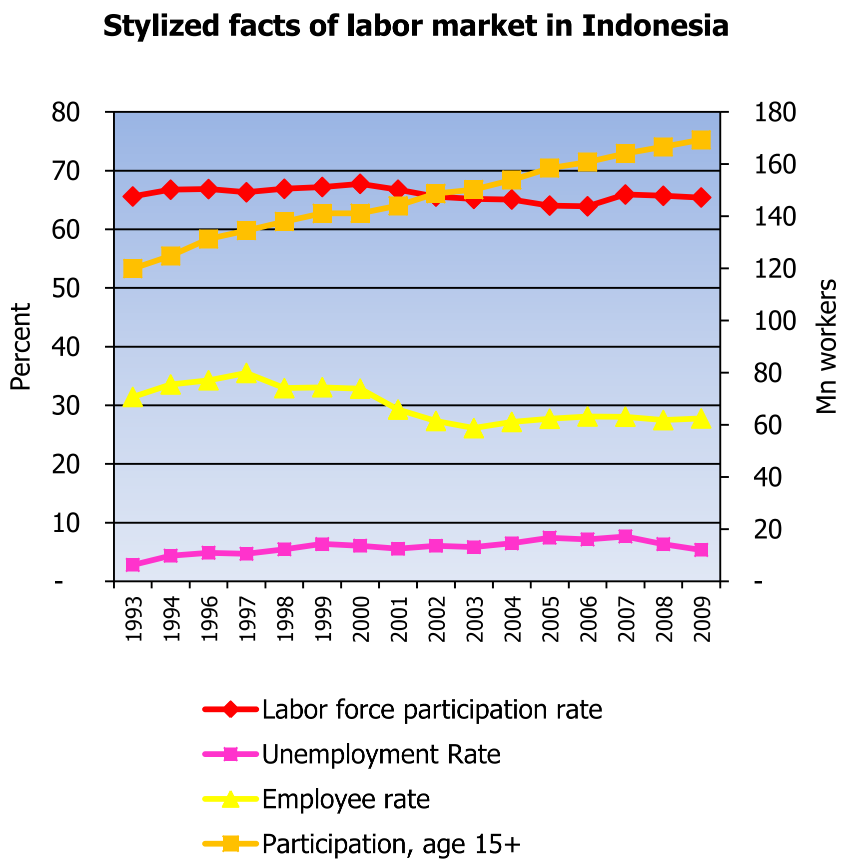
- **Weak link between Trade and Employment**




Source: World Development Indicator Online

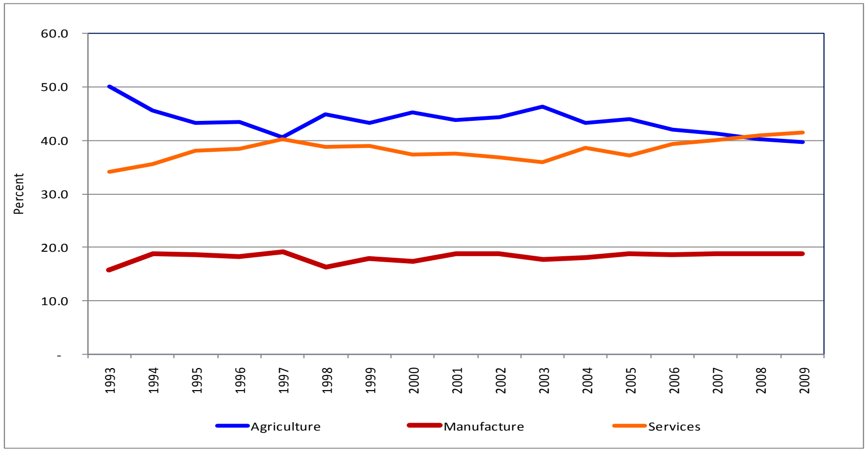
# Labor Market Dynamics

- Working age (15+) population accounts for 172 million in 2010, grew by 40m during 1993-2010.
- Labor force participation rate was relatively stable at 66-68%
- Unemployment rate is relatively low and stable.
- Wage earners remain lower vs. pre-AFC level as Self employed still dominant.



# Employment by sector and education

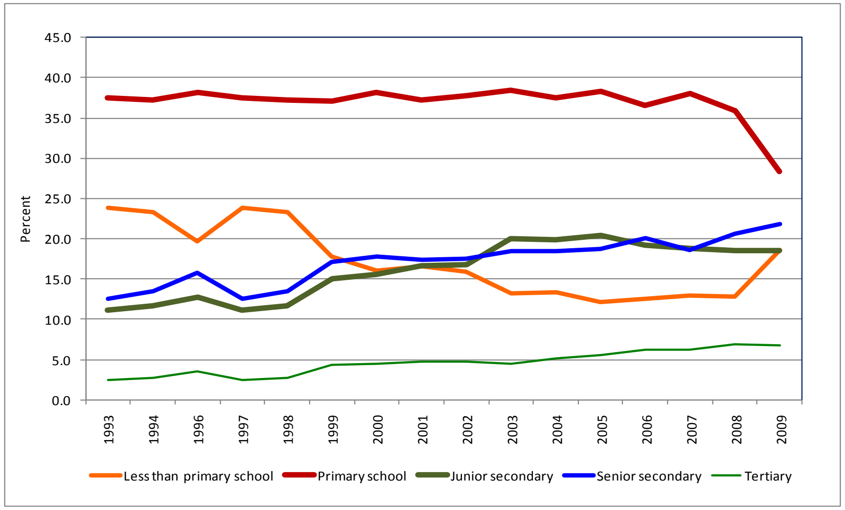
Employment Rates by Sector, 1993-2009 (%)




Source: Calculated from Sakernas

- Agriculture remains dominant, followed by services and manufacturing industry.
- Higher among male and less educated groups.

Workers by Education Level, 1993-2009 (%)

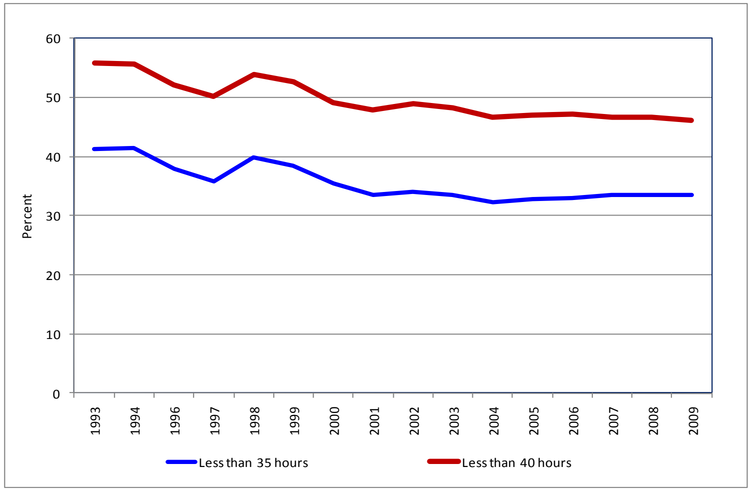



Source: Calculated from Sakernas

# Underemployment

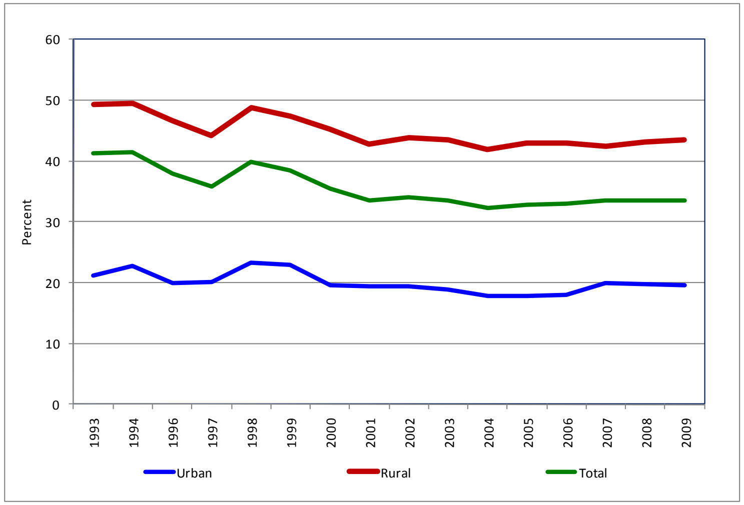
- Underemployment is massive.
- Mostly in rural and among woman.
- Rural-urban gap remains the same, while women-men gap narrows due to declining underemployment among women.

**Underemployment Rates by Working Hours, 1993-2009 (%)**




Source: Calculated from Sakernas

**Underemployment Rates by Residence, 1993-2010 (%)**




Source: Calculated from Sakernas

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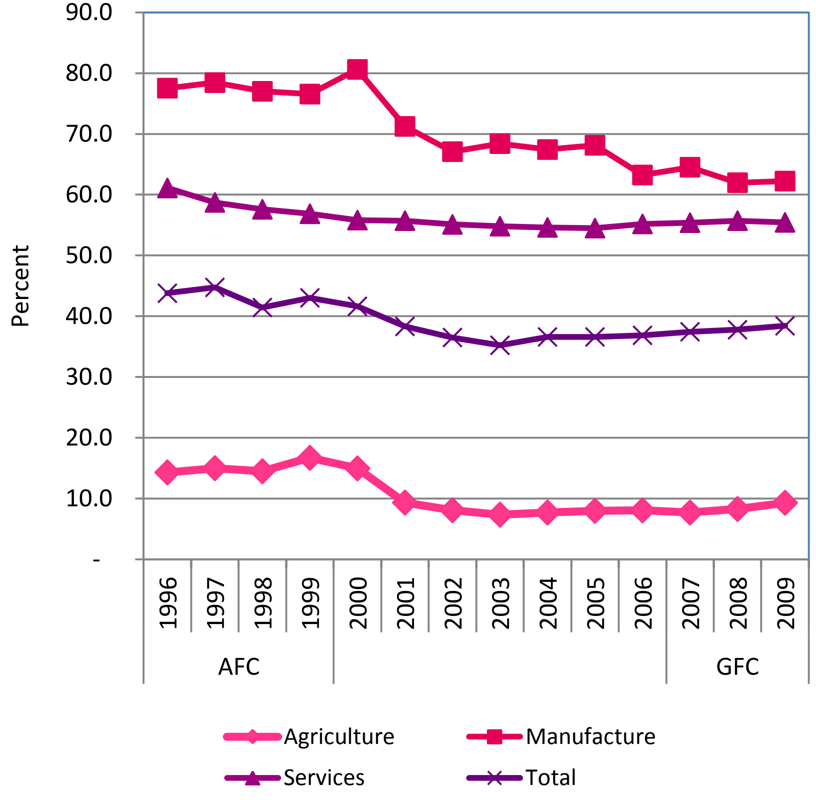
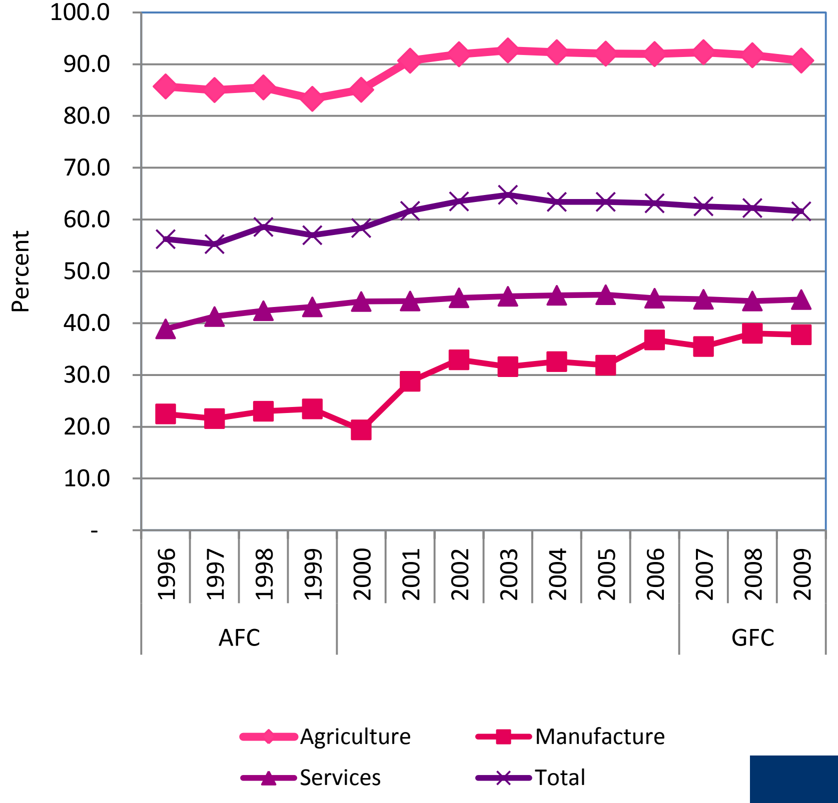
# Employment rate in formal and informal and by sector

## Formal




## Informal

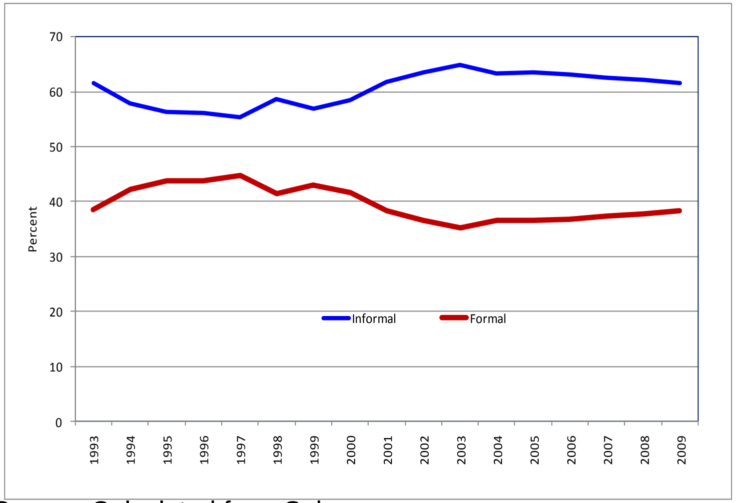



Source: Staff estimates using data from BPS (various years), SAKERNAS.

# Informal Employment

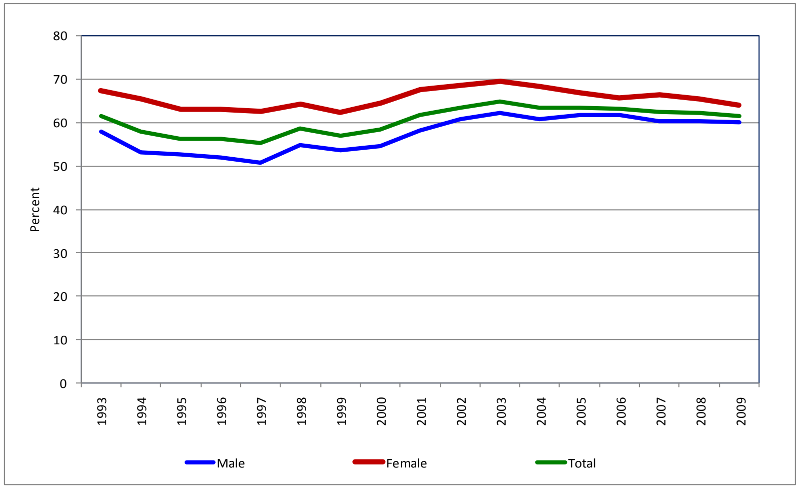
- Relatively widespread and tends to increase.
- Higher in rural and among women.
- Gender gap narrowing but not between rural and urban.

**Formal and Informal Employment Rates, 1993-2009 (%)**

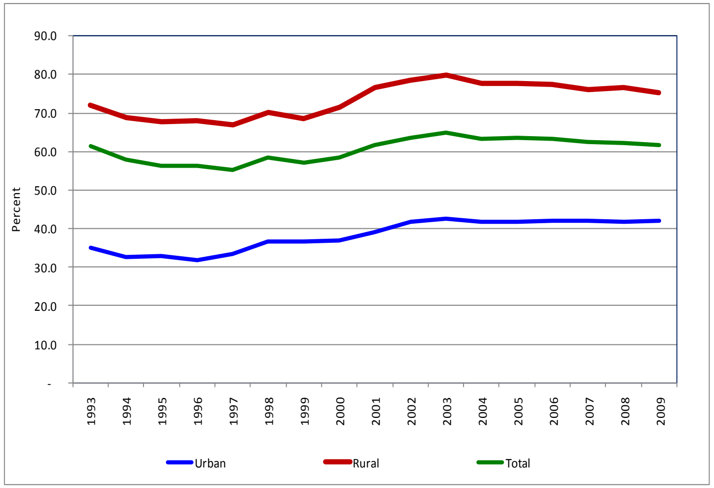



Source: Calculated from Sakernas

**Informal Employment by Gender, 1993-2009 (%)**




**Informal Employment by Residence, 1993-2009 (%)**




Source: Calculated from Sakernas

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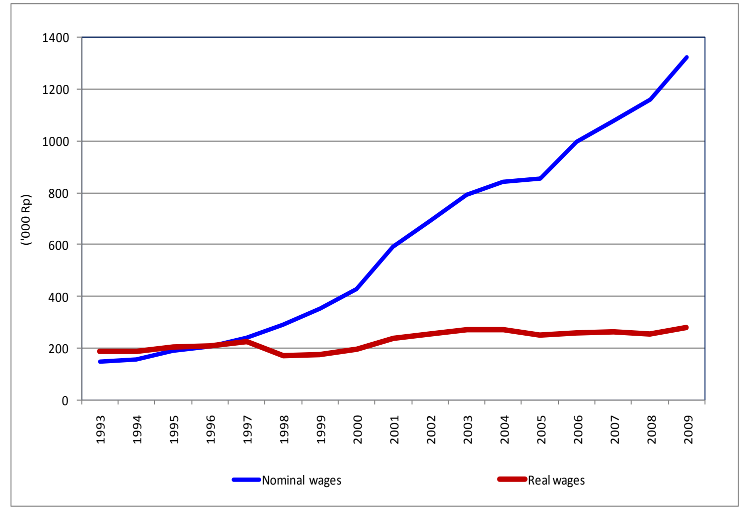
# Wage: Nominal and Real

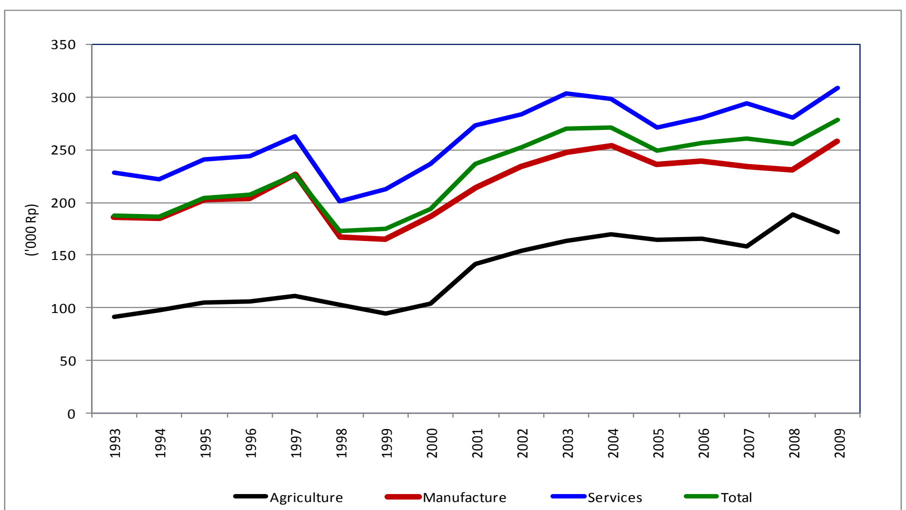
- Real Wage is stagnant.
- Women earn less and the gender gap remains.
- Service sector is the highest, followed by industry and agriculture sectors.

**Nominal and Real Wages, 1993-2009 (%)**

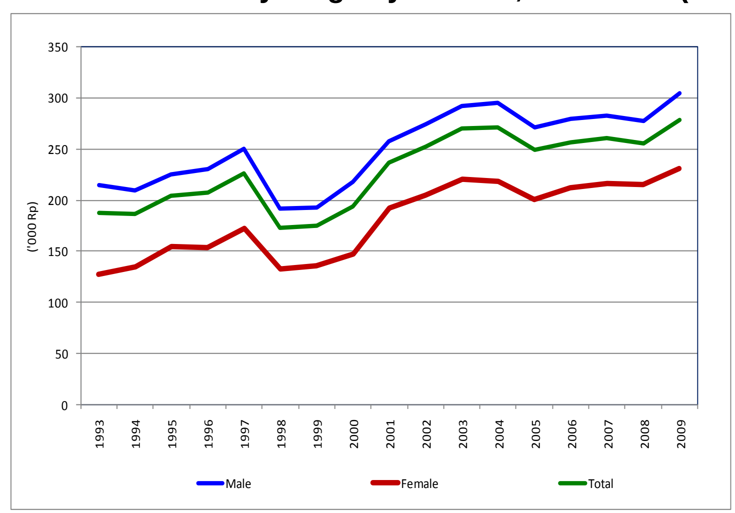



Source: Calculated from Sakernas. Note: for employee only.

**Real Monthly Wage by Sector, 1993-2009 (000Rp)**




**Real Monthly Wage by Gender, 1993-2009 (000Rp)**




Source: Calculated from Sakernas

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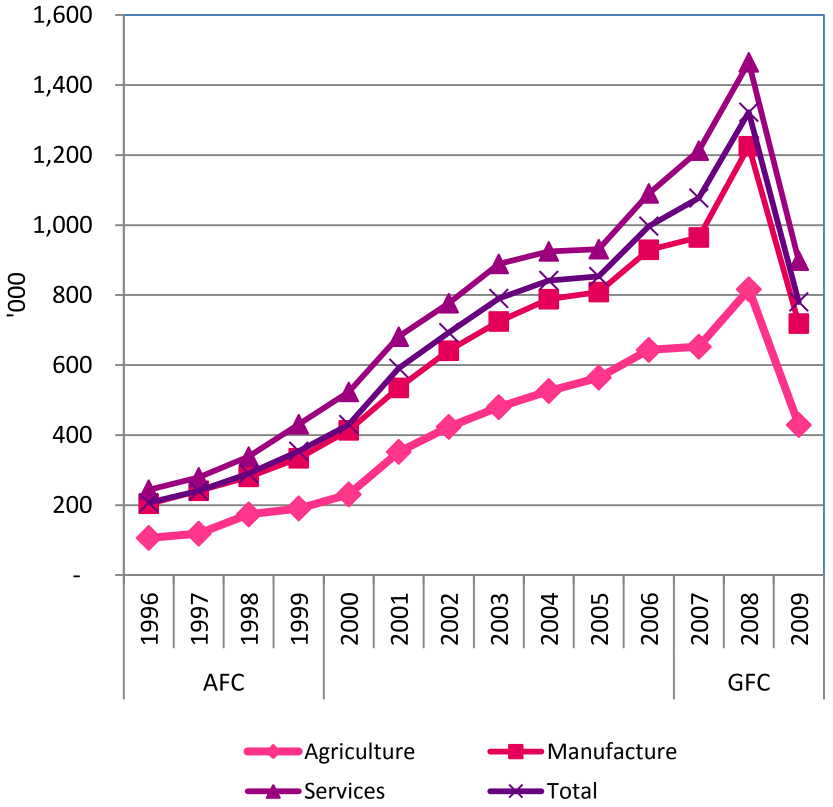
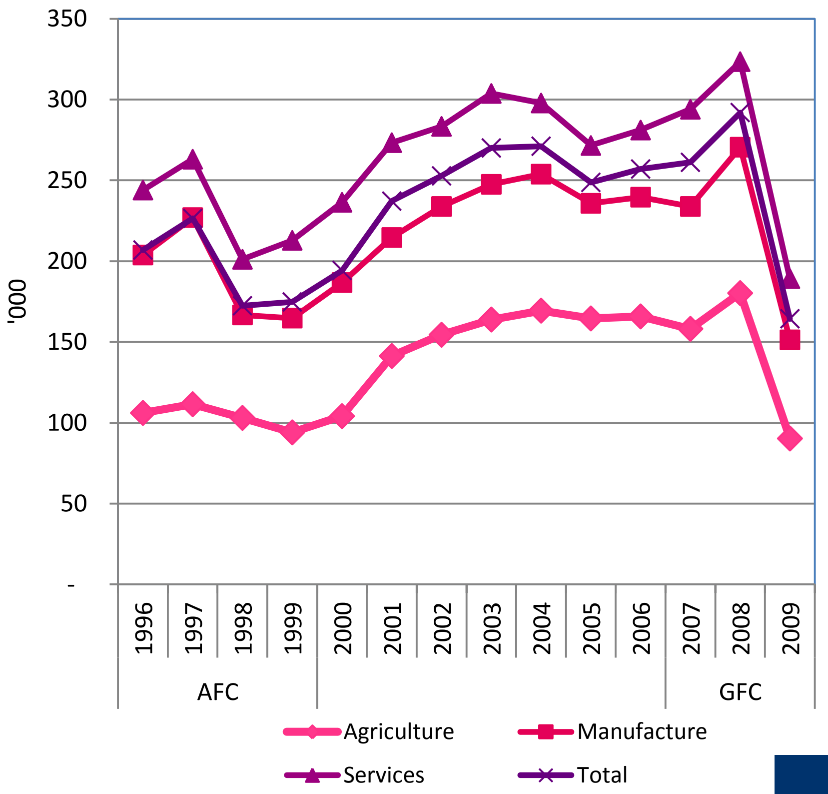
# Monthly wage of employee by sector (000)

## Nominal wage rate



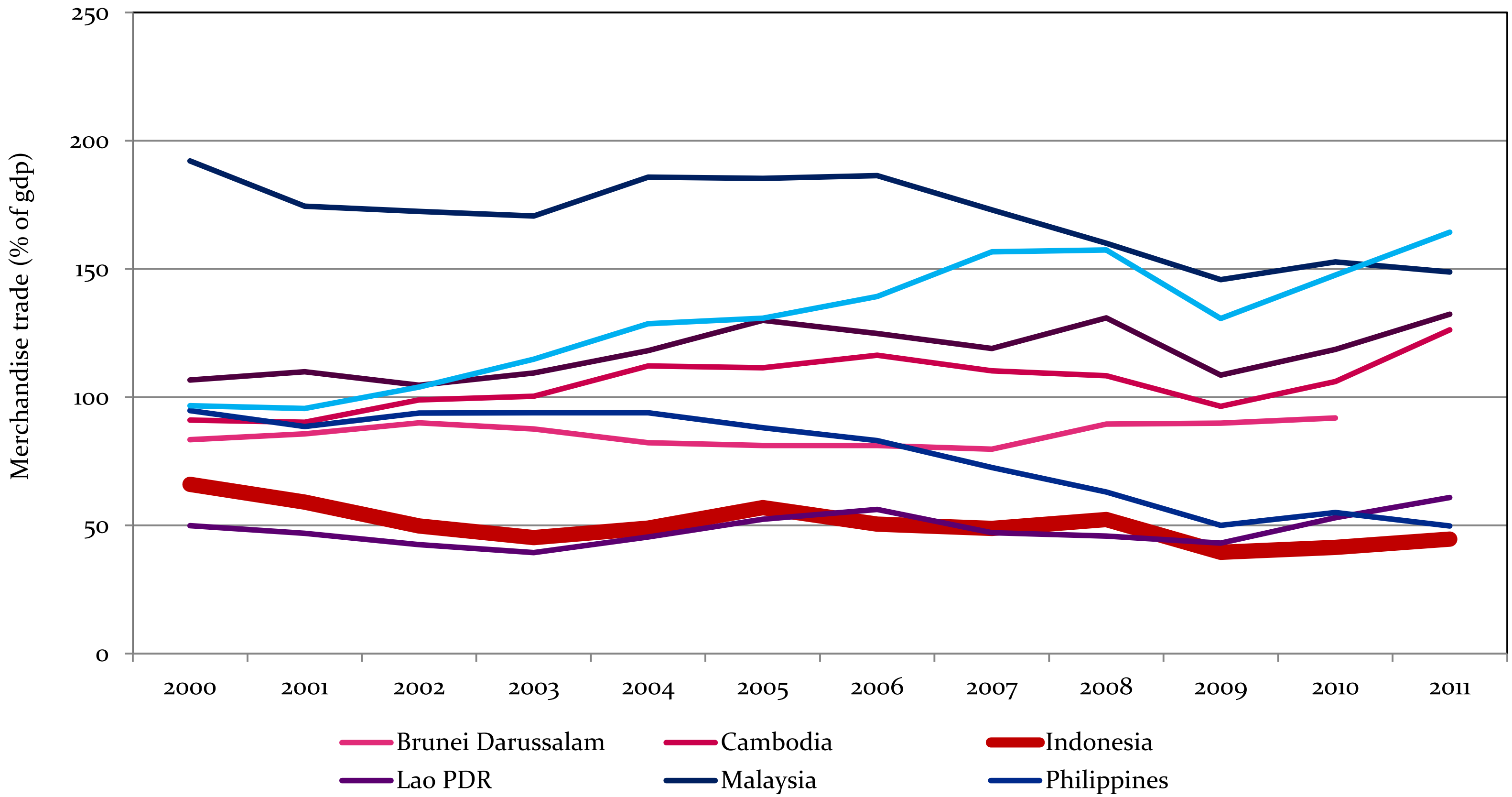

## Real wage rate (CPI deflator)




Source: Staff estimates using data from BPS (various years), SAKERNAS.

# Merchandise trade (% of GDP)

- Low trade-led growth
- Relatively flat, lack of a big improvement

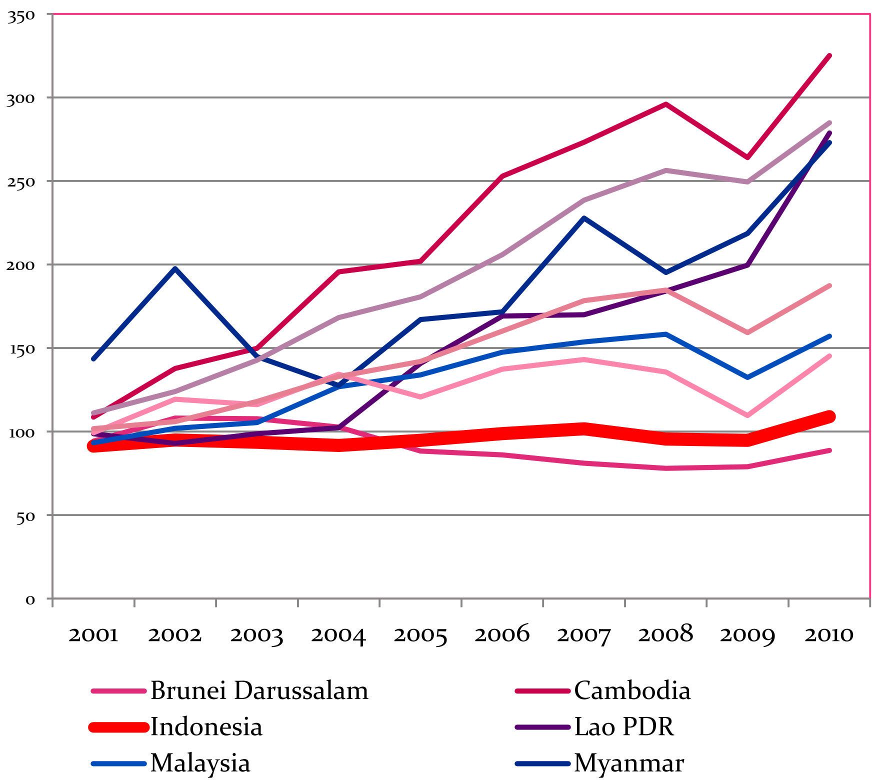



Source: ADB Key Indicators 2012

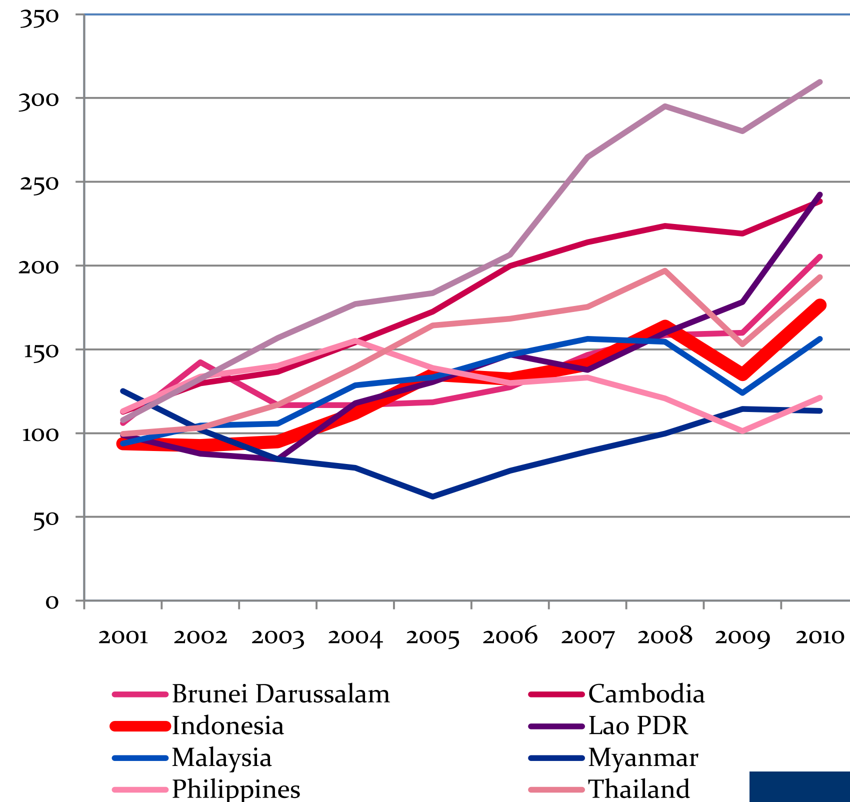
# VOLUME INDEX (2000=100)

- Exports: relatively flat
- Imports: tend to increase but small

## Export




## Import




Source: World Development Indicator Online

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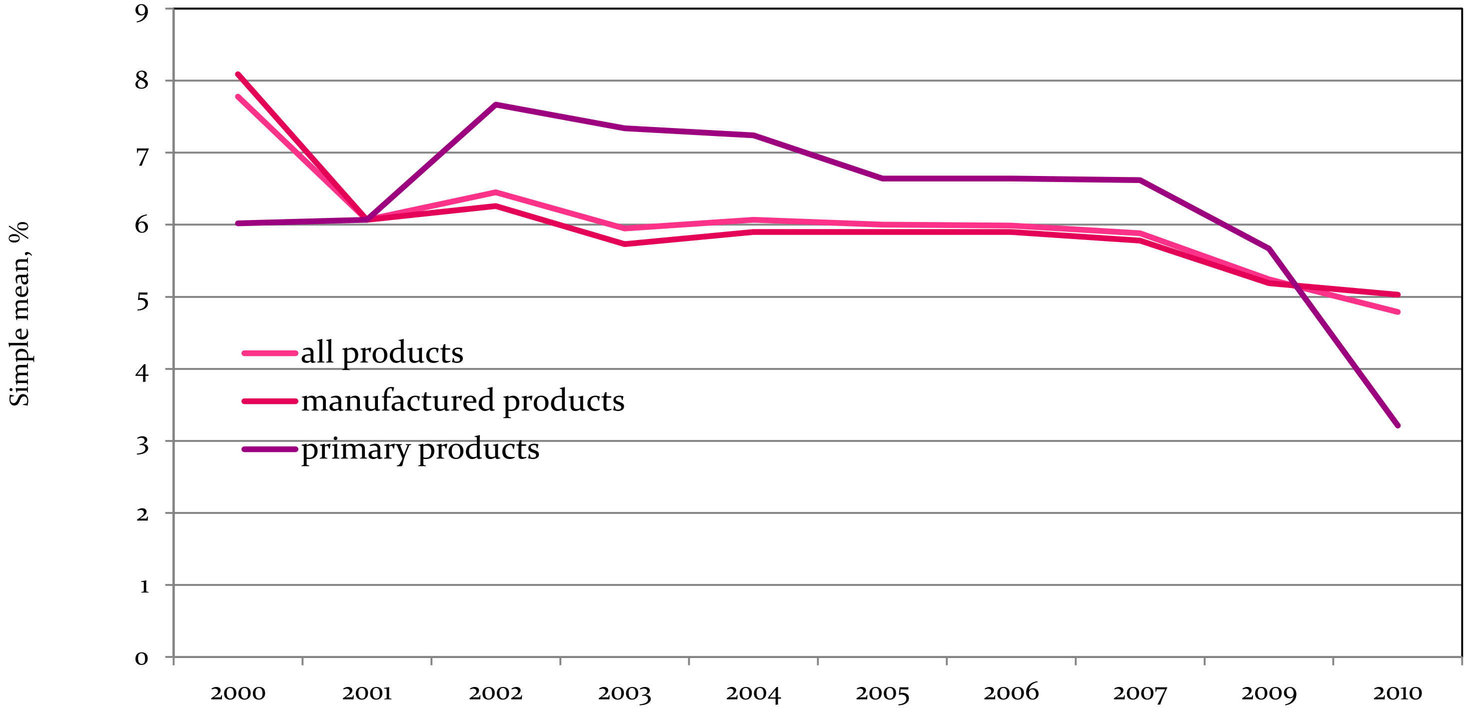
# Tariff rates

- **Already low and decreasing**

**Tariff rate, applied, simple mean (%)**




Source: World Development Indicator Online

# Indonesia: Destination of merchandise goods, 2011

## Exports

| | |
|---|---|
| Japan | 16.57 |
| China, People's Rep. of | 11.27 |
| United States | 8.11 |
| Singapore | 9.06 |
| Korea, Rep. of | 8.05 |
| India | 6.55 |
| Malaysia | 5.40 |
| Australia | 2.74 |
| Thailand | 2.90 |
| Netherlands | 2.52 |

- **Limited destinations**
- **Traditional markets or trading partners**

Source: Key Indicators for Asia and the Pacific 2012

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# Indonesia: Origin of Imports, 2011

## Imports

| | |
|---|---|
| Singapore | 14.63 |
| China, People's Rep. of | 14.77 |
| Japan | 10.95 |
| Malaysia | 5.86 |
| United States | 6.11 |
| Korea, Rep. of | 7.33 |
| Thailand | 5.86 |
| Saudi Arabia | 3.06 |
| Australia | 2.92 |
| India | 2.44 |

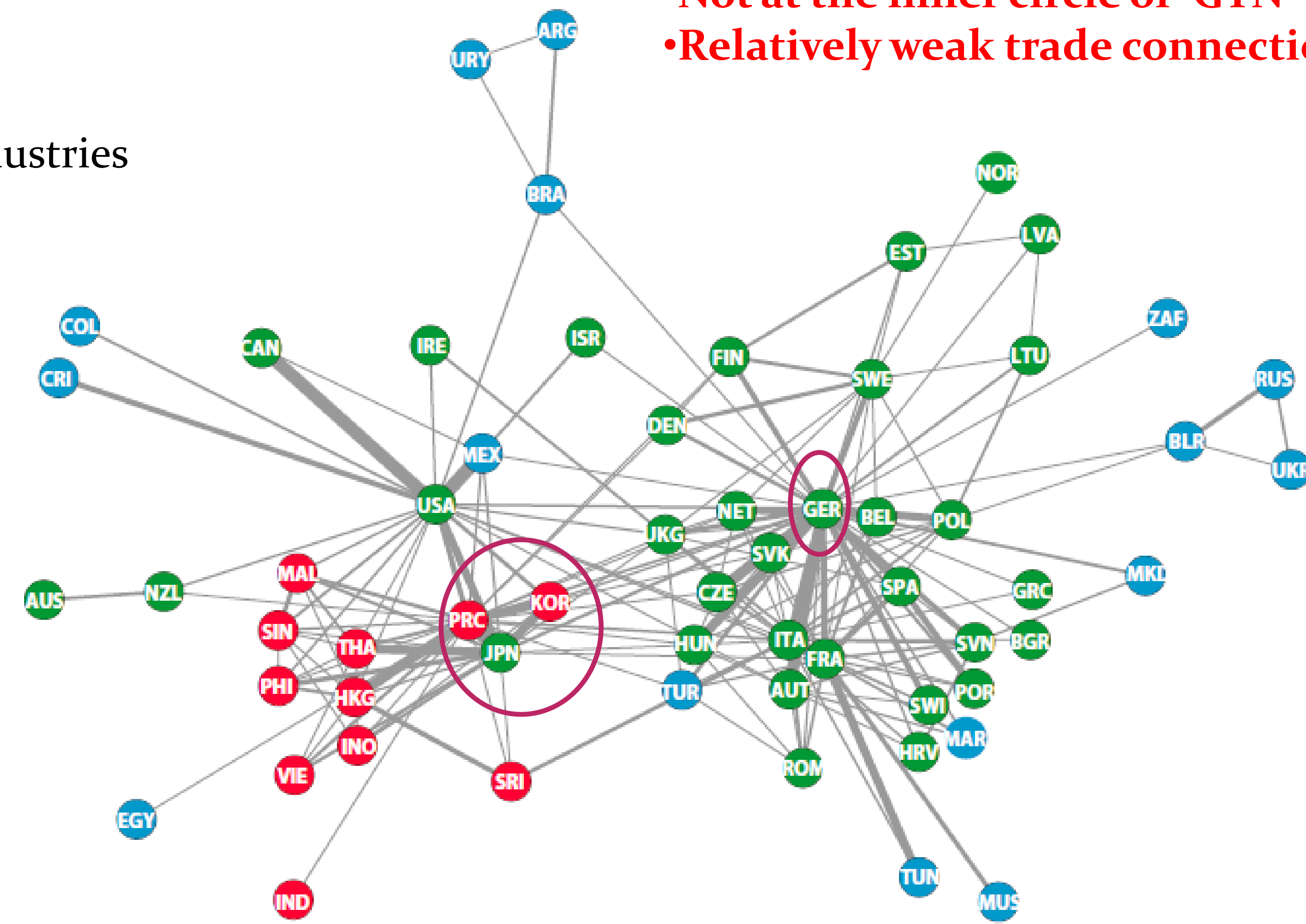
- **Limited sources**
- **Traditional trading partners**

Source: Key Indicators for Asia and the Pacific 2012

# Production trade networks: importance of global supply chains

- Not at the inner circle of GTN
- Relatively weak trade connections

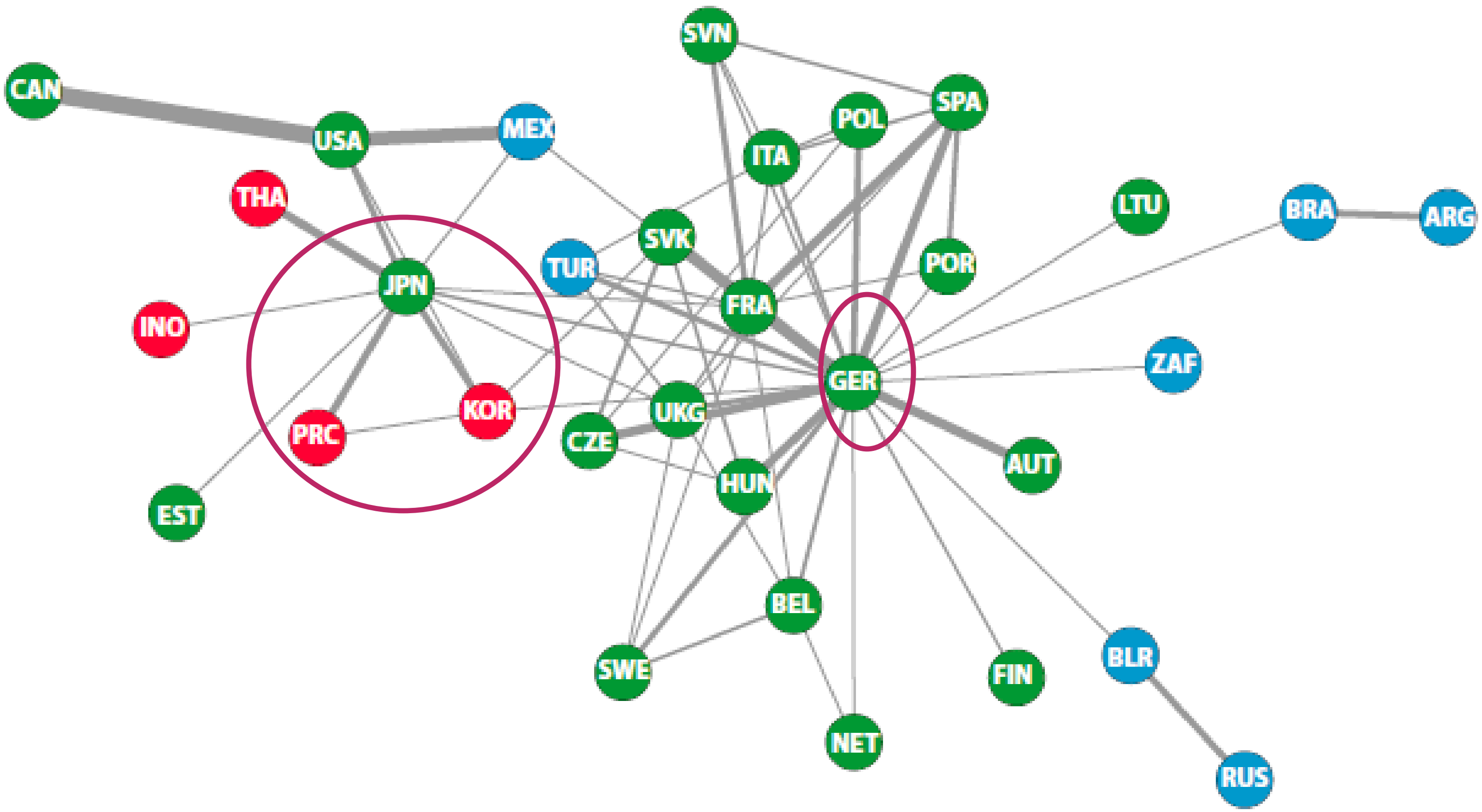
All industries




Source: Ferrarini (2011)

# Automotives industry

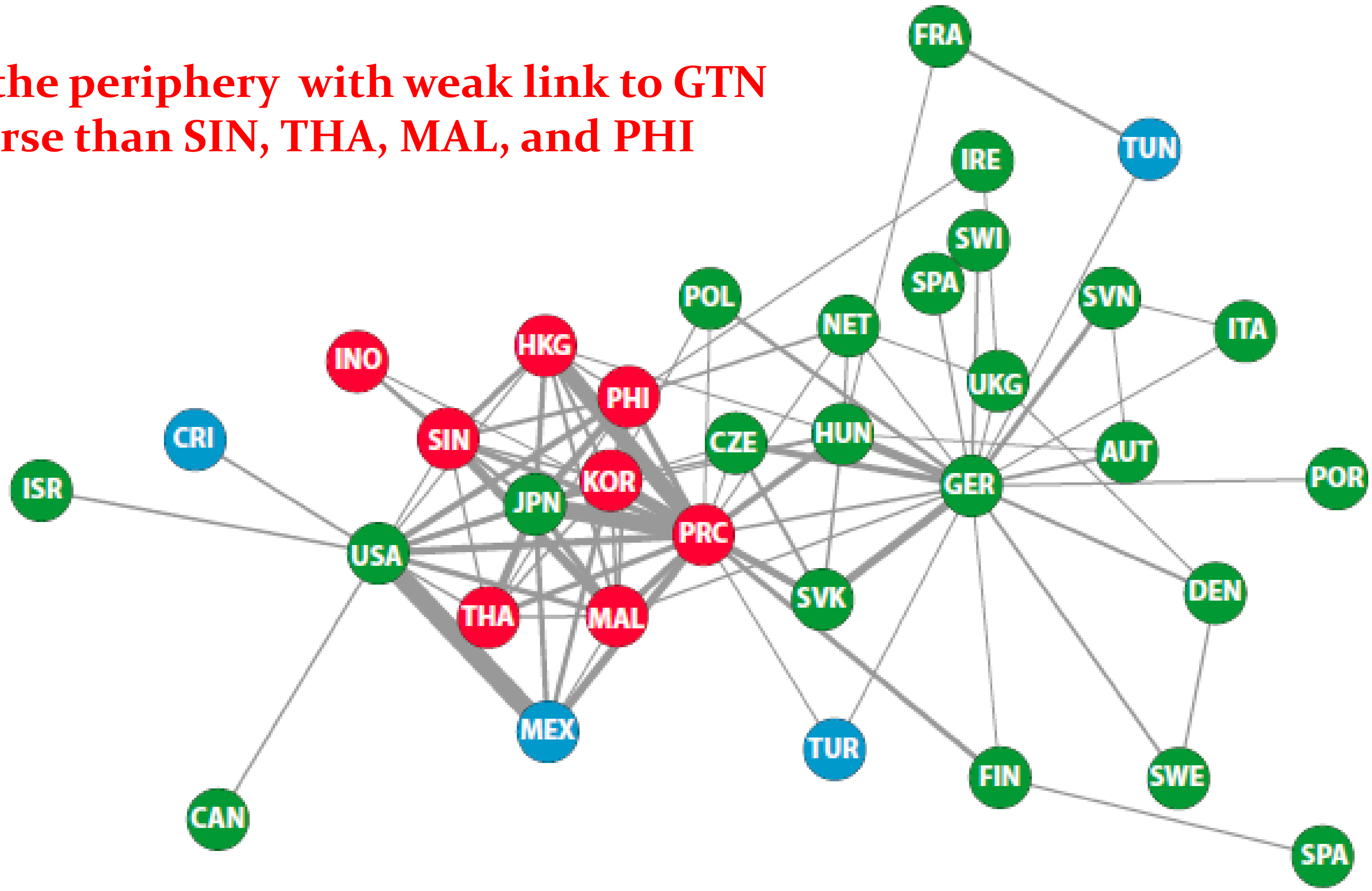
•Part of auto GTN but weak link to JPN
•Worse than THA




Source: Ferrarini (2011)

# Electronics industry

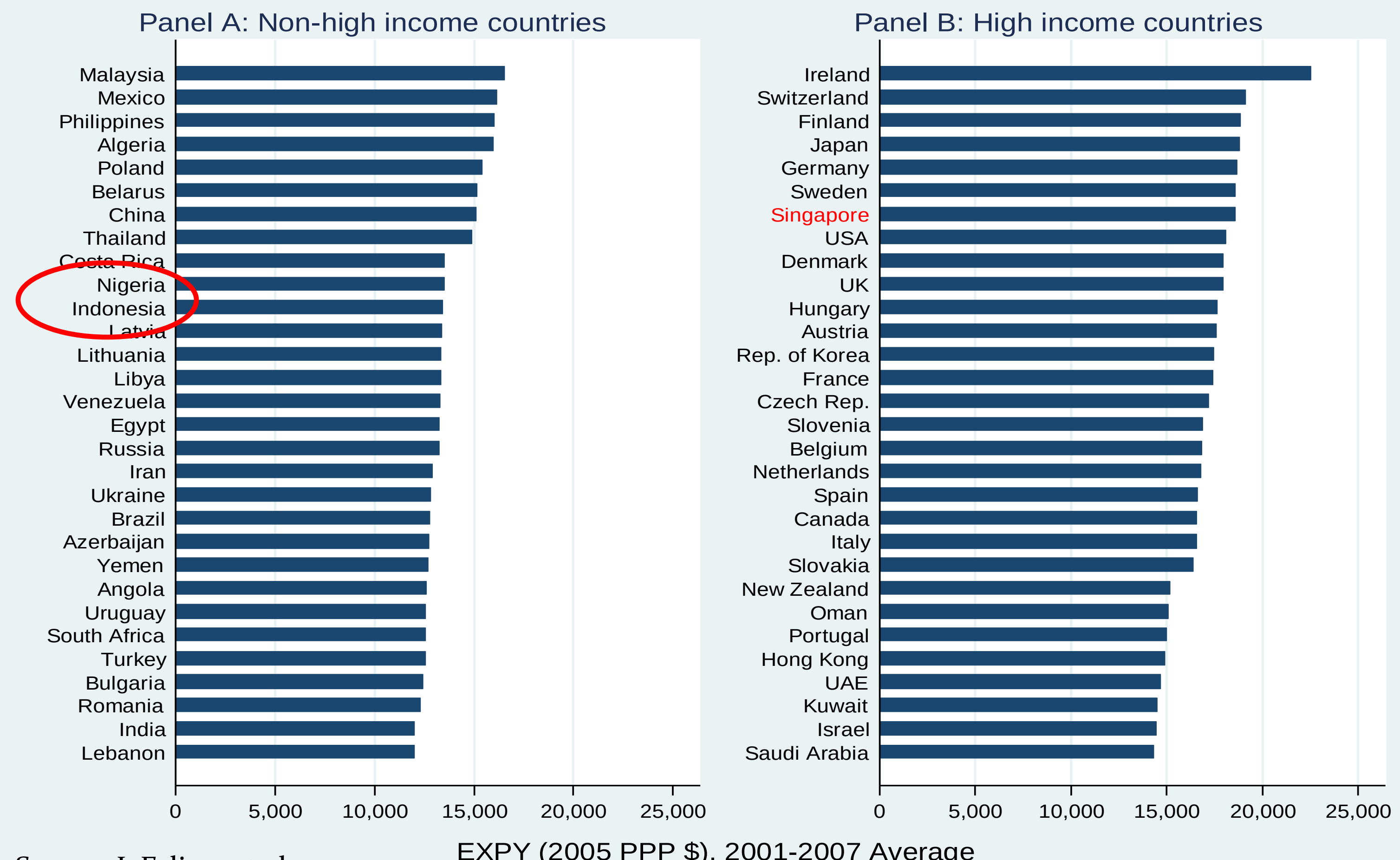
- At the periphery  with weak link to GTN
- Worse than SIN, THA, MAL, and PHI




Source: Ferrarini (2011)

# Export Sophistication (EXPY)

## Average 2001-2007




Source: J. Felipe, et.al. 2011

- **Less sophisticated**
- **Improve sophistication**

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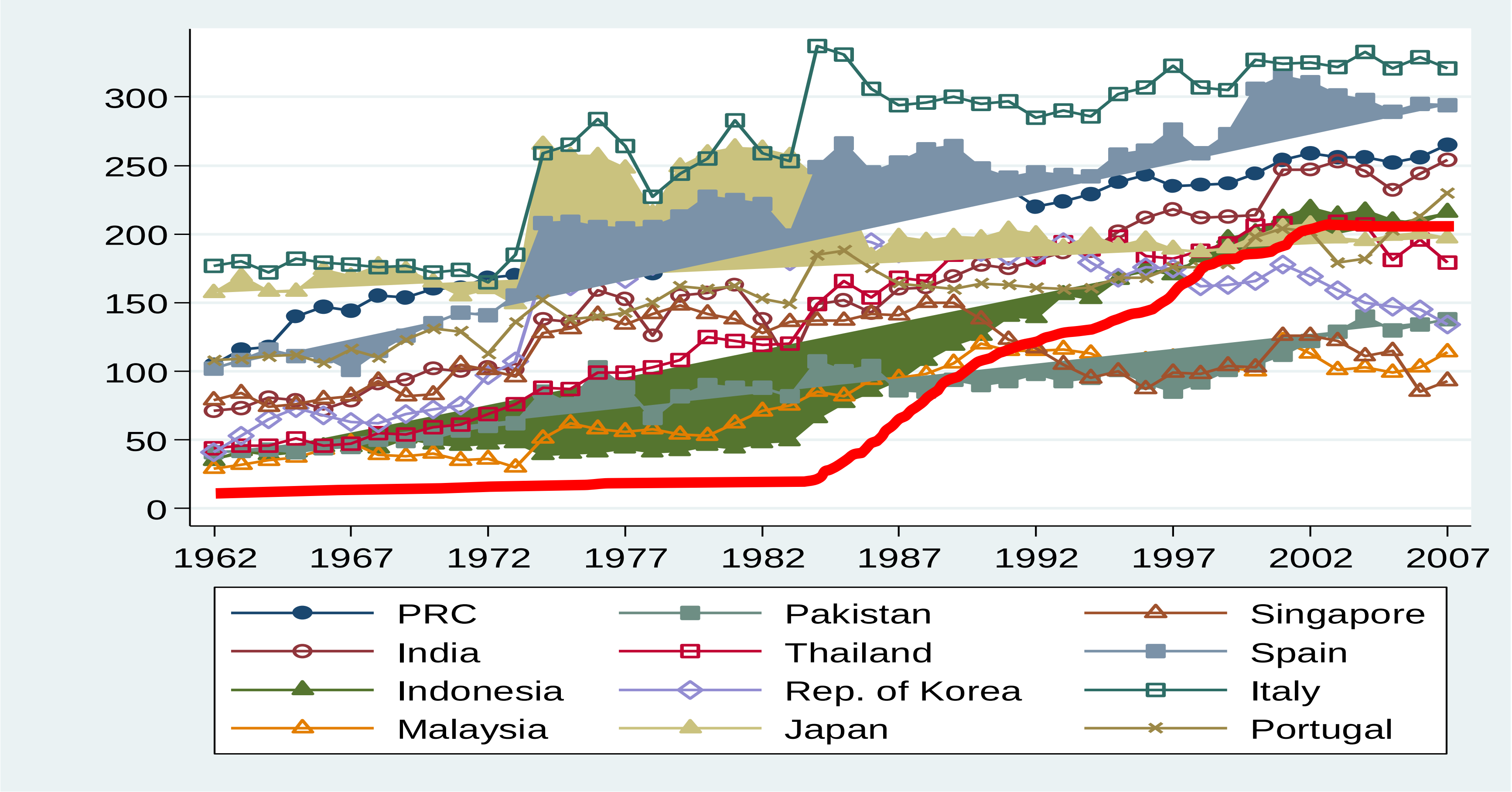
# Diversification of Export Basket

- **Low level: need to improve diversification**

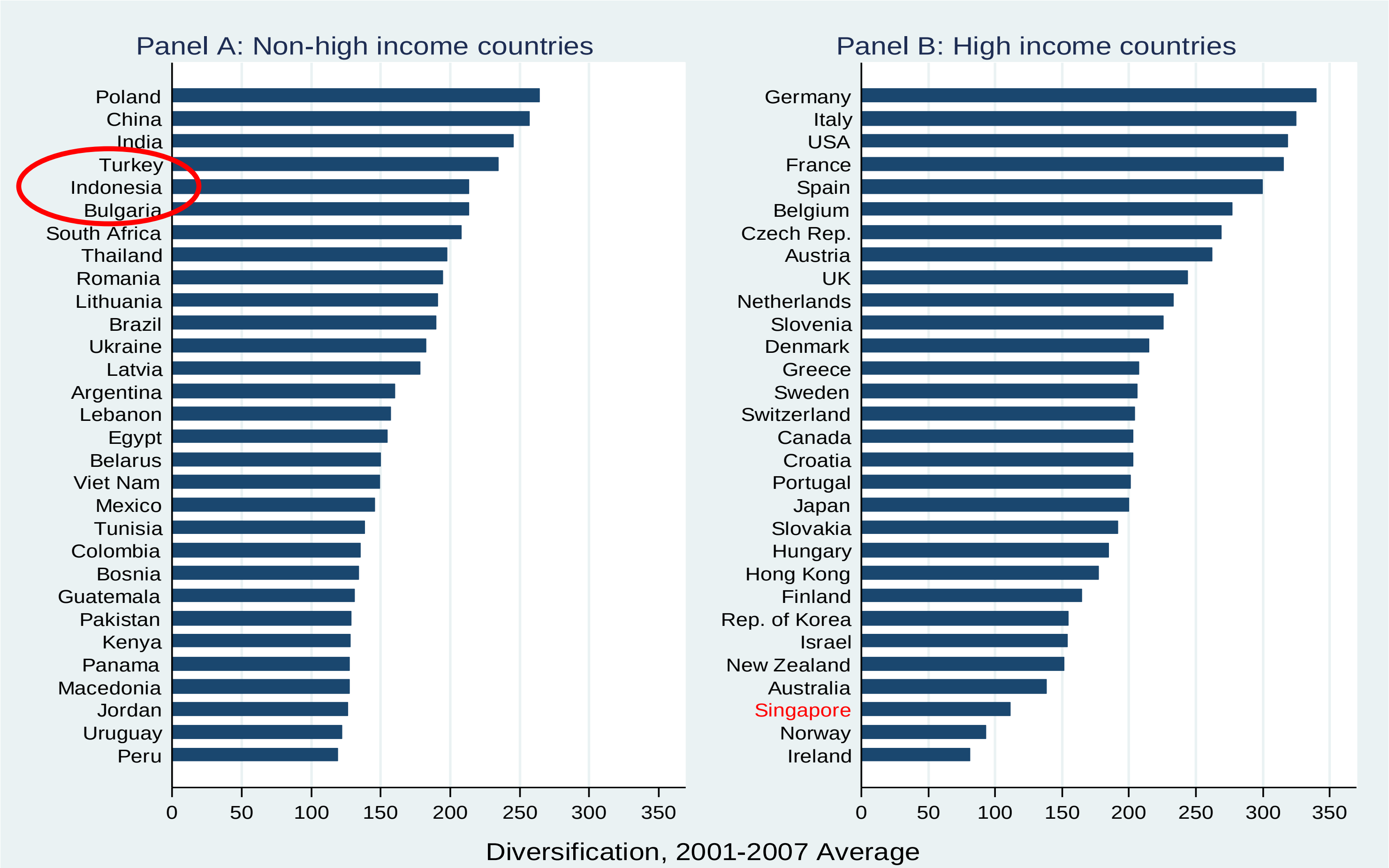



Source: J. Felipe, et.al. 2011.

# Level of Diversification

## Average 2001-2007

- **Better than sophistication**
- **Still need for improvement**

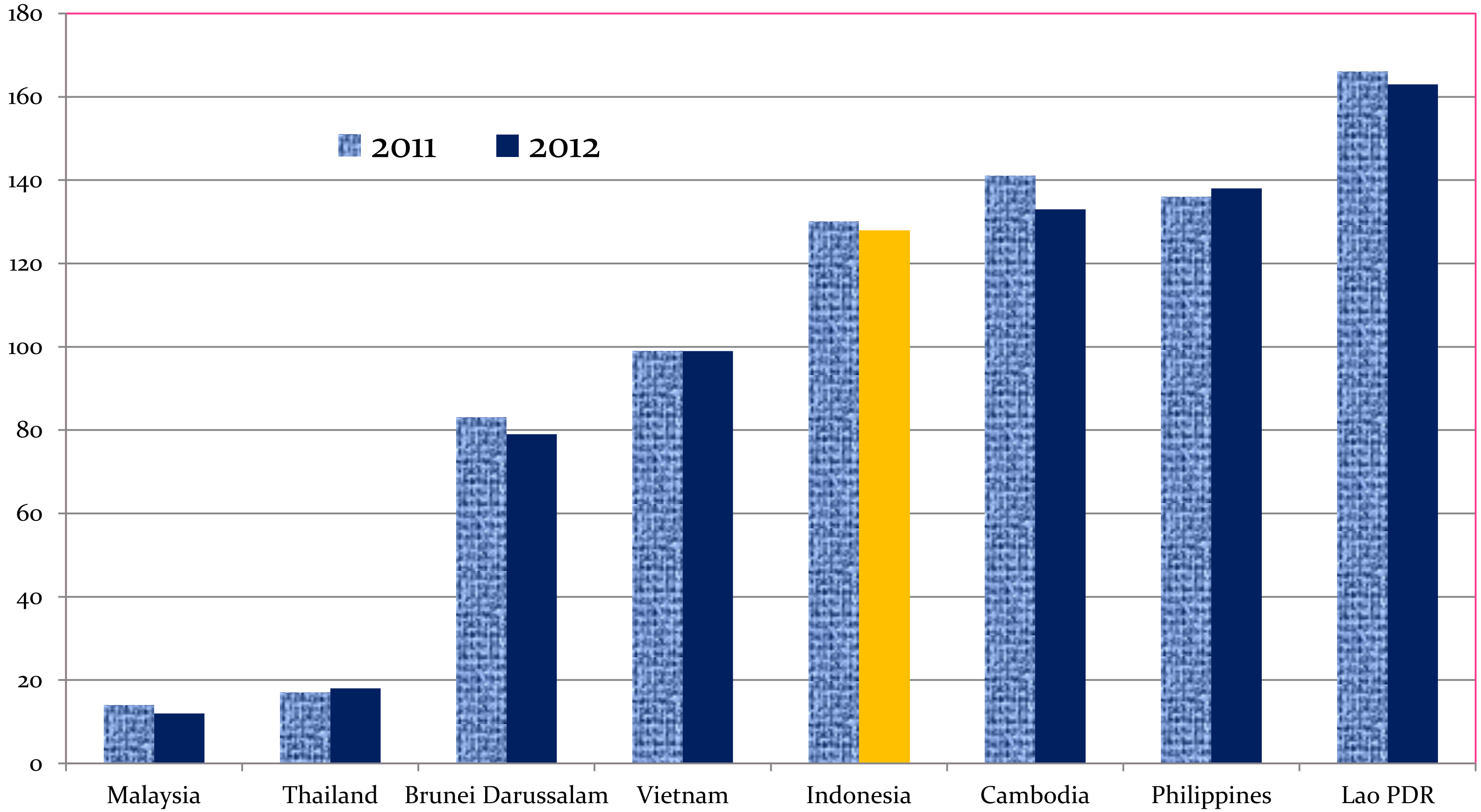



Source: J. Felipe, et.al. 2011

# Ease of doing business index

## (1=most business-friendly)

- Worse than comparable countries
- Getting worse
- Need some improvements

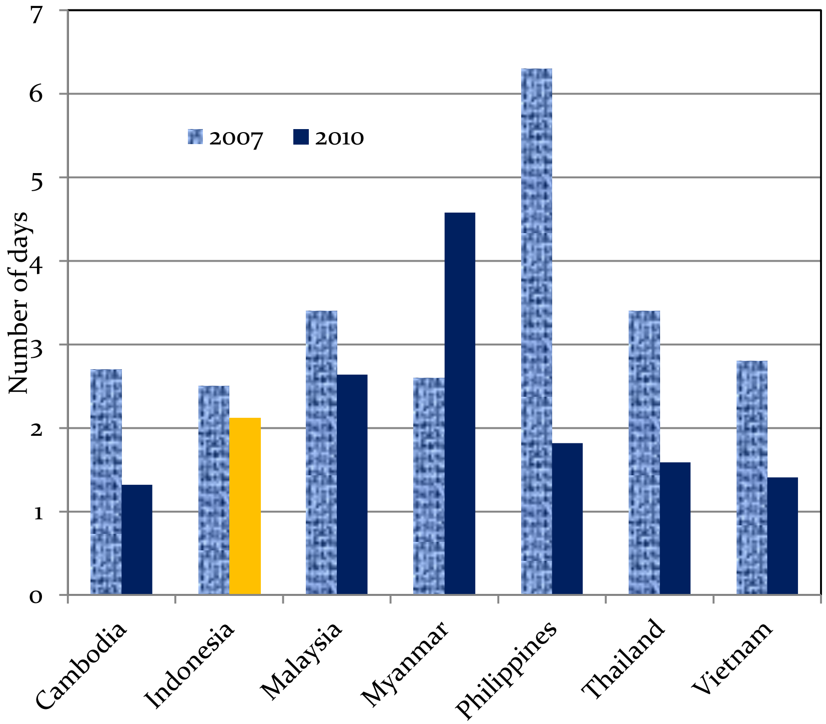



Source: World Development Indicator Online

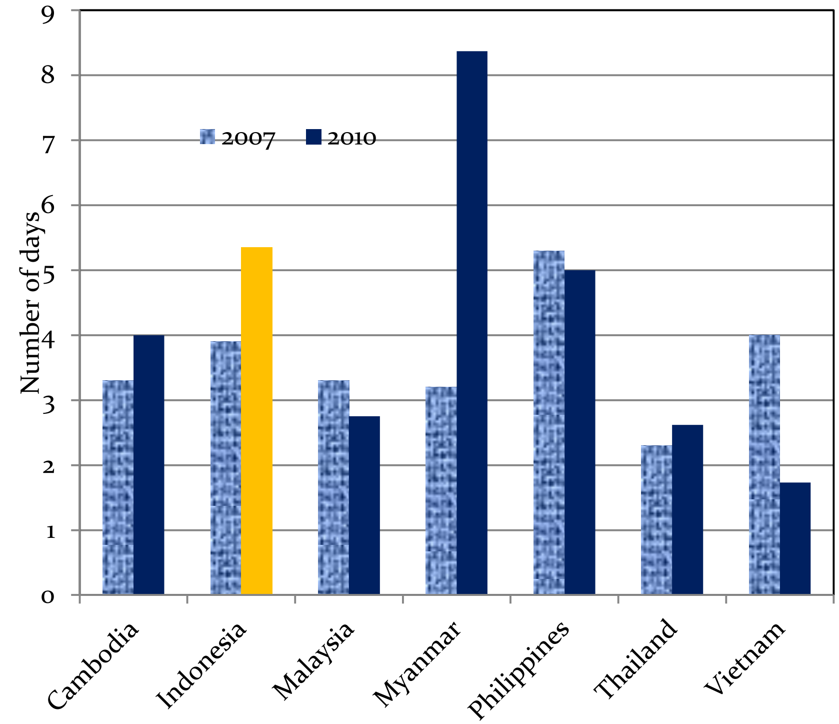
# Lead time to trade, median (days)

- Exports: Relatively good and improving
- Imports: Worsening and need more improvement

## Exports




## Imports

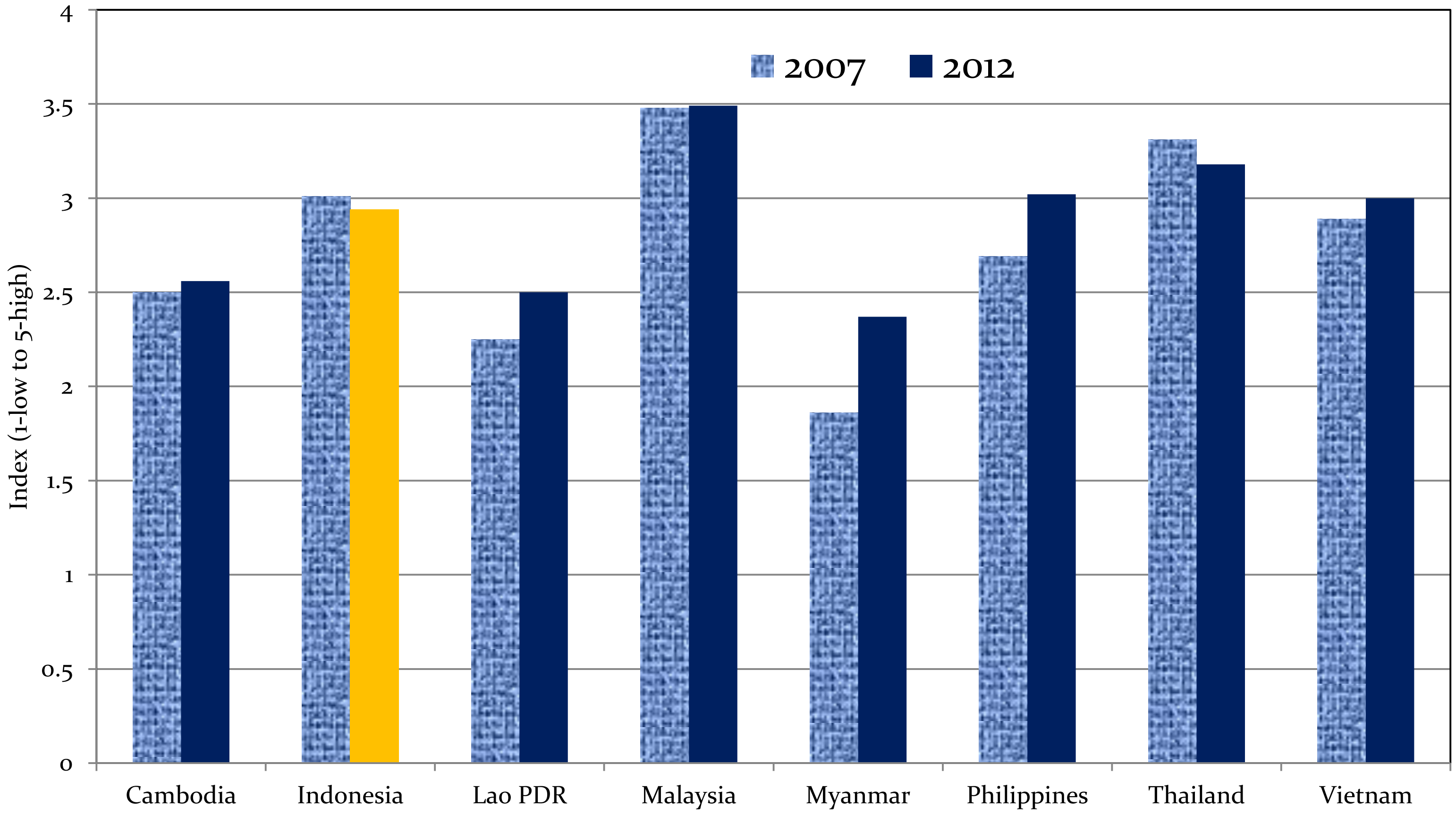



Source: World Development Indicator Online

# Logistics performance index

## (1=low to 5=high)

- **Declining LP**
- **Lower than THAI and MAL**




Source: World Development Indicator Online

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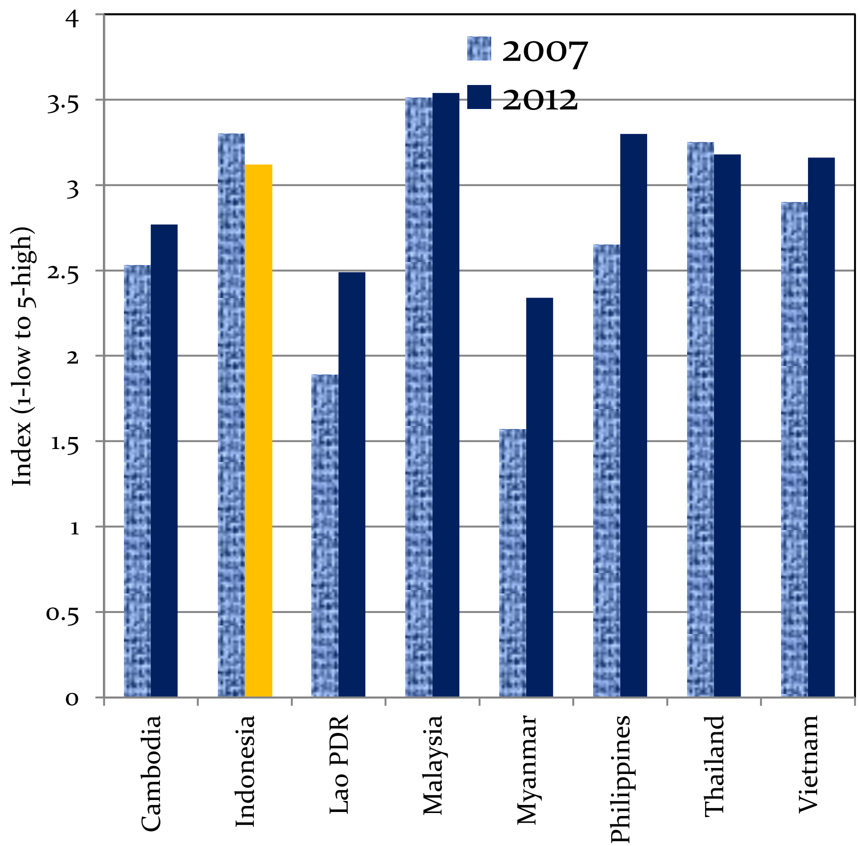
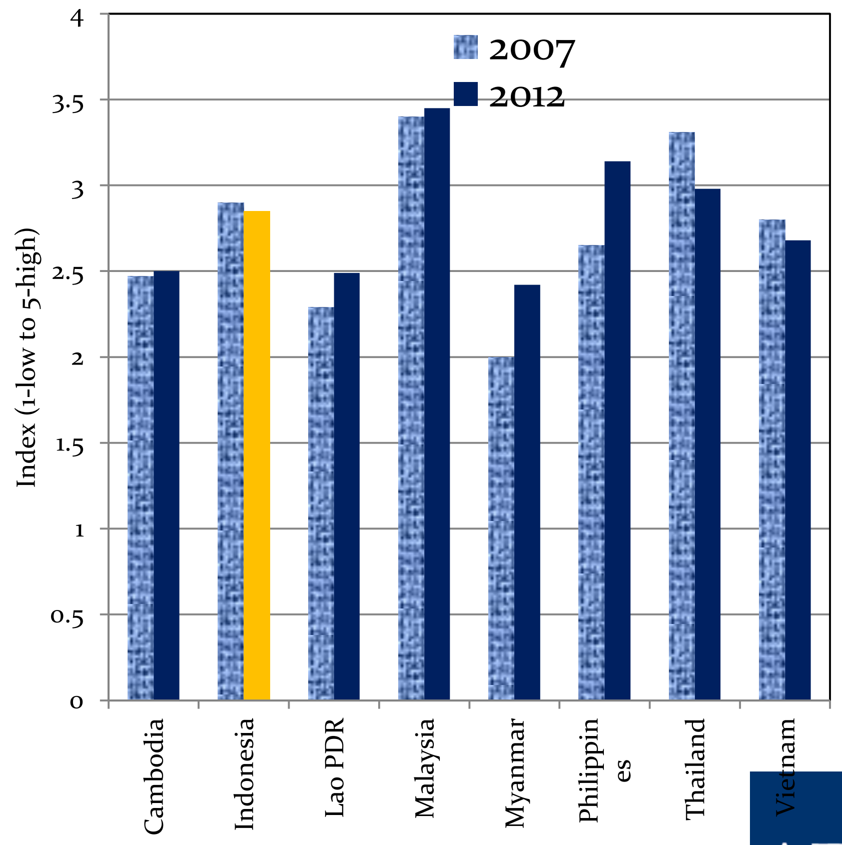
# Logistics performance index
## (1=low to 5=high)

• Declining: need to improve the system and service performances

### Ability to track and trace consignments




### Competence and quality of logistics services




Source: World Development Indicator Online

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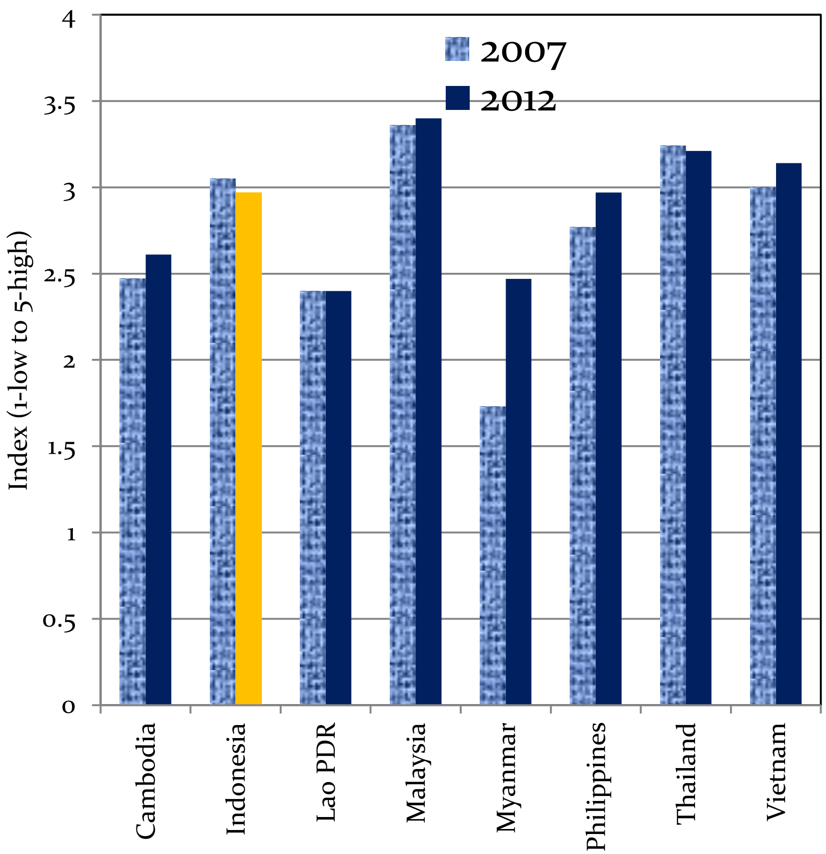
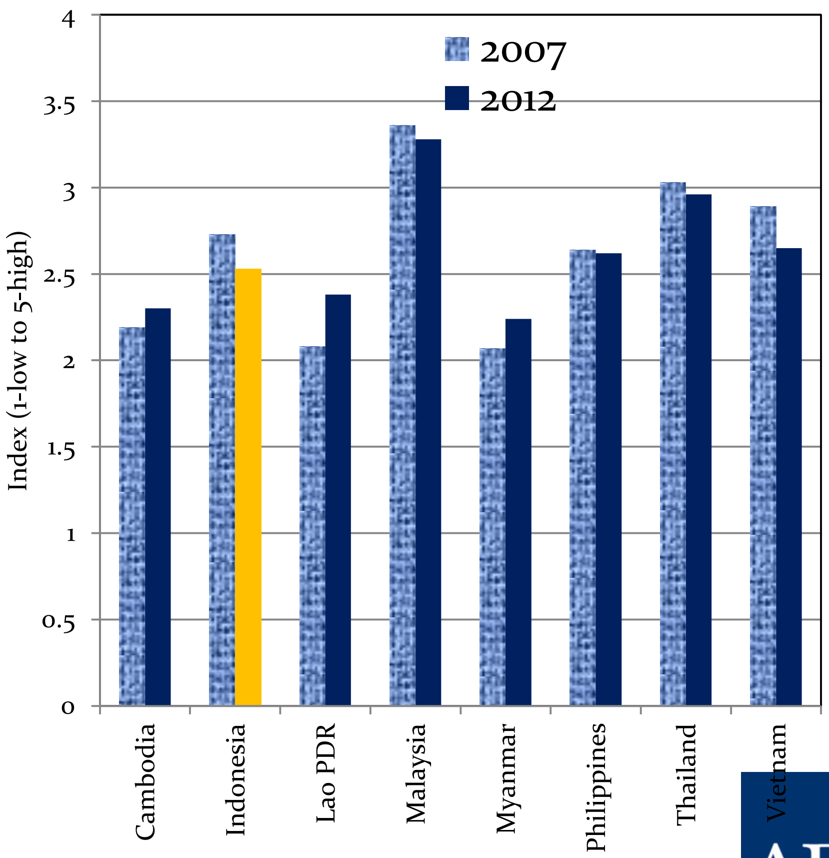
# Logistics performance index
## (1=low to 5=high)

- **Declining: need to improve the system and service performances**

**Ease of arranging competitively priced shipments**




**Efficiency of customs clearance process**




Source: World Development Indicator Online

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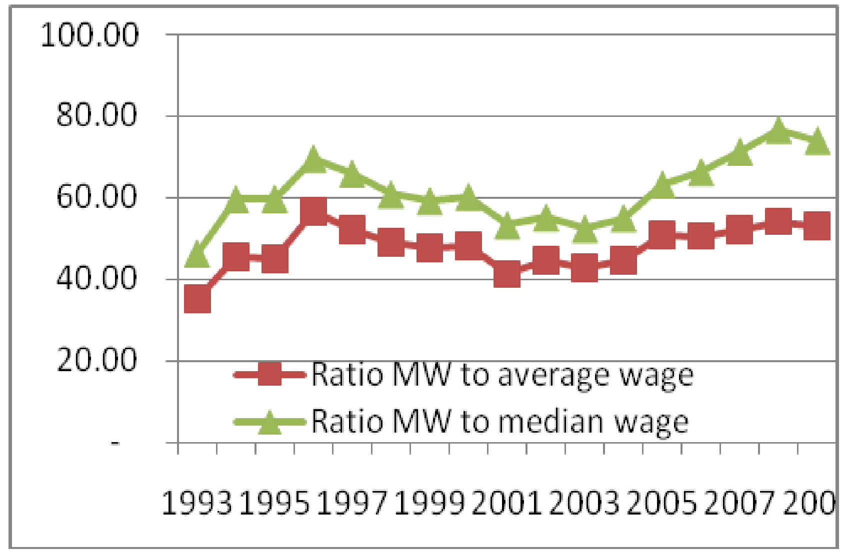
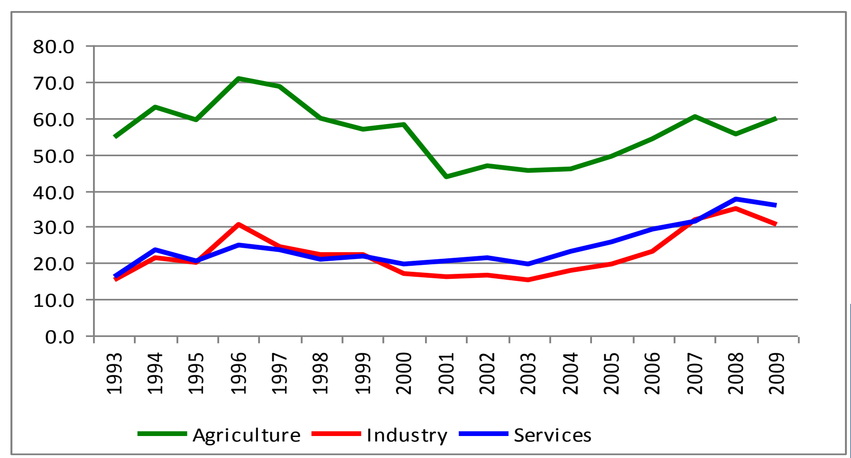
# Key Government Policies: Minimum Wage

- Key Problems:
  1. Increasing significantly regardless of other factors, i.e. higher than Average and Median Wages.
  2. Arbitrary across different districts: adverse effects of decentralization worsening the matter.
  3. Increasing non-compliance to MW especially after 2003.
  4. Not an effective tool for social protection and poverty reduction, creating adverse effects.
  5. Need to find a better way to determine MW to keep it relevant and competitive.

**Ratio of Minimum wage to median and average wage 1993 – 2009 (%)**



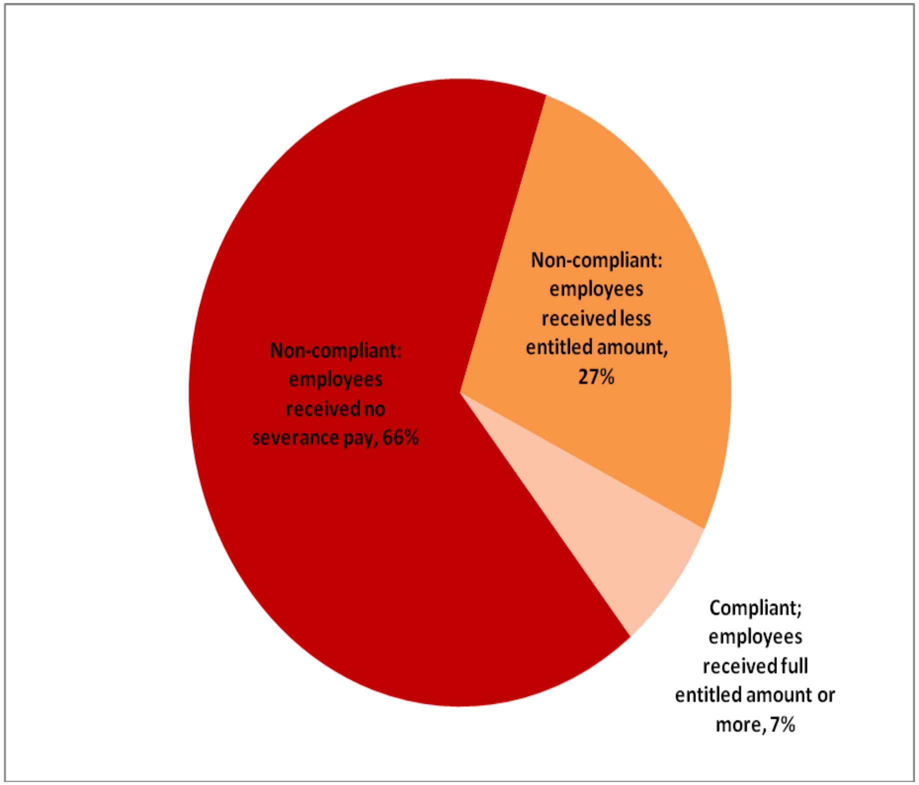

**Non-compliance to minimum wage by sector,1993-2009 (%)**



# Severance Pay

- Key Problems:
  1. Firing is the most expensive.
  2. Firms response by changing the labor contracts:
     - output based or other more flexible arrangements.
  3. Low enforcement .
  4. High non-compliance.
  5. Ineffective and creating adverse effects.

Receipt of Severance Pay, as reported by terminated workers




Source: Alatas and Newhouse (2010, p. 15)

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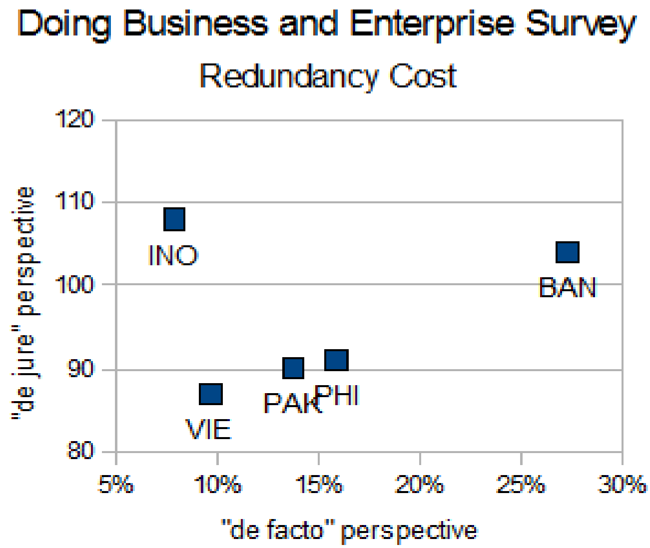
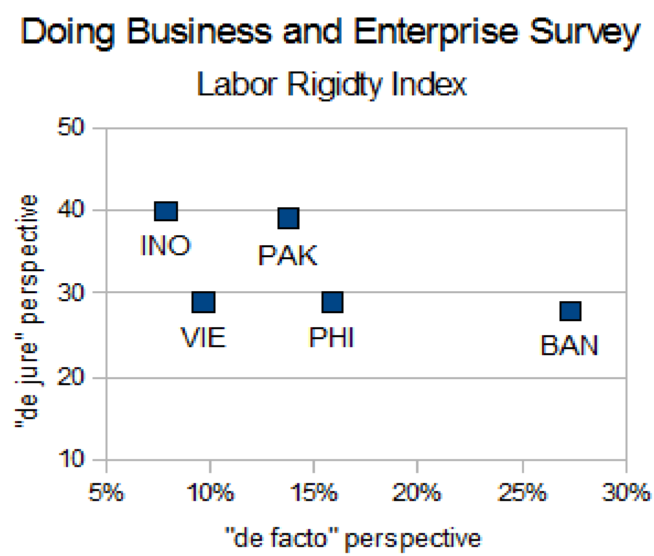
# Reality of the Policies

- **Minimum Wage**
- **Severance Pay**

Result:

A cross-country survey comparing labor regulation rigidity, Indonesia ranked 157 out of 181 countries. Compared with its neighbors in the East Asia and Pacific, Indonesia ranked 23 out of 24 countries with no other country in the region has firing costs as expensive as Indonesia (WB 2011).

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# Adverse Impacts

- Adverse effects of inconsistent rigid labor market regulations:
  1. Driving away new investments (good firms), which are more likely to generate good jobs.
  2. Encouraging existing (and new firms) to hire workers in short and less-permanent terms.
  3. Creating more uncertainties, worsening governance (corruption) issue and investment climate.
  4. Discouraging existing firms to expand and improve the quality of working relationship.
  5. Lowering potential growth.

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# Concluding Remarks

1. The economy: needs to grow faster and generate more good jobs to cater the growing number of labor force and to improve the overall quality of employment.
2. Trade : second generation of reforms
3. Employment:
   - As LM is very fragmented, improving the quality of employment must include addressing informality and underutilization issues, in addition to gender, urbanity etc.
   - Labor Market: workers always bear the costs of any economic downturns and the existing growth does not guarantee for quality employments. Therefore, a separate policy intervention is needed to improve LM and the quality of employment.
   - Moreover, workers and self employed are trapped in "lose-lose situation" and reforming LM only will not solve the problem. A more comprehensive reform is needed including improving the investment climate and revamping the industrial policy to strengthen the performance of industry sector.

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Thank You!

# Additional Slides: LM Policies

- Increasing labor productivity: higher labor productivity leads to increased employment and higher wages that would be beneficial to workers.
- Improving industrial relation: unions and collective bargaining to maximize aggregate utility.
- Improving labor quality at entry, including improving quality of education and training and reducing education and skill mismatch to improve skill and competitiveness of workers.
- Improve regulations and increase the role of public employment services to get a better labor market outcome.

# Social Protection and Programs

- Social protection to formal sector only will miss target. Need to move to a combination of different social insurances.
- Developing informal and formal social system such as unemployment benefits, better public services, and microfinance.
- Three cluster systems of social programs: Social assistance and protection, Community empowerment, and Micro and small enterprise development.