



This publication was financed with  
the support of the European Union



# Trade and Employment: Country Report for Indonesia



**Trade and Employment Programme, International Labour Office  
and ILO Office for Indonesia**

Trade and Employment:

---

**Country Report for Indonesia**

---

Copyright © International Labour Organization 2013

First published 2013

Publications of the International Labour Office enjoy copyright under Protocol 2 of the Universal Copyright Convention. Nevertheless, short excerpts from them may be reproduced without authorization, on condition that the source is indicated. For rights of reproduction or translation, application should be made to ILO Publications (Rights and Permissions), International Labour Office, CH-1211 Geneva 22, Switzerland, or by e-mail: [pubdroit@ilo.org](mailto:pubdroit@ilo.org). The International Labour Office welcomes such applications.

Libraries, institutions and other users registered with reproduction rights organizations may make copies in accordance with the licences issued to them for this purpose. Visit [www.ifro.org](http://www.ifro.org) to find the reproduction rights organization in your country.

---

ISBN 978-92-2-127810-8 (print)  
978-92-2-127811-5 (web pdf)

ILO

*Trade and Employment: Country Report for Indonesia*/International Labour Office – Jakarta: ILO, 2013

xii, 92 p

*ILO Cataloguing in Publication Data*

---

This publication has been produced with the assistance of the European Union. The contents of this publication are the sole responsibility of the authors and can in no way be taken to reflect the views of the European Union or the International Labour Organization.

The designations employed in ILO publications, which are in conformity with United Nations practice, and the presentation of material therein do not imply the expression of any opinion whatsoever on the part of the International Labour Office concerning the legal status of any country, area or territory or of its authorities, or concerning the delimitation of its frontiers.

The responsibility for opinions expressed in signed articles, studies and other contributions rests solely with their authors, and publication does not constitute an endorsement by the International Labour Office of the opinions expressed in them.

Reference to names of firms and commercial products and processes does not imply their endorsement by the International Labour Office, and any failure to mention a particular firm, commercial product or process is not a sign of disapproval.

ILO publications and electronic products can be obtained through major booksellers or ILO local offices in many countries, or direct from ILO Publications, International Labour Office, CH-1211 Geneva 22, Switzerland. Catalogues or lists of new publications are available free of charge from the above address, or by e-mail: [pubvente@ilo.org](mailto:pubvente@ilo.org)

Visit our web site: [www.ilo.org/publns](http://www.ilo.org/publns)

*“The contents of this publication are the sole responsibility of the authors and can in no way to reflect the views of the European Union”*

---

Printed in Indonesia

# Foreword

Trade reforms and openness have a significant impact on employment, particularly in developing countries. As Indonesia's economy has become increasingly dependent on trade, the impact of trade on employment in Indonesia is a subject of great interest but also major concern for the country.

Indonesia, as a member of the ASEAN (Association of South-East Asian Nations), is deeply involved in the region's trade integration initiatives, including the ASEAN Economic Community, which is supposed to be realized by 2015. Indonesia, as part of ASEAN or on its own, is signatory to several bilateral trade agreements with China, Japan, Korea, Australia, New Zealand, and India. As a consequence of these trade agreements, Indonesia has undertaken several measures of trade reform in recent years. Underlying these efforts is the assumption that trade will have a positive impact on businesses and workers in Indonesia. However, research shows, especially in developing countries, that trade has very uneven effects on the labour market in terms of creation and destruction of jobs, wages and workers' rights.

This publication is the result of a project funded by the European Union and implemented by the International Labour Office (ILO). The project, entitled "Assessing and Addressing the Effects of Trade on Employment (ETE)", aims to provide constituents with capacity building, policy recommendations from the studies conducted by the project, and a platform for discussion and formulation of national policies related to trade and employment by key stakeholders in the government and the private sector, in particular representatives of employers and workers.

This report highlights the relationship between trade and employment in Indonesia for the formulation of national policy. It draws on the studies conducted by the ETE Project in Indonesia and discussions held during the meetings of the ETE Policy Working Group in Indonesia. The report stresses the need for Indonesia to take appropriate measures to mitigate the adjustment costs of trade liberalization. It also emphasizes the need for additional policies to improve the country's supply capacity, which would require a significant improvement in physical infrastructure, higher labour productivity, and better economic governance.

We expect that the findings of this report will be of great interest to all those, especially policy makers and social partners in Indonesia, who are concerned about the challenges of development in a globalized world. We would like to thank Ms. Diah Widarti (ETE National Project Coordinator in Indonesia) and Dr. Carunia Mulya Firdausy for their contributions to this report and Mr. Lucky Lumingkewas (ETE National Project Officer) for facilitating its publication. We hope this report paves the way for useful discussions and contributes to policy reforms for inclusive and job-rich development in Indonesia.



**Peter van Rooij**  
Director, ILO Jakarta



**David Cheong**  
Chief Technical Adviser,  
ETE Project, ILO Geneva.



# Executive Summary

This report aims at assessing and addressing the effects of trade on employment in Indonesia. The significance of this report is to support the analysis of effective and coherent trade and labour market policies that address the adjustment challenges that workers and employers face and expand opportunities for the creation of decent employment in Indonesia. Methods to collect the data and information are based on secondary sources advanced in the published literature and meetings with individual constituents including the National Planning Board (Bappenas), Ministry of Manpower and Transmigration (MOMT), Ministry of Trade (MOT), Confederation of Technical Units, National Chambers of Commerce (KADIN), Trade Association (APINDO), and other relevant individuals. The findings of this report are as follows.

The Asian Financial Crisis (AFC) and the global crisis have had an important impact on Indonesia's development. After GDP growth plummeted to -13.8 per cent in 1998, the economy quickly recovered and has performed relatively well since 2003. It is now predicted to continue improving. The World Bank Economic Report on Indonesia's Trade Development (2011) states that Indonesia's economic growth in the fourth quarter of 2010 exceeded expectations and was well above the average quarterly growth rate for the last ten years. The earlier growth forecast for 2011 has been upgraded to 6.4 percent, moving up to 6.7 percent in 2012.

Although agriculture is the main livelihood for Indonesia's population, its share in GDP is relatively small: 14.9 per cent in 2004 and estimated to come down to 12.7 per cent in 2011. While the manufacturing sector accounted for 28.4 per cent of the Indonesian GDP, but since 2009 its share has declined. This sector has faced problems for several years, and Indonesia's manufacturing has become less competitive. Meanwhile, a rising trend in the services sector's share has been observed: 46.39 per cent of the GDP in 2004 growing to 53.1 per cent in 2011.<sup>1</sup>

Indonesia has been attempting to attract foreign investment in order to serve the domestic market as well as to support the supply of competitive products to international markets. Indonesia's Foreign Direct Investment (FDI) has been fluctuating, but with a positive trend. In 2010 Indonesia's FDI more than doubled from the previous year amounting to \$12.7 billion, with the biggest investments coming from Singapore, the United Kingdom, the United States, Japan and the Netherlands.

---

<sup>1</sup> The services sector includes construction, wholesale/retail trades, transportation/storage/communication, finance/real estate/business services and community/personal services.

Despite its economic progress, Indonesia's Human Development Index (HDI) in 2010 ranked 108 out of 169 countries; and in 2011 its rank went down to 124 out of 187 countries. The level of Indonesia's HDI is still lower than that of either the world or levels in East Asia and the Pacific.

Indonesia has made some progress in educational development. Decline in illiteracy rates were noted in the last decade. The proportion of the population aged 15+ who had no schooling or never completed primary school, as well as those of with a low educational level (i.e., completed primary school or junior high school) has also decreased. On the other hand the proportion of those with a higher educational level (senior high school and above) has increased over time.

In the last decade, the poverty incidence has declined although it remains high, while the rise of the middle class population has increased steadily. In spite of such progress, many social indicators demonstrate that Indonesia continues to face huge challenges in promoting its human resources in terms of skills and education as well as in further reducing poverty.

Although Indonesia has made substantial progress in implementing trade reforms, the country's attitude towards trade liberalization can be described as inconsistent. Major changes in Indonesia's trade policies in many cases are considered to be instigated by several external factors. Trade liberalization will make Indonesia face more severe competition in import-competing markets.

Although the free-trade momentum attempts to facilitate access to the global market particularly for developing countries, Indonesia remains challenged by many impediments in particular the technical barriers to trade in many trading partners, especially developed countries. Meanwhile, Indonesia's market is deemed too difficult by many traders from developed nations to access because of the burdensome requirements imposed, for example, in registration and licensing. As a consequence, trading partners resolve such inhibiting factors through bilateral trade agreements, which by some are considered effective.

To achieve the objective of creating productive and full employment through external trade, Indonesia should identify its trade strategies, for example by moving up the value chain, and better exploit its comparative advantages as well as use production factors more efficiently. In order to generate policy coherence, trade policies are not to stand alone in reaching this goal, as they are intertwined and interlinked with other policies such related to labour, finance, education, industry, etc. Hopefully, coherence in policies particularly between trade and employment may support and strengthen the path towards decent work for all.

With the increase of Indonesia's working age population from 164 million in 2007 to 174 million in 2012, the labour force accordingly grew from 110 to 118 million for the same years. In other words, the labour force grew at 1.5 per cent on average annually. Although Indonesia's unemployment rate is declining, the number remains high, 6.14 per cent in 2012 (7.2 million unemployed). Youth unemployment is one of the most problematic issues for Indonesia; almost one in every five youth in 2010 was unemployed. Moreover, the ratio of youth to adult unemployed was very high, 10 times in 2004, although declining to 5.7 times in 2008.

Some changes in employment structure are noted, which are attributed mainly to changes in economic and demographic structures. The shift from agriculture to higher value-added economic sector has been happening, which is expected to be an important key to increase labour productivity.

The majority of the employed population in Indonesia (2005-2009) has a low educational level; more than 50 per cent either have never been to school or have only less than a primary school level, although their share has seemed to decline with time. The share of the employed population with university education is relatively small although increasing.

Only one third of employed people in Indonesia were working as an “employee” in 2010, which roughly means that only around one third of Indonesians worked in a formal working relationship, leaving a considerable share in the informal sector. Throughout 2004 to 2010 the employed population working in precarious jobs has increased.<sup>2</sup> Over the last decade, the rising trend of precarious work went along with the declining unemployment rate, which demonstrates that more job opportunities have been created but more frequently in insecure conditions.

In general, the average real wages for all employees has increased since 2000, even though a downturn was noted in 2005, which was caused by a 200 per cent increase in the price of fuel. Despite the increase in average real wages for both sexes, the gender gap in average real wage is relatively large, albeit declining with time. There has been a rapid increase in average real wages, but the share of low paid employees, especially casual employees, has increased in the last 15 years. It seems that the minimum wage policy is inadequate to protect workers especially casual employees and female employees, in addition to the fact that the government faces non-compliance problems in implementing the minimum wage policy.

Indonesia’s labour productivity measured as the ratio of output per worker has increased slowly, after experiencing a slight dip during the 1997/1998 AFC. In line with the economic recovery, labour productivity increased from 15.5 million IDR in 2000 to 21 million IDR in 2009, an annual average growth of 3 per cent.

After 1998, the union movement in Indonesia has been flourishing. The country has now at least 70 national trade unions and as many as 10,000 factory unions. Even though the number of trade unions has been mushrooming after the reformation, the number during 2005 to 2009 fluctuated with generally a negative trend. The union density rate relative to total employees in Indonesia is relatively low: 13 percent in 2005 decreasing to 11.7 in 2009. In 2005 the union density rate relative to employed people in 2005 was 3.6, which means that only 3.6 out of 100 employed people were members of trade unions. The low and declining trade union density rate most possibly reflects the rather fragmented structure of trade unions in Indonesia.

The share of registered firms in Indonesia belonging to employers’ organizations has tended to stagnate. Although the number of companies that were registered with the authority showed an increasing trend, the share of the registered firms belonging to the employers’ association APINDO showed no increase.

The increasing number of collective labour agreements (CLA) as an indicator of social dialogue in Indonesia has been noted. There were 9,168 CLAs in 2005, which increased to 10,683 in 2009 or grew at 4 per cent annually. Despite the increase in the CLA number, the coverage rate of workers by collective labour agreements is still very low. An increasing number of strikes/lockouts have been observed during 2005 to 2009. A relatively high rise was noted in 2005/2006. In 2005, there were 96 strike and lockout activities, while in 2006 this number increased to 282. This was almost a three-fold

---

2 Precarious jobs are generally referred to as jobs that lack of stability and security.



increase in that one year. Consequently, the workers involved, working hours lost, and working days lost also increased by multiples of 10.5, 6.3 and 6.3 respectively.

The government policy strategy in the area of employment is to advocate the “decent work agenda”, which has become the ultimate goal of Indonesian development with regard to employment. Job creation is a major concern for Indonesia, role that is frequently played by the informal economy particularly during times of crisis. The mandate of employment creation in Indonesia is well mainstreamed across all economic sectors and development programs. The government strategy to stimulate employment in the country is to promote economic growth and to increase trade and investments. There have been efforts to provide a favourable investment and business climate as well as supportive labour-market conditions through regulations.

The government initiatives to achieve decent work include the establishment of various institutions such as the Wage Council, the Productivity Council, the Training Council, and the National Skills Certificate System (*BNSP*). The latter evaluates and certifies the skills of workers to enable them to work in the country and abroad. The government adopts active labour-market policies such as training, job-search assistance and career guidance which can provide both a cushion and encouragement to vulnerable groups, although more improvements are deemed necessary. Enhancing labour-market information (LMI) services is critical for informed decision making and in social dialogue between the government, employers and workers. LMI services may support monitoring of the labour market, detecting early signs of changes and help design and allocate resources for policy making. Furthermore, they assist employers in their operational decisions and job seekers in their labour market choices.

Indonesia’s exports are mainly resource-based commodities, while manufactured-product exports have not been well developed. In general, merchandise exports have a much larger share than those of services exports. The structure of Indonesia’s trading partners has altered since 1990 with the main partners being increasingly Asian countries followed by European as well as North/Central American countries. In the last twenty years, imports particularly came from Europe and North/Central America, but now they are mainly coming from Asia (more than 20 per cent). A shift of Indonesia’s export market destinations has occurred from 5 main destination countries (i.e., Japan, the European Union, China, the USA and Singapore) to emerging-market destinations.

Lagging infrastructure development is deemed as the primary constraint on Indonesia’s economic growth. The government has made infrastructure development a key priority in both its Medium-Term National Development Plan (RPJM) 2010–2014 and the longer-term national development (RPJPN). The subdued external economic environment in 2012 should provide an incentive for a stronger push on infrastructure development to support growth in the near term, as well as raise the country’s potential in the medium term.

Most studies on the impact of international trade (globalization, trade openness and free trade arrangements) on the labour market outcomes in Indonesia generally conclude that trade liberalization will have a positive impact on employment, wages and household income. Nevertheless, the benefits may not be distributed equally across groups (skilled vs. unskilled, urban vs. rural, etc.).

Given the importance and potential controversy of the topic – international trade can be argued as either good or bad for workers – there has been not too many studies analyzing the impact of free trade on the labour market. Of those that have attempted to analyse the issue, practically no studies have provided clear and direct evidence of causal impact of trade on labour market outcomes. Most

studies using survey data relied on association or, at best, indirect evidence, since it is difficult to show the counterfactuals – what would have happened to the labour market in the absence of trade openness. The other group of studies has provided CGE simulations. While CGE simulation is another method to consider, it has many limitations as the results would depend heavily on a set of assumed parameters as well as specific scenarios.

Seeing that there has been a shift in the employment structure whether it is trade-led or non-trade led, facilitating labour mobility across sectors should be a key policy concern. This can be accomplished, *inter alia*, through increased investment in the agricultural sector with a view to raising its productivity. This productivity improvement in the agricultural sector can potentially maintain the present number of the workers employed in this sector but provide them with better terms and conditions of work.

The changes in sector composition of employment would also lead to changes in skills demanded in the labour market. The rise of modern service sectors demands specific sets of higher skills such as computer literacy and customer-oriented mind sets. In addition, with Indonesia's new status of a middle-income economy, the country is losing its labour-cost advantage, and industries are requiring an increasingly skilled labour force to perform more capital-intensive and value-added production. Improving the skills of the labour force to meet the needs of such industries has emerged as both an opportunity and a challenge in the labour market. In this regard, the education and vocational training system plays a critical role in preparing the workforce to effectively adjust to structural shifts, changing technologies and volatile economic landscapes.

Another particular concern is the existence of casual workers. Although the share of casual employment is still small at less than 10 per cent of the total employment in 2010, its share in the workforce is expanding, thus the government should be alarmed because they are not protected by any labour or employment regulation including social protection.

Introducing an optimal balance between security for workers against various risks in the labour market and flexibility of the labour market that fosters an enabling business environment should be a major concern for the stakeholders. It is necessary to promote constructive social dialogue that can seek an optimal balance of security and flexibility in the labour market by taking into consideration existing labour market institutions, tax regimes, and other factors.

To sum up, the impact of international markets through globalization, trade openness and free trade arrangements on employment in Indonesia have not always been fully positive as there are still the problems of high unemployment both open unemployment and under-employment. The incidence of open unemployment in particular has continued to be more pronounced among women, the educated workforce and youth. This is simply because Indonesia's economy is still characterized by economic duality. Hence, the benefits of international trade have not been distributed equally across groups (skilled vs. unskilled, urban vs. rural, etc.). However, this does not suggest that there should be policies to protect the economy from future trade liberalization. What it suggests is that future employment policies should be sensitive toward the dynamics of trade liberalization. This, for instance, can be done by optimizing investments in productive human resources and creating a better domestic industrial and working environment. Without coherence between trade and employment policies, there will be almost no gains from opening international trade for employment in Indonesia.



# Contents

Foreword	iii
Executive Summary	v
Chapter 1. The Economic Situation and Social Conditions in Indonesia	1
1.1. Economic Conditions	1
1.2. Social Conditions.	10
References	14
Chapter 2. National Development Strategies and Trade Policies	17
2.1. National Development Strategies and Policies	17
2.2. Trade Strategies and Policies	18
2.3. Trade Measures	21
2.4. Trade Development Strategy	30
2.5. Indonesia's Trade Cooperation	31
2.6. The Impacts of Trade Cooperation on Employment: Government and Trade Unions Perspectives	34
References	38
Annex 2.1	41
Chapter 3. Indonesia's Labour Market and Employment Policy	43
3.1. Characteristics of Indonesia's labour force	43
3.2. Labour market policies in Indonesia	60
References	64
Chapter 4. Effect of International Trade on Indonesia's Labor Market	67
4. 1. Introduction	67

4.2. Sources for Indonesian Trade and Employment Data	69
4.3. Trade, Economic Liberalization and the Labor Market: an Overview	70
4.4. General Equilibrium Simulations	76
4.5. Micro-level Studies	79
References	84
Chapter 5. Conclusions and Policy Recommendations	89
5.1 Conclusions	89
5.2 Policy Recommendations	90

# The Economic Situation and Social Conditions in Indonesia

This chapter provides brief investigation on social-economic conditions of Indonesia as a background in understanding the country's trade and employment development. The chapter described macro economic conditions, especially sectoral growth and distribution of GDP, rate of inflation and investment before 2012. In addition, this chapter also discusses the development of social conditions including poverty, rate of population growth and education level, and other related issues that will be discussed in the second part of this chapter. Data and information used throughout this chapter were collected from, among others, the Central Board of Statistics (CBS), The World Bank, Asian Development Bank (ADB), International Labour Organization (ILO), United Nations Development Programme, and Bank Indonesia.

## 1.1. Economic Conditions

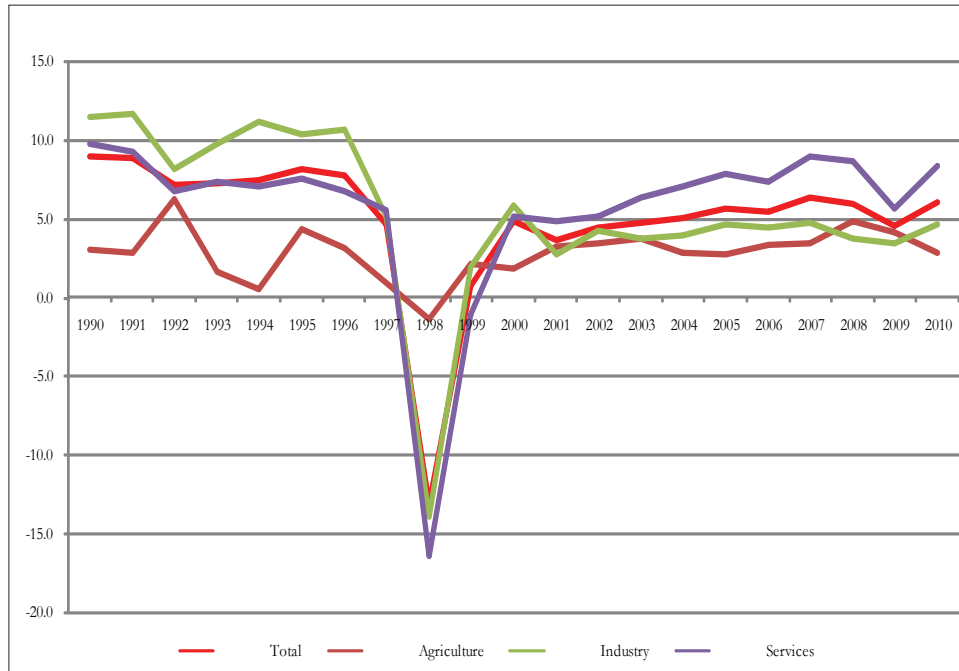
### Sectoral Growth of Indonesia's Gross Domestic Product

From 1990 to 2010, growth of Indonesia Gross Domestic Products (GDP) have fluctuated. In the past years until 1997, Indonesia's economy grew at an average of 7 percent annually. It was among the fastest growing economies in the region and among developing countries. The country's economic growth had brought significant benefits to the population in general. A steadily growing share of Indonesia's labor force, supported by the constantly growing economy and globalization in the past, has made a significant transition from agriculture employment opportunities to high productivity jobs in the industry and services sector.

Such impressive picture of the Indonesian economy however, was overturned when the 1997/98 Asian Financial Crisis (AFC) hit the country. As a result, GDP growth plummeted to -13.8 percent in 1998. The country's economic recovery went slow, as indicated by an increase of employment rate in the agriculture sector, declining employment rate in the industrial sector, and an increase of employment

rate in the informal sector. Nonetheless, the country's GDP has managed to increase to approximately 5 percent annually since 2003, even reaching 6.3 per cent in 2007 despite a slight decrease in 2008 (**Figure 1.1.**). This condition was likely to be caused by global downturn of exports and manufacturing.

**Figure 1.1. Growth of GDP by main sector, Indonesia 1990–2010**



Source: ADB Key Indicators for Asia and the Pacific 2011.

Due to reduced domestic and external demand, GDP growth in 2009 experienced a slight slow down before picking up again in 2010. Several economic sectors that experienced an increase in its GDP are mining sector; transport and telecommunication; as well as utilities like electricity, gas and water supply. Transport and telecommunication sector had grown at 8.3 percent in 2003 and increased to 16.7 percent in 2008. Such a significant growth also reflects the expansion of its sub sectors. The telecommunications sub-sector continues to expand in line with the increasing demand for telecommunication services, as indicated by the rapid increase of telephone line subscribers ratio from 6 out of 1000 people in 1990, to 58 out of 1000 in 2005, and further to 130 out of 1000 in 2008 (**UNDP, 2007/2008 and WDI 2010**), followed by the increase of mobile phone and internet users ratio from 6 to 62 users out of 100 people and 2 to 7.9 users out of 100 people during the period of 2003 to 2008, respectively (**WDI 2010**). The mining sector also had grown at a much higher rate in 2009 compared to the previous years.

On the other hand, growth rate of the manufacturing industry experienced a downturn after the 1990s, from 11.5 per cent in 1990, to 5.2 in 1997, and further plummeted to -14 percent; and from 4.7 per cent in 2007 to 3.7 per cent in 2008, and further decreased to 3.5 per cent in 2009, which was the industry's lowest growth rate since 2002. The deceleration was caused partly by slow growth of the manufacturing sector, which was hindered by a decreasing external demand and suppression of domestic credits, notably credits for working capital. Power shortages in several cities caused by low investment in the energy sector, also affected factory output. In 2010 however, the growth rate returned to 4.7 percent (**ADB, Key Indicators 2011**).

Despite the global financial and economic crisis, Indonesia's economy in 2008 has continued to grow, achieving 6.0 per cent growth. However, global economic decline in 2009 slowed the country's economic growth down to 4.6 per cent in 2009, which was the third highest economic growth rate in the world after China and India at that time. Indonesia's economy has managed to endure its difficult years in a relatively good shape under the support of, among others, strengthened macroeconomic management and oversight of the financial sector; high household consumption in GDP compared to exports; and increased domestic consumption.

Strong momentum experienced by the country's domestic economy, coupled with increasing international and domestic commodity prices similar to the conditions in 2008, was observed during the first quarter of 2011.<sup>1</sup> Recent economic report from the World Bank stated that Indonesia is displaying a strong economic performance. Growth in the fourth quarter of 2010 exceeded any expectations and was well above the average quarterly growth rate for the last ten years. Initial World Bank's economic forecast for 2011 that has been increased to 6.4 percent, was increased even further to 6.7 percent in 2012. Balance of payments inflows are substantial and foreign direct investment has increased to record levels. Despite this bright economic outlook, increasing commodity prices up to or even higher than its previous 2008 peaks, had bring inevitable risks for Indonesian. Although increasing commodity prices may bring benefits for the country's GDP as a whole, mainly because of the country's abundant resources, underprivileged and low-income citizens may be affected by a sharp increase of living costs.<sup>2</sup>

Despite the Indonesia's economic achievements over the recent years, generating more investment in infrastructures and creating new job opportunities are the country's major challenges. Moreover, low economic growth will led to lower wages. The NLFS (National Labor Force Survey) data projected that global crisis has resulted in the increase of casual and temporary workers (**BPS, Sakernas 2009**). Although it remains high, decreasing trend of unemployment rate suggested that many unemployed individuals are likely to be absorbed into the informal sector. It is possible that the increase of employment rate in the informal sector has bring a significant impact in the country's labor market crisis.<sup>3</sup> In addition, the rate of individuals who are underemployed in Indonesia remains high at around 30 per cent.<sup>4</sup> With a large number of individuals or households are dangerously close to the poverty line, the smallest distortion on income can led them below the poverty line, forcing them to cut back on long-term investments such as education (**ILO Labour and Social Trends 2009**).

In response to the global crisis, the Indonesian government has prepared a stimulus package in form of tax rebates, aimed at promoting aggregate demand. However, the package may have limited applicability because most Indonesian labor force is concentrated in the informal sector. In addition to the stimulus package, developing labor-intensive infrastructure, eradicating poverty and organizing programs to improve labor skills and competitiveness, and other measures to restore the economy were some of the measures taken by the government to mitigate the impact of global crisis. The crisis has also highlighted the importance of labor market information and statistics in detecting early signs of change and drafting the appropriate policies (**Bank Indonesia, 2010**).

---

1 World Bank's March 2011 Indonesia Economic Quarterly- "2008 Again?". <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/EASTASIAPACIFICEXT/INDONESIAEXTN/0,,contentMDK:22860454~pagePK:141137~piPK:141127~theSitePK:226309,00.html>

2 Shubham Chaudhuri, Indonesia Lead Economist, World Bank.

3 Sakernas data show that in 2009 around 60 percent of the employed people in Indonesia were in the informal employment.

4 Underemployment is defined as those working less than 35 hours per week whether their being underemployed is voluntary or not.



In order to generate both direct and indirect employment opportunities, the Government has launched an integrated economic policy package that is aimed to improve investment related services, harmonize central and regional laws and regulations, improve customs, excise, and taxation services, create more jobs, and promote small and medium enterprises.<sup>5</sup> In addition, other Government programs that were designed to reduce unemployment rate, such as the National Community Empowerment Program (*PNPM*) for block grants, disbursement of Grass roots Business Credit (*KUR*), the Unemployment Reduction Movement and distribution of Direct Cash Transfers, all have some positive influence on the improvement of welfare indicators.<sup>6</sup>

## Sectoral Distribution of Gross Domestic Product (GDP)

Indonesia possesses abundant natural resources, and has a wide range of export commodities such as oil and its derivative products, gas (natural and manufactured), minerals, and other manufactured products including textiles, electrical appliances, and agricultural commodities that include coffee, tea, cocoa, spices, rubber, vegetable oils and fats, fish, and their preparations (**Bank Indonesia, 2009 and 2010**). Most of Indonesia's major export commodities are high quality products.

During the period of 2004 to 2009, one fourth of the Indonesian GDP had been originated from the manufacturing sector. In fact, manufacturing sector contributed a large amount of share in the Indonesian GDP, accounted for 28.4 percent of the country's total GDP in 2004. Since then however, it has slowly decreasing down to 26.8 percent in 2008, and 26.2 percent in 2009 (**Table 1.1**). Despite its substantial contribution to the country's economy, manufacturing sector has faced many problems for several years. Exports of textiles, electronics, footwear, pulp and paper, and wood products have come to a halt even as the world market expanded, suggesting that Indonesia is becoming less competitive. Indonesian competitiveness industrial performance (CIP) index in 2005 was experiencing a 0.198 decrease to 0.203 in 2009, lowering Indonesia's rank from 40th in 2005 to 43<sup>rd</sup> in 2009 among 118 countries (**UNIDO, 2011**). In fact, the country's exports of mineral and agricultural commodities have become highly dependent on unstable world markets. Meanwhile in 2008, Indonesia's mining sector (which includes oil and gas) grew at an extremely low 0.5 percent rate, and estimated to grow even slower (at 0.3 percent in 2009) regardless of high global prices for metals and energy in the first semester.<sup>7</sup>

Agriculture sector in the Indonesian economy constituted a relatively small 14.9 per cent of the GDP in 2004 and has a tendency to went even lower each year, as low as 13.6 percent in 2009, and 12.7 percent in 2011. It is however, provides substantial employment opportunities for many Indonesians. In 2008 the agriculture sector absorbed 40 per cent of the country's total labor force. Food production grew firmly at the average of 5.9 per cent in 2007 to 2008, well above the average growth rate of agriculture (4.8 per cent) in the same year (**BPS website**).<sup>8</sup> On the other hand, the services sector (including construction, wholesale/retail trades, transportation/storage/communication, finance/real estate/business services and community/personal services) tends to have an increasing trend, contributed 46.39 percent of the GDP in 2004, 50.6 percent in 2008, 51.2 percent in 2009, and an estimation of 53.1 per cent in 2011 (**Table 1.1**).

5 Presidential Instruction (INPRES) No. 3/2006.

6 Bank Indonesia, 2009. "Economic Reports on Indonesia 2008", available at: [www.bi.go.id](http://www.bi.go.id).

7 Bank Indonesia estimate (Bank Indonesia, 2009)

8 Food crops include paddy, maize, soybeans, peanuts, casava and sweet potatoes.

**Table 1.1. Share of GDP at 2000 Constant market prices  
By Industrial origin, Indonesia 2004–2011 (%)**

Industrial Origin	2004	2005	2006	2007	2008	2009	2010*	2011**
1. Agriculture, Livestock, Forestry and Fishery	14.9	14.5	14.2	13.8	13.7	13.6	13.2	12.7
2. Mining and Quarrying	9.7	9.4	9.1	8.7	8.3	8.3	8.1	7.7
3. Manufacturing Industry	28.4	28.1	27.8	27.4	26.8	26.2	25.8	25.7
4. Electricity, Gas & Water Supply	0.7	0.7	0.7	0.7	0.7	0.8	0.8	0.8
5. Construction	5.8	5.9	6.1	6.2	6.3	6.4	6.5	6.5
6. Trade, Hotel & Restaurants	16.4	16.8	16.9	17.3	17.5	16.9	17.3	17.8
7. Transport and Communication	5.8	6.2	6.8	7.2	8.0	8.8	9.4	9.8
8. Finance, Real Estate and Business Services	9.1	9.2	9.2	9.3	9.5	9.6	9.6	9.6
9. Services	9.2	9.2	9.2	9.3	9.3	9.4	9.4	9.4
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Total GDP	1.656.517	1.750.815	1.847.127	1.964.327	2.082.456	2.178.850	2.313.838	2.463.242

Note : \* Provincial figures

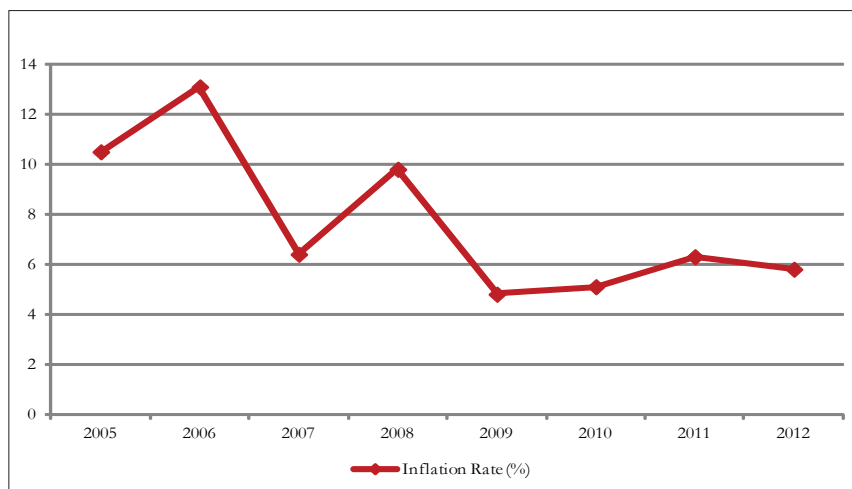
\*\* Very provincial figures

Source: BPS web site.

Utilities and construction sector managed to sustain an annual growth of 10.5 and 9.5 per cent, respectively, a fairly robust growth during the period of 2004 to 2011.<sup>9</sup> Meanwhile, in the last decade, oil and mining sector have been recording negative growth. For example, in 2004/2005, it grew at a minus 1.8 per cent, and continued to decrease. However, both sectors are starting to pick up and by 2009, it was estimated to grow at 4.4 percent (**BPS web site**).

## Inflation

The period of 2005 to 2012 had bear witness to the fluctuating rate of inflation in Indonesia, which tends to take a declining trend within the range from 4.8 to 13.1 per cent annually. The two digit inflation rate was recorded in 2005 and 2006(**Figure 1.2.**). Improved macroeconomic management and financial sector was believed to keep the inflation rate at a lower level in the recent years. The country's economic condition was also considered to be in a better shape compared than during the Asian financial crisis (**Bank Indonesia, 2009 and 2010**).

**Figure 1.2. Inflation Rates of Indonesia (%), 2005-2012**

Notes: 2005-2007 from ADO 2010

2008-2012 from ADO 2011 (2011 and 2012 are estimated)

Source: ADB, ADO 2010 and 2011.

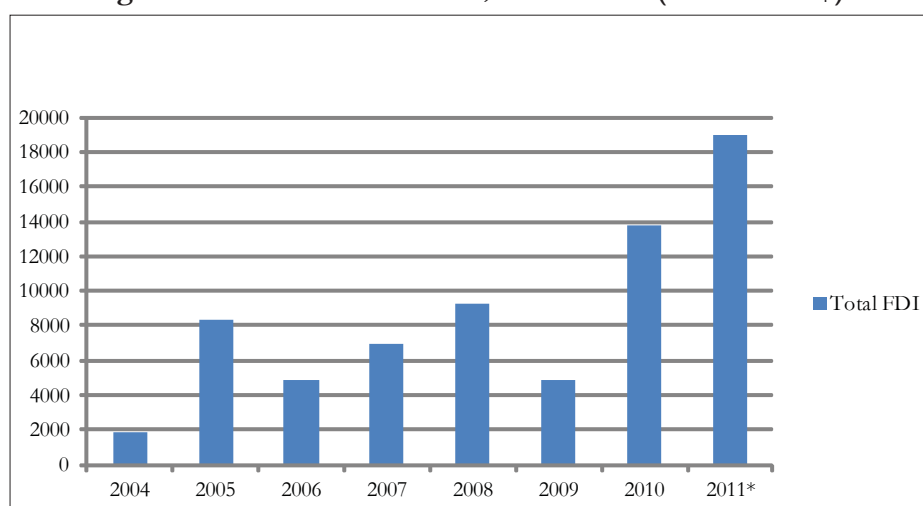
## Investments

The Indonesian Investment Coordinating Board (BKPM) has encouraged the inflow of investment into the country – targeting a total value of investment of USD 26,4 billion for 2011. The United Nations Conference on Trade and Development's 'World Investment Prospects Survey' (WIPS) identifies Indonesia as one of the top ten attractive destinations for foreign direct investment (FDI) in 2009 to 2011. It is estimated that medium term developing and transition economies, including Indonesia, will continue to keep up with the global rate of FDI growth. WIPS had ranked 6 developing and transition economies among their top 10 prospective investment destinations by the end of 2014, in which Indonesia was ranked among the top five investment destinations for the first time (UNCTAD, 2012). Two global rating agencies (S&P and Moody's) have included Indonesia at the investment grade level since the beginning of 2012 (see EU, 2011: *Invigorating the Indonesian EU Partnership*).

During the period of 2005 to 2010, Indonesia's FDI continues to book positive trend. In 2005 the total value of FDI was US\$ 8,3 million, while in 2006, the value was reduced to US\$ 4,9 million only to be picked up again in 2007 to US\$ 6,9 million and continue to increase up to US\$ 9,3 million in 2008. The number somehow declined to US\$ 5.3 million in 2009. Despite the fluctuation over the years, Indonesian FDI in 2010 was more than doubled up to US\$12.7 million, a reflection of improvement in the domestic and international investment climate (Figure 1.3).

In fact, during the period of 2005 to 2007, Indonesia's Inward FDI performance index and Inward FDI potential index have experienced slight changes. Indonesia's inward FDI performance rank improved from 106<sup>th</sup> in 2005 to 104<sup>th</sup> in 2007, while its potential index improved from the 103<sup>rd</sup> to 100<sup>th</sup> in 2005 and 2006 respectively (UNCTAD, 2008).

**Figure 1.3. FDI in Indonesia, 2004–2011 (million US\$)**



Note: \* preliminary figure

Source: Bank Indonesia.

This FDI positive development in late 2009 was likely to be caused by a robust outlook for domestic and global demand that were revived by early signs of global economic recovery. Such certain investment growth was also explained by rapid decline of lending rates, despite it remains at generally high levels.

**Table 1.2.** shows FDI distribution by economic sector in Indonesia for the period of 2004 to 2011. From 2004 to 2007 the manufacturing sector attracted the highest portion of total FDI. In 2005 the sector received more than 60 percent of total FDI in the country. Despite being corrected slightly in 2008, the sector managed to climb back up in 2009. Meanwhile in 2010 and 2011, the manufacturing sector received the highest share of FDI. In general, the FDI share varied according to the country's economic sectors, although some such sectors have shown relatively high percentage of FDI compared with others, such as mining and quarrying; wholesales trade; transportation/storage/communication; and financial industry.

**Table 1.2. FDI by economic sector, Indonesia 2004–2011  
(US\$ million)**

Sector	2004	2005	2006	2007	2008	2009	2010	2011*	2012**
1. Agriculture, Hunting, and Forestry	141	2	225	285	197	-52	286	284	158
2. Fishing	-	9	4	19	-24	10	51	61	13
3. Mining and Quarrying	99	1226	322	1905	3609	1302	1896	4171	609
4. Manufacturing	834	5265	1691	2412	2323	1573	4971	7675	1761
5. Electricity, Gas, and Water Supply	-	163	-1	-61	-56	53	204	400	88
6. Construction	-18	130	85	196	24	6	-50	400	32
7. Wholesale and Retail Trade; Repair of Motor Vehicles, Motorcycles; and Personal and Household Goods	-214	60	375	214	1160	73	2463	2826	554
8. Hotel and Restaurant	-	-	7	-10	16	0	1	-1	-
9. Transportation, Storage, and Communication	228	384	592	598	133	1799	2390	2372	634
10. Financial Intermediation	233	780	1028	1338	1926	149	409	559	134
11. Real Estate, Renting and Business Activities	-18	17	-14	-4	-201	-25	28	618	415
16. Others	609	301	599	37	212	-11	1121	-423	178
Total	1894	8337	4913	6929	9319	4877	13770	18942	4576

Source: Bank of Indonesia.

In response to the collapsing FDI, particularly after the 1997/98 financial crisis, the Indonesian government has decided to put less constraints to its investment (WTO, 2007).<sup>10</sup> It seemed that most policies implemented in the regional level were aimed to promote foreign investments. Steps taken to promote investment include liberalization of investment and deregulations such as in China, India, Indonesia, Iraq, Malaysia, Taiwan Province of China and the Republic of Korea. However, several countries like India and Indonesia have introduced new requirements for certain activities (UNCTAD 2010).<sup>11</sup>

Indonesia's BKPM (Investment Coordinating Board) noted that in 2008, five biggest investors in the country were Mauritius, Singapore, Japan, United Kingdom and Malaysia, with investments mainly allocated in Java island.<sup>12</sup> The pattern changed in 2010, when the highest amount of investments subsequently coming from Singapore, United Kingdom, United States, Japan and the Netherlands.

In terms of FDI receivers in Southeast Asia, Indonesia was the second country after Vietnam to receive the largest FDI. In 2008, however, this was no longer the case. Since then Indonesia was listed as the fourth largest recipient after Singapore, Vietnam and Thailand. In 2010, Indonesia received the second largest FDI after Singapore among the Southeast Asian countries (Table 1.3).

**Table 1.3. FDI in Southeast Asian Countries, 2008–2010**  
(US\$ million)

Country	2008	2009	2010	% net inflow 2010
Brunei Darussalam	239.2	369.7	629.5	0.8
Cambodia	815.2	539.1	782.6	1
Indonesia	9,318.10	4,876.80	13,304.30	17.5
Lao PDR	227.8	318.6	332.6	0.4
Malaysia	7,248.40	1,381.00	9,155.90	12
Myanmar	975.6	963.3	450.2	0.6
The Philippines	1,544.00	1,963.00	1,713.00	2.2
Singapore	8,588.90	15,279.00	35,520.20	46.6
Thailand	8,539.50	4,975.60	6,319.70	8.3
Viet Nam	9,579.00	7,600.00	8,000.00	10.5
Total	47,075.60	38,266.00	76,207.90	100
ASEAN 51/	35,238.90	28,475.30	66,013.10	86.6
BLCMV1/	11,836.70	9,790.70	10,194.80	13.4

Source: ASEAN Foreign Direct Investment Statistics Database (Compiled/computed from data submission, publications and/or web sites of ASEAN Member States' central banks, national statistics offices, and relevant government agencies through the ASEAN Working Group on FDI statistics.

10 The schemes include permitting foreign companies to operate retail outlets, exposing goods distribution and the banking sector to foreign investment, and reducing the negative list of activities restricted for foreign investment. At the same time, measure to boost the flow of investments was done through the introduction of a new investment law in October 2002 that replaces the 1967 investment regulation.

11 For example, Indonesia stops the monopoly of the state electricity company on electricity supply and distribution, paving the way for private domestic and foreign investment (Indonesia's Act No. 30 of 2009 concerning Electricity).

12 BKPM web site, accessed in January 2009 and April 2011.

In terms of FDI share of the total GDP, Indonesia has the lowest percentage in the Southeast Asia region, and it is only comparable to the Philippines (**Table 1.4**).<sup>13</sup> Restoring foreign direct investment to a level prior to the 1997 financial crisis, especially for key sectors such as mining, remains a major challenge for Indonesia.

**Table 1.4. FDI as % of GDP in Southeast Asian Countries, 2003-2009**

	2003	2004	2005	2006	2007	2008	2009
Brunei Darussalam	134.27	116.09	98.91	85.97	82.40	71.29	100.22
Cambodia	41.98	39.15	39.27	40.61	44.24	41.43	48.21
Indonesia	4.40	6.17	14.41	14.96	18.46	13.31	13.47
Lao's Republic	30.73	26.75	24.42	25.75	28.69	26.43	27.72
Malaysia	37.37	34.51	32.23	34.34	41.03	33.08	39.01
Myanmar	45.39	46.72	40.75	36.13	29.69	20.91	18.47
Philippines	14.33	14.65	15.16	14.39	14.20	12.82	14.54
Singapore	155.30	154.50	160.87	173.57	193.46	179.61	200.72
Thailand	34.31	32.97	34.25	37.28	38.25	32.98	36.22
Timor-Leste	48.20	48.66	47.10	49.16	40.15	38.62	35.41
Vietnam	69.54	64.09	58.84	55.06	56.71	53.31	57.14

Source: UNCTAD, UNCTAD stat accessed on 13 April 2011

The improvement of Indonesia's investment climate can be seen from the improving rating according to the *Doing Business 2010 Survey* conducted by the IBRD/World Bank.<sup>14</sup> The improvement was likely caused by the reduction of business start-up time from 105 days in 2008 to 60 days. However, the survey still discovered several hindrance including tax regulation, labour regulations and legal protection. Findings of the IMD Competitive Centre study also displayed Indonesia's improved competitiveness, from being ranked on the 42<sup>nd</sup> position in 2009, to 35<sup>th</sup> position in 2010.<sup>15</sup> The IMD competitiveness rating improvement was driven by economic resilience, improvement in business efficiency, and the Indonesian Government policy, for example, the government's decision to revoke regional regulations that may hinder investment.<sup>16</sup>

Further efforts to improve the countries investment climate were demonstrated by a reduction in corporate income tax rate to 25 percent in 2010, the exposure of more economic sectors to foreign investors, and new tax concessions for certain investments. The government launched a new system to reduce time and costs of importing and exporting goods by allowing single submission, processing, and approval of import and export documents. In wake of such improvements, coupled with improved macroeconomic performance, the World Economic Forum's *Global Competitiveness Report* upgraded Indonesia's ranking by 10 places in 2010 to 44.

13 UNCTAD, accessed on 13 April 2011

14 *Doing Business 2010*, IBRD/the World Bank, 2009

15 *IMD World Competitiveness Yearbook*, IMD, 2009

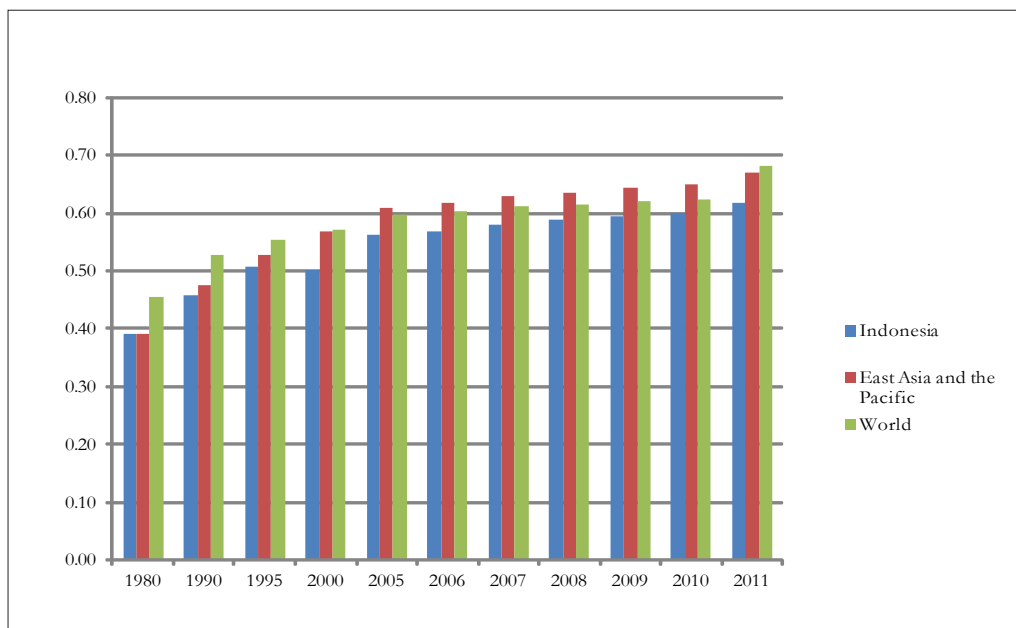
16 Since 2002 to 2009, a total of 1408 regional regulations on several issues, including taxes and levies in the transport, industry and trade, agriculture and culture, as well as tourism sectors, had been revoked (see [www.depdagri.go.id/.../daftar\\_kepmen\\_pembatalan](http://www.depdagri.go.id/.../daftar_kepmen_pembatalan) (visited in September 2010))

## 1.2. Social Conditions.

### Human development

Indonesia's Human Development Index (HDI) had increased overtime. Indonesia's HDI was recorded at 0.390 in 1980, 0.458 in 1990, 0.500 in 2000, and continue to experience further increase to 0.561 in 2005, 0.600 in 2010, and 0.617 in 2011 (**Figure 1.4.**)<sup>17</sup>

**Figure 1.4. Human Development Index, 1980-2011**



Source: Data based on the HDR 2011 available at [http://hdr.undp.org/en/media/HDR\\_2011\\_EN\\_Tables\\_reprint.pdf](http://hdr.undp.org/en/media/HDR_2011_EN_Tables_reprint.pdf)

In 2005, Indonesian HDI was ranked at the 107<sup>th</sup> position, while in 2006 and 2010, Indonesia was ranked at number 111<sup>th</sup> and 108<sup>th</sup>, out of 169 countries, respectively. However, in 2011, its rank went down to number 124<sup>th</sup> out of 187 countries. Indonesia remains as one of the countries categorized in the medium human development group. In addition, the level of Indonesia's HDI is lower compared to that of either the world, or East Asia Pacific levels. Nevertheless, improvements can be seen in the annual increase of HDI growth rate (**Table 1.5.**). As a matter of fact, Indonesia is considered as one of the fast movers in its HDI growth progression (**UNDP 2010: 27.**)

**Table 1.5. Average annual rate of Indonesia's HDI growth, 1980-2010**

Year	Rate of growth per year
1980-2010	1.43
1990-2010	1.35
2000-2010	1.85

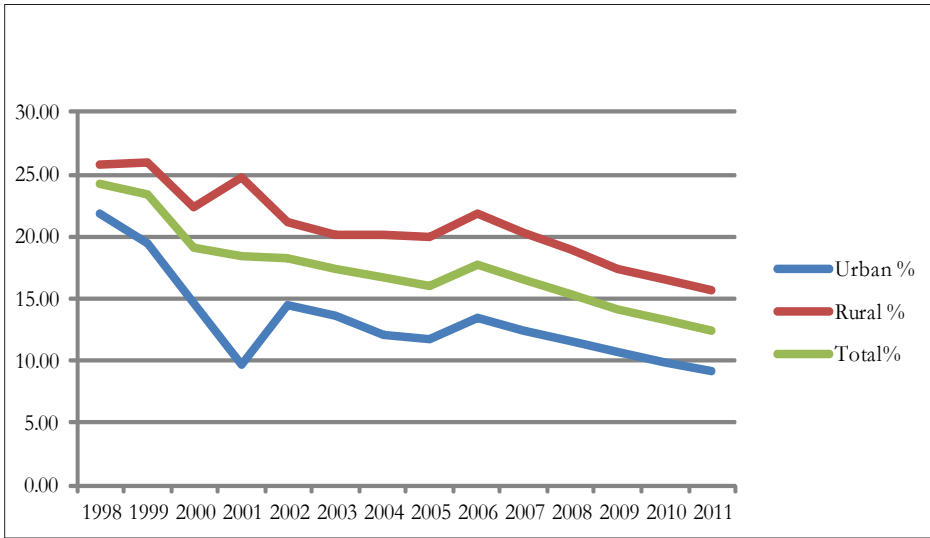
Source : UNDP, 2010.

<sup>17</sup> [http://hdr.undp.org/en/media/HDR\\_2010\\_EN\\_Tables\\_reprint.pdf](http://hdr.undp.org/en/media/HDR_2010_EN_Tables_reprint.pdf)

## The Incidence of Poverty

Poverty in Indonesia was going rampant in the past. According to national records, the 1976 witnessed 54,2 million of Indonesians were classified as underprivileged people, most of whom living in rural areas. Since then, the situation was improving; in 1990 there were only 27,2 million underprivileged people or equals to 15,1 percent of the total population (**BPS web site**). The 1997/1998 Asian Financial Crisis (AFC) took its toll by rapidly increasing poverty rate in Indonesia. Almost 50 million Indonesians went under the poverty line in 1998. However, the number of underprivileged people steadily decreased; in line with declining poverty rate from 16.7 per cent (36,1 million people) in 2004, to 15.4 per cent (around 35 million people) in 2008, and further decreased to 14.1 per cent (32,5 million people) in March 2009. In 2010, the number of underprivileged people in Indonesia was recorded at 31 million (13.3 percent), with 64 percent of them living in rural areas. The number continues to decrease in 2011, recorded at 30 million or 12,5 per cent (**Figure 1.5**).

**Figure 1.5. Poverty Rate (%) by Residence, Indonesia 1999-2011**



Source: BPS. 2011. Strategic Data of Indonesia. BPS Jakarta.

The World Bank argued that unusually high prices of rice were the main cause of poverty compared to fuel-price increase.<sup>18</sup> Decreasing poverty rate was partly attributed to various government programs, which aims to fulfill the basic needs and rights of the people. During the economic slowdown, micro and small medium enterprises (MSMEs) played an important role in absorbing labor force. Several factors that helps in eradicating poverty were higher daily wage levels for farm workers, lower national average prices for rice, and stable rate of inflation (**World Bank**). Poverty reduction was recorded in both rural and urban areas. In 2011, the percentage of underprivileged people in the urban and rural areas had lessened to 9.23 and 15.72 per cent, respectively, compared to the previous year’s 9.87 and 16.56 per cent (**Figure 1.5**). The reduction of poverty was more prominent in rural areas with nearly one million reduction, while the numbers of underprivileged people living urban areas only reduced by 50 thousand. Nevertheless, the number of under privileged people living in rural areas continue to

18 The World Bank further argued that this happened because most underprivileged people spend a quarter of their earnings on rice, which price has increased by more than one-third in the past year. Apart from that, 75 percent of underprivileged earn their living from agricultural activities and at least 75 percent of underprivileged people are net rice consumers (the Economist, September 14, 2006).



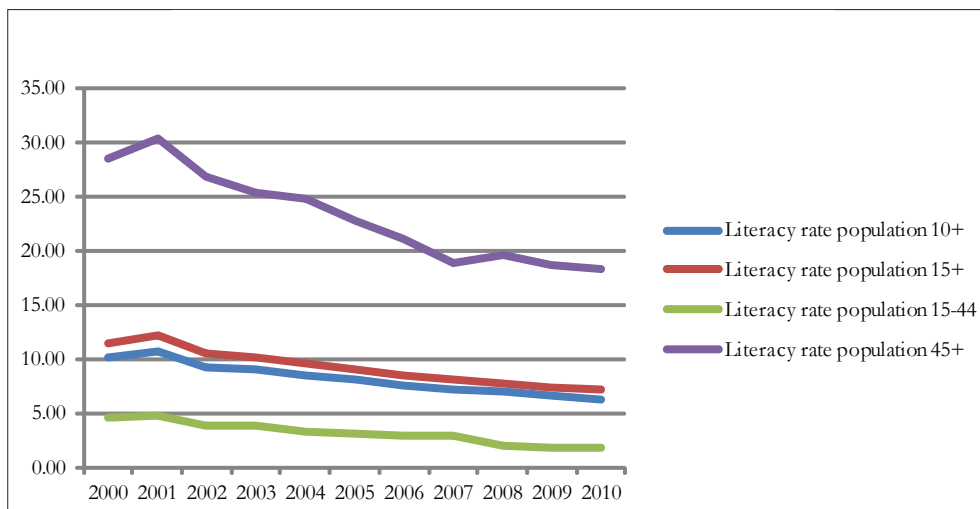
outnumber those living in urban areas. Despite the decline, the ratio of rural underprivileged people to the total number of underprivileged people remained relatively constant at more than 60 percent.

Interestingly, the World Bank report has highlighted the emergence of the middle-income class in Indonesia,<sup>19</sup> whose percentage increased from 25 per cent in 1999, to 43 percent in 2009. Similar increase also occurred in urban and rural areas (15 to 18 percent).<sup>20</sup> For over ten years, Indonesia's middle class roughly doubled from 45 to 93 million people. These changes will definitely have an impact on future policy making because *policies should take rising middle class expectations of productive employment opportunities into account. Otherwise, problems that could significantly slowdown the growth of the economy and increase the number of underprivileged people may occur.*

## Population and education

Indonesia has made some progress in educational development of its population. In the last decade, a decrease in illiteracy rates were recorded in different age groups (**Figure 1.6.**). Illiteracy rates amongst population aged less than 45 years old, has decreased in a range of 2 to 4 percent, while the most significant decrease of illiteracy level occurred amongst population older than 45 years-old at more than 10 percent. The decrease was likely to be prompted by a large portion of young people included in the 45+ category who generally have better literacy rate compared to the older group.

**Figure 1.6. Literacy rate of Indonesia's population by age, 2000-2010**



Source: BPS, *Susenas data, various years.*

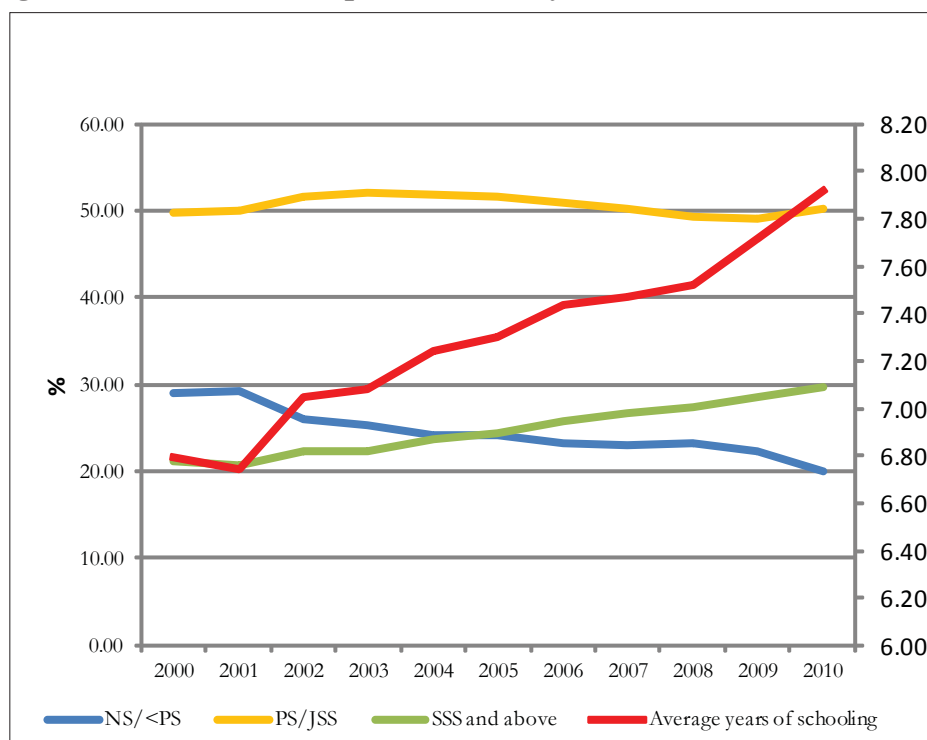
The last ten years has also witnessed a declining trend on the number of population older than 15 years-old that had no schooling or never having completed primary school, as well as those categorized in the low education group (completed primary school or junior high school). On the other hand the number of people with higher educational level (senior high school and above) continues to increase over time (**Figure 1.7.**).

### Notes:

19 Middle class is defined here as those who are in the spending bracket of US\$ 2 to US\$ 20 per day.

20 ADB 2010. Key Indicator for Asia and the Pacific 2010. Special Chapter: The Rise of Asia's Middle Class

**Figure 1.7. Indonesia's Population 15+ by Education Level, 2000-2010**



NS/< PS= No schooling or lower than primary school level  
 PS and ≤ JSS= completed primary school or lower than junior school level  
 ≥ SSS+= equals to or higher than secondary school level or above  
 Source: BPS. Susenas data from different years.

The discussion of the social economic situation above confirmed that Indonesia has been successful in managing its economy during both the Asian Financial crisis and the global crisis. This achievement can be seen not only from the macroeconomic indicators such as the growth of GDP, inflation rate, and rate of investment, but it can also be seen from social indicators particularly in terms of the improvement of HDI, poverty rate, and the educational level of the total population. The Asian Financial Crisis in 1997/1998 and the global crisis have also made structural changes in the economy. The manufacturing sector that used to contribute the biggest portion of the Indonesian GDP in 2004, has been replaced by the services sector.

However, despite Indonesia's economic achievements over the recent years, improving investment in infrastructures and generating more jobs remains as the major challenges. This condition is mainly caused by the fact that many of the country's labor force is being absorbed in the informal sector, and most of them have no skills. Also, the rate of underemployment in Indonesia remains excessive at around 30 per cent with an average income barely above the poverty line. Therefore, many steps still need to be taken to create more working opportunities in Indonesia.

## References

- .....“Poverty in Indonesia Always with them.” *The Economist*, September 14, 2006. Retrieved from [http://www.economist.com/world/asia/displaystory.cfm?story\\_id7925064](http://www.economist.com/world/asia/displaystory.cfm?story_id7925064) in November 2006.
- Asian Development Bank. 2009. “Asian Development Outlook 2009”. ADB Manila.
- Asian Development Bank. 2010. “Key Indicators for Asia and the Pacific 2010, Special Chapter: the Rise of the Asia’s Middle Class”. Manila.
- Bank Indonesia. 2009. “*Maintaining Economic Stability During the Global Financial Crisis.*” 2008 Economic Report on Indonesia. Bank Indonesia. Jakarta
- Bank Indonesia. 2010. “*2009 Economic Report on Indonesia: Strengthening Resilience, Promoting the Momentum of Economic Recovery.*” Jakarta.
- Bank Indonesia. 2011. “*2010 Economic Report on Indonesia: Strengthening National Economy Amid A Multi-Speed Global Economic Recovery.*” Jakarta.
- Business News. No. 7963. June 4, 2010.
- European Union. 2011. “Invigorating the Indonesian EU Partnership: towards the CEPA)
- International Labour Organization, Jakarta Office. 2004. Safety and Health Culture at the Workplace is Urgently Needed. Bilingual Newsletter- August 2004, Vol. 2 No. 2, page 21. Jakarta
- International Labour Organization, Jakarta Office. 2006. “*Overview of Youth Employment in Indonesia.*” Jakarta.
- International Labour Organization, Jakarta Office. 2009. “*Labour and Social Trends in Indonesia.*” Jakarta.
- International Labour Organization. 2004. “*A Fair Globalization: Creating Opportunities for All.*” World Commission on the Social Dimension of Globalization. Geneva.
- Republic of Indonesia. Board of National Investment Coordination [www.bkpm.go.id](http://www.bkpm.go.id)
- Statistics Indonesia. Central Board of Statistics web site [www.bps.go.id](http://www.bps.go.id)
- Statistics Indonesia. Various years. “*Labour Force Situation in Indonesia.*” National Labour Force Survey Results”. Jakarta.
- Republic of Indonesia. Ministry of Home Affairs web site [www.depdagri.go.id/.../daftar\\_kepmen\\_pembatalan](http://www.depdagri.go.id/.../daftar_kepmen_pembatalan). Retrieved January 12, 2006, from <http://www.usembassyjakarta.org/econ/invest/2001/investment2001-2.html>.
- Sziraczki, G and A, Reerink, 2003. “Report of Survey on the School to Work Transition in Indonesia. “GENRPOM Working Paper No. 14. Geneva: Gender Promotion Programme, ILO.

- The President of Indonesia's Decree No. 99 of 1998 and No. 127 of 2001. Retrieved on January 12, 2006, from <http://www.dprin.go.id/regulasi/english/2001/12/127PD.htm>
- United Nations Conference on Trade Development (UNCTAD). 2008. *World Investment Report 2008: Transnational Corporations and the Infrastructure Challenge*. United Nations. Geneva. Available from [www.unctad.org/en/docs/wir2008\\_en.pdf](http://www.unctad.org/en/docs/wir2008_en.pdf)
- United Nations Conference on Trade Development (UNCTAD). 2010. *World Investment Report 2010: Investing in a Low Carbon Economy*. United Nations. Geneva.
- United Nations Conference on Trade Development (UNCTAD). 2012. *World Investment Report 2012: Towards A Generation of Investment Policies*. United Nations. Geneva.
- United Nations Development Program. 2006. *Beyond Scarcity: Power, poverty and the global water crisis.* *Human Development Report 2006*. Geneva.
- United Nations Development Program. 2007/2008. "Human Development Report United Nations Development Program. Geneva.
- United Nations Development Program. 2010. *The Real Wealth of Nations: Pathways to Human Development*. "Human Development Report 2010: 20th Anniversary Edition. United Nations Development Program. Geneva. [http://hdr.undp.org/en/media/HDR\\_2010\\_EN\\_Complete\\_reprint.pdf](http://hdr.undp.org/en/media/HDR_2010_EN_Complete_reprint.pdf)
- United Nations Industrial Development Organization (UNIDO). 2011. *Industrial energy efficiency for sustainable wealth creation: Capturing environmental, economic and social dividends.* Industrial Development Report 2011. Vienna. Available at [http://www.unido.org/file\\_admin/user\\_media/Publications/IDR/2011/UNIDO\\_FULL\\_REPORT\\_EBOOK.pdf](http://www.unido.org/file_admin/user_media/Publications/IDR/2011/UNIDO_FULL_REPORT_EBOOK.pdf)
- World Bank web site [www.worldbank.org](http://www.worldbank.org)
- World Bank. 2010. "World Development Indicators 2010." Washington D.C.
- World Trade Organization. 2007. "2007 Trade Policy Review on Indonesia". World Trade Organization Secretariat. Geneva.



# National Development Strategies and Trade Policies

Globalization has made significant changes on development strategies and trade policies in Indonesia. Of these changes, many trade agreements with other countries have been signed by this country *inter alia* to ease the flow of goods and services. From the perspective of tariff liberalization, Indonesia presented significant achievements in reducing tariff on the vast majority of its products. However, on other measures, Indonesia still needs improvement to facilitate international trade.

This section discusses Indonesia's development strategies and policies, which are elucidate in the country's 2010-2014 Medium Term Development Plan (locally referred to as *RPJM*). In addition, trade related policies which influences Indonesia's economy are also highlighted. The data and information provided throughout this Chapter were not only obtained from the literature as in Chapter 1, but it is also collected from meetings with individual constituents such as : (1) National Planning Board (Bappenas), (2) Ministry of Manpower and Transmigration (MOMT), (3) Ministry of Trade, (4) Confederation of Technical Units, (5) Chambers of Commerce (KADIN) and APINDO, and (6) other individuals relevant for this study.

## 2.1. National Development Strategies and Policies

The *RPJMN* 2010-2014 is the guideline that the government at all level, civil as well as business society should follow in order to achieve the national goals contained in the Preamble of the 1945 Constitution of the Republic of Indonesia. The 2010-2014 *RPJMN* was formulated on the basis of four development approaches, namely, "pro-growth, pro- job, pro-poor and pro-environment". The latter approach reflects the government's commitment for taking part in minimizing global warming as this issue becoming critical in recent years. Indonesia's *RPJMN* 2010-2014 is the second phase implementation of the National Long-Term Development Plan (*RPJPN*) for the period 2005-2025, which is legalized through the Act No. 17/2007. The *RPJMN* is the basis for government's ministries and agencies to formulate their respective Strategic Plans (locally referred to as *Renstra*).<sup>21</sup>

---

21 Strategic plan contains the national development strategy, general policies, ministry/agency and joint-ministry/agency programs, regional and inter-regional programs, as well as the macroeconomic framework, including regulatory and indicative funding frameworks.

Indonesia has passed through a number of challenges and obstacles in the past. Nevertheless, the country succeeded to remain steadfast, and made it in the course of a long historical process towards better democracy, decentralization, and amendment of the constitution. Social life had been drastically changed, and some public institutions had no longer become functional. After the reforms, Indonesian had been experiencing euphoria of freedom, added to difficulties as a consequence of the complexity of the problems encountered. The change of government has stimulated the conception of vision and mission of the National Long-Term Development for 2005-2025 envisaging the picture of “Indonesia being self-reliant, advanced, equitable and prosperous country”.

Although Indonesia’s economy did relatively well compare to that of other countries in Southeast Asia since the turn of this century, the growth nonetheless has not returned to the level that had been achieved before the 1997/1998 Asian Financial Crisis. Employment has been sluggish since the crisis, and hardly keeping up with the pace of labor force growth (as it will be discussed later at Chapter 3). In addition, the growth pattern is putting increasing pressure on the environment and natural resources, creating risks to the country’s long-term prosperity (ADB-ILO-IDB, 2010).

To realize its development goals the Indonesian government sets up the following agendas (1) economic development and enhanced people welfare (2) promotion of good governance (3) strengthening pillars of democracy (4) law enforcement and corruption eradication and (5) inclusive and equitable development. Most importantly, the government is committed to employ trade-related policies to promote economic development by enhancing investment and non-oil/gas exports.

One of the government national priorities, which being critical to economic development is improving investment and business climate. This is done by improving the certainty of legal aspect, the simplification of investment administrative procedures, information systems, and by establishing Special Economic Zones (*Kawasan Ekonomi Khusus/KEK*)<sup>22</sup> as well as business-friendly employment policies.

## 2.2. Trade Strategies and Policies

In order to increase and maintain the positive trade balance with its trading partners, Indonesia’s main trade policies and strategies rely on (1) promoting the competitiveness of non-oil/gas exports products to diversify its export markets and increase diversity, quality and image of export products; (2) improving the business climate for external trade by improving services in licensing and non-licensing related to external trade; (3) increasing Indonesia’s role and capacity in international trade diplomacy to minimize tariff and non-tariff barriers in exports markets by increasing participation at various international forums and negotiations, and (4) improving distribution networks to support the development of the national logistics system, strengthening the internal market and the effectiveness of the goods market, and improving the effectiveness on monitoring and business climate.

Although Indonesia has made perpetual progress in implementing trade reforms, some scholars nonetheless argue that Indonesia’s attitude towards trade liberalization can be described as reluctant and inconsistent (**Sugiyarto et al, undated and Basri and Hill, 2010**). This is because major changes

22 through Public Private Partnership (PPP)

in the trade pattern and industrial policies have always been related to and prompted by major political and economic crises. Furthermore most changes in the main economic policies have been in response to urgent external conditions, such as changes in the world price of petroleum and the prices of other primary commodities, rather than being stimulated by the benefits of economic reform. Trade liberalization in Indonesia has never been managed in a systematic and consistent way in a search for the benefits of open trade **(Sugiyarto et al, undated)**.

The sequence of Indonesia’s liberalization can be identified as follows.<sup>23</sup> The country began to liberalize trade and investment in the late 1960s. In the early years, Indonesia’s trade policy concentrated on early adjustments of tariff and investment policy which lasted until 1980. Also, capital account and financial market have been liberalized substantially before the 1980s. Only after 1985 foreign trade liberalization has been conducted and mostly in response to the problem of balance of payments **(see Table 2.1)**. When there is no problem in the balance of payments, the government policies tend to revert to be more protective. Since then trade liberalization was continued extensively into a wider range of initiatives, yet it was disrupted by the 1997/1998 Asian Financial Crisis (AFC). In the aftermath of such crisis, Indonesia took up trade liberalization in 1998 under the auspices of IMF.

**Table 2.1. Indicators of Reforms**

Measures	1985	1991
Average tariff: unweighted	27	22
Production weighted	19	17
Import Licensing: Import weighted	43	13
Production weighted	41	12
Index of Dispersion *)	108	89

Source: based on Sugiyarto et al’s table (undated), which is sourced from World Bank (1992), Indonesia Growth, Infrastructure and Human Resources, Report No. 10470-IND.

Note: \*) Measured by the coefficient of variation

In the recent years the Indonesian trade policies have been more progressive and in the occurrence of the recent crisis the reform has expanded at an increase rate **(World Bank, 2010)**. Although Indonesia is now as one of East Asia’s most liberal trade regimes countries, the path to this status has been long and winding with episodes of trade liberalization followed by increased protection and vice versa **(Basri and Hill, 2004)**. Trade reform has not tended to be an ongoing reform process, but one that acts in response to the external developments particularly due to changes in the price of world oil as argued previously **(Basri and Hill, 2004)**.

23 See (Basri and Hill, 2004) for further details



## Trade strategies

Indonesia's government strategies to promote trade are conducted through (1) *inward supportive approach*, a strategy that aims to strengthen domestic market<sup>24</sup> and (2) *outward friendly approach*, a strategy aims to promote exports.<sup>25</sup> The government indicates the strategy for increasing non-oil/gas exports competitiveness is through promotions of market, product diversification and product quality (**RPJM 2010-2014**).<sup>26</sup> Indonesia's competitiveness has historically been driven by FDI as firms invested in the country by the Multinational Companies (MNCs) which have generally demonstrated higher productivity than domestic firms. Frequently, their increases in productivity were transmitted to domestic firms passing through FDI-related productivity spill overs (**Chemonics, 2009**).

The government has identified factors hindering Indonesia exports competitiveness. These factors are: (1) the lack of export market access to many destination countries; (2) the quality of product which is not able to fulfill the international standards requirements<sup>27</sup> (3) the growing number of NTBs applied by many export market destination countries to minimize the impact of global crisis (4) lacking efforts to enhance export products diversification in the global market (5) non-optimum use of the existing free trade agreements (multilateral, regional or bilateral) and (6) non-optimum use of exports/imports facilitation.<sup>28</sup>

The time lines of processing exports and imports was considered as the most important factor affecting foreign trade in Indonesia (**Bappenas/LPEM study, 2008**).<sup>29</sup> Business community in Indonesia admitted that this factor may only contribute to 55.2 percent to foreign trade competitiveness (**Table 2.2**).<sup>30</sup> Complaints about long waits at customs and the high percentage of red-channel goods and illegally high inspection rates were continually reported by investors (**World Bank/IFC Doing Business 2011 report**).<sup>31</sup> Indonesia in many aspects remains a difficult country to do business in especially compared with the rest of the region. Besides, its poor infrastructure adds huge extra burdens to production costs. If on the one hand almost every other neighboring country is building new ports or expanding old ones, on the other hand Indonesia's lag far behind in efficiency and productivity.

24 For instances, the application of Mandatory National Standardization, labeling, designated points of entry for imports, SP & Special Safeguard, as well as anti-dumping watch and others.

25 Excerpt of the presentation of the DG of International Trade Cooperation, the Republic of Indonesia Ministry of Trade, presented in the opening of the Knowledge Sharing Workshop conducted by the ILO/EU project on "Assessing and Addressing the Effects of Trade on Employment", in Jakarta 16 July 2010.

26 To strengthen exports promotion, other means are implied, for instance by taking optimum advantage of ASEAN and China market's potentials; strengthening Indonesia's trade representatives abroad; tourism, trade, and investment (TTI); managing export issues; monitoring Indonesia's certificate; promoting Indonesia's role in the export funding institution (*LPEI*) in supporting export facilitation; and strengthening Indonesia's trade position through diplomatic and trade negotiations (multi tracks: bilateral, regional, and multilateral).

27 Export products particularly food materials/products as well as wood products and its processed products have frequently faced impediments in the export markets of advanced countries. This is because advanced countries enforce strict import policies on the grounds of consumer protection and environmental preservation. To comply with quality standards as obliged by developed countries importers seems to be the most critical challenge faced by the Indonesian exporters that frequently lack the capacity to comply (**Oktaviani and Erwidodo, undated**). For classifying imports and exports, Indonesia uses the Harmonized Commodity Description and Coding System.

28 This can be reflected in (i) non-optimum use of various trade schemes (ii) lengthy time lines for exports procedures and documentations compared to other ASEAN countries such as Thailand, Singapore, and Malaysia; and (iv) relatively high cost of exports per container compared to neighbouring countries due to less efficient logistic system (see Table 3.27 RPJM Doing Business World Bank 2010). This has caused high-cost cargo transportation, inefficient port management, and low infrastructure quantity and quality.

29 *BAPPENAS and LPEM University of Indonesia survey (2008)* on 200 establishments in five (5) cities in Indonesia

30 It was identified that it takes on average 20 days to prepare forms of exports for customs clearance and 27 days for imports to do so. This is more than twice the average of developed countries.

31 Indonesia ranked 121 out of 183 economies; meanwhile Singapore was the top ranked economy in the *Ease of Doing Business*.

In the World Bank's 2010 Logistics Performance Index, Indonesia's ranks at a lowly 75<sup>th</sup>, well below Thailand, Malaysia and even the Philippines. This means that a great deal of foreign investment that might want to go to Indonesia now goes elsewhere (**Economist, 2011**).<sup>32</sup>

**Table 2.2. Factors affecting Indonesia's foreign trade competitiveness**

Factors	Percentage
Macro economic conditions	10.3
Infrastructure	32.2
Taxes	2.4
Exports Imports processing	55.2
Exports procedure	15.8
Time to process exports	10.3
Exports costs	2.1
Imports procedure	11.0
Time to process imports	14.3
Imports cost	1.7

Source: Trade and Investment in Indonesia: a Note on Competitiveness and Challenges ahead, *Bappenas* and *LPEM* University of Indonesia (2008).

## 2.3. Trade Measures<sup>33</sup>

G20 countries including Indonesia in the recent years have introduced more trade barriers, including export restrictions compared to the previous periods since the financial crisis began (**WTO, 2011b**).<sup>34</sup>

Export restrictions are also on the rise, which adds to the cumulative total of world trade affected by new restrictions since the crisis began. Despite the positive forecasts for 2011, the outlook for world trade remains unclear by a number of significant risky factors in addition to the recent natural disasters in Japan.<sup>35</sup>

### Tariff measures

Indonesia remains to use tariff as the main trade policy scheme. Taxation on foreign trade has commonly been considered as one of the main sources of government revenue especially in developing countries. In Sub Sahara Africa for example trade taxes contributed to nearly 27 percent of total revenue, while in some other African countries the shares are even more than 40 percent (**Devarajan et al. 1999**). However, the share of trade taxes in Indonesia was only at about 4.3 percent of the total tax revenues in 2005 (**WTO, 2007**).

32 The Economist, July 23rd 2011. "*Indonesia's middle class: Missing BRIC in the wall.*"

33 Unless stated, this part is heavily cited from the Indonesian Trade Policy Review conducted by the WTO Secretariat (WTO, 2007)

34 Although measures to lower trade barriers are also accelerating, over the period October 2010 to April 2011 new import restrictive measures taken by G20 economies cover around 0.6 percent of total G20 imports, which is also an increase over the previous six months (0.3 percent) (a monitoring report by the WTO, OECD and the UNCTAD).

35 WTO. 2011a. "Protectionist pressures on the rise." (24 May 2011). Available at [http://www.wto.org/english/news\\_e/news11\\_e/igo\\_24may11\\_e.htm](http://www.wto.org/english/news_e/news11_e/igo_24may11_e.htm)

In conformity with the IMF in April 1998, Indonesia agreed to cut export tariffs on 34 commodities and to reinstate procedures related to export tax payments. By the end of 1998 Indonesia reduced export taxes by 20 percent and another 25 percent at the end of 2000. These initiatives are aimed to augment exports and increase Indonesia's foreign-exchange reserves. Commodities under these initiatives include paper pulp, wood chips, veneer, railway sleepers, rattan, logs, sawn timber and natural sand, and the raw materials for producing these products. Export taxes on these goods had run as high as 200 percent for logs, but now they have fallen to just 10 percent. The export tax on rattan, however, fell to just 5 percent **(EIU, 2011)**.

Although Indonesia has a very open economy in terms of tariffs, its NTBs remain significant and cause a perturbing increase to importing countries **(World Bank, 2011 March)**. WTO deems Indonesia to have moderately high tariffs. Around 80 percent of their import lines face tariffs of 0-5 percent for countries that chosen to grant WTO-designated most-favored nations (MFN) status **(EIU, 2011)**. Bound tariff rates tend to be substantially higher than applied rates and the gap has widened in many cases since 2003 as a result of scheduled tariff cuts.<sup>36</sup> The difference between the applied tariff rates and the bound rates of tariff in Indonesia remains higher for agricultural products than for industrial products. Over 99 percent of applied tariff rates are *ad valorem*, a feature that plays a role to tariff transparency. The 2007 WTO-Indonesia's Trade Policy Review deemed Indonesia's tariff structure remains complex, containing over 11000 lines and involving 16 *ad valorem* rates and 3 specific rates.

In 2010, Indonesia's average MFN applied tariff was 7.6 percent **(USTR, 2011)**. Over the past two years, Indonesia has raised tariffs on a number of products. In 2009, Indonesia increased rates on a number of goods that compete with locally manufactured products, including certain chemicals, electronic products, electrical and non-electrical milling machines, iron wire and wire nails, and a range of agricultural products including milk products, animal or vegetable oils, fruit juices, coffee, and tea.

Most Indonesian tariffs are bound at 40 percent, even if tariff bindings exceed 40 percent or remain unbound on automobiles, iron, steel, and some chemical products. In the agricultural sector, tariffs on more than 1,300 products have bindings at or above 40 percent. Tariffs on fresh potatoes, for instance, are bound at 50 percent, although applied rates are 25 percent. Indonesia's applied tariff on imported distilled spirits is 150 percent, which is its bound rate **(USTR, 2011)**.

The act on value added tax (VAT) and luxury tax was passed on September 2009.<sup>27</sup> In addition to a 10 percent VAT and an import duty of 150 percent, Indonesia charges luxury taxes on imported distilled spirits of 40 percent to 75 percent. The combined effect of these measures, which produces an effective rate of protection of more than 200 percent, is to place imports at a significant disadvantage in Indonesia's market. But, Indonesia removed its luxury tax on imported distilled spirits on April 1, 2010. At the same time it significantly increased excises taxes on such beverages. The current excise tax regime imposes higher excise taxes on imported spirits than on domestic spirits.

36 As such it lends increased opportunity for the authorities to raise applied rates on strategic commodities. For instance the authority was to increase import duties on corn and soybeans from 0 percent to 5 and 10 percent respectively in 2005.

37 The Act No. 42/2009

## Non tariff measures

Indonesia's non tariff measures include various schemes ranging from product registration,<sup>38</sup> custom barriers,<sup>39</sup> to luxury taxes and others.<sup>40</sup> For food security reason and price management considerations, in 2008 the Indonesian government appointed the National Logistics Agency (*BULOG*) to have an exclusive authority to import rice.<sup>41</sup>

The Indonesian government demands that Indonesia's food and drug agencies approve every shipment of processed food, food raw materials, and other food-related ingredients (**USTR, 2009**). Combined with an aggressive enforcement campaign in which large quantities of imported products were seized and destroyed for not being properly registered, the process for registering products has become increasingly burdensome, opaque, and costly. Some companies have discontinued or reduced sales to Indonesia as a result of the manner in which BPOM is implementing this requirement (**USTR, 2010**). Meanwhile, a custom valuation assessment is carried out by customs based on the perceived risk status of the importer and the average price of a same or similar product imported during the previous 90 days.

Luxury sales tax imposed on 4,000cc sedans, 4x4 Jeeps and vans are 75 percent. The tax on automobiles with 1500-cc or less engine capacities is ranging from 10 to 30 percent. Passenger cars with engine displacement less than 1500cc comprise 40 percent of the market, including a large group of vehicles predominantly produced in Indonesia that are taxed at a rate of 10 percent.

Up to mid-1980s Indonesia applied licensing to restrict imports, which was intended to protect infant industries from competition. The licensing system gave enormous benefits to the licensees and increased input costs for domestic industries (**EIU, 2011**). Since 1986, the country progressively switched these NTBs with tariffs and has reduced these tariffs in line with Indonesia's commitments to the IMF, ASEAN, AFTA, APEC and WTO. During 2010, the Indonesia imposed NTBs which were mainly using the practice of stricter product-quality and labeling standard, and by requiring imports of certain goods to be shipped via five designated ports. Such stringent licensing requirements delayed the import of goods into the country (**EIU, 2011**). Successive trade reforms launched since 1985 have reduced Indonesia's non-tariff barriers. In 1990 there were 1,112 tariff lines faced import-licensing restrictions, the figures came down to 141 in 2007 (**EIU, 2011**). A 1995 trade-deregulation package removed many import-licensing restrictions.

Since 2002, Indonesia has continued to maintain other additional non-automatic licensing requirements on textiles, clothing, and other *made-up goods* such as curtains and blankets. As such the country limits market access for a wide range of products. In 2009, the Indonesian government implemented an extensive regulation obliging non-automatic import licensing procedures on a broad range of products, including electronics, household appliances, textiles and footwear, toys, and food and beverage products. Only approved local producers are authorized to import products covered by

---

38 In particular for foods and beverages and other products including health supplements, which would be reviewed by the BPOM

39 Indonesia's customs service uses a schedule of reference prices to assess duties on some imports, rather than using actual transaction prices as it committed to do under the WTO Customs Valuation Agreement.

40 For example, luxury sales tax imposed on 4,000cc sedans, 4x4 Jeeps and vans is 75 percent; meanwhile, on automobiles with engine capacities of 1500cc or less, such tax ranges from 10 percent to 30 percent.

41 Private firms can import rice for special purposes only, such as for seed and specialty rice, but they must obtain a special importer identification number issued by the Ministry of Agriculture, and even imports are not permitted before, during, and immediately after the main harvest period, effectively the first quarter of the year.

this regulation, and these products are permitted for use only as inputs in domestic production, not for resale or transfer. Approval must be obtained for both the quantity and timing of imports. Additional burdensome product-specific import licensing and registration requirements also apply to agricultural products, including beef, sugar, and dairy (USTR, 2010). Such various and overlapping import licensing requirements that must be fulfilled by exporters to Indonesia hinder access to Indonesia's market.

Indonesia is not a signatory of the WTO Agreement on Government Procurement (GPA), yet the country manages its procurement framework more into line with international public procurement practice. Indonesia gives special preferences and encourages domestic sourcing and to maximize the use of local content.<sup>42</sup> Foreign companies are entitled to tender in government procurement projects as part of a joint partnership or as a sub-contractor to a domestic firm although participation is limited to \$5 million.<sup>43</sup> State-owned enterprises that publicly offer shares through the stock exchange are exempt from government procurement regulations. The ongoing decentralization of procurement decisions to local and provincial governments seem to create additional barriers as these authorities adopt their own procurement rules and manage their own procurements.

Indonesia has remained a relatively active user of anti-dumping measures. The years of 2002 to 2006 witnessed Indonesia initiated 26 anti-dumping investigations, and over the period of 1995 to 2008, the country was the 13<sup>th</sup> largest initiator of antidumping (AD) investigations (of 44 AD user countries). Most AD investigations were on steel products, paper products, and wheat flour and the main target countries were China, the Republic of Korea, and India. During 2005 to the end of 2009 Indonesia has handled the accusation of dumping, subsidy and safeguards in 196 cases (dumping accusation 163, subsidy accusation 12 cases and safeguards accusation 21 cases).

Standardization is a supporting component of technical barriers to trade (TBT) that has an important role in optimizing the utilization of resources in Indonesia's development activities. Government Regulation No. 102/2000 regarding National Standardization sets out the National Standardization System (SSN), which is coordinated by the National Standardization Agency (BSN) assisted by the technical Ministries in implementation. The implementation of Indonesian National Standards (*Standar Nasional Indonesia/SNI*) is mostly voluntary, meaning that the activities and products that do not meet the provisions of the SNI are not prohibited for trade, except for the specific products in which the SNI is mandatory.

Wherever feasible, national standards are formulated in compliance with international standards. Mandatory standards accounting for just over 3 percent of all standards have been introduced. Involvement in mutual recognition arrangements has increased. Regarding Sanitary and Phyto Sanitary (SPS) regulations, animal and plant quarantine measures are strictly enforced.<sup>44</sup>

42 Government departments, institutes, and corporations are expected to utilize domestic goods and services to the maximum extent feasible, with the exception of foreign aid-financed procurement of goods and services. Even in February 2009, the Minister of Industry issued a circular "recommending" that civil servants purchase domestic goods and services in their official capacities, as well as in their private purchasing, in order to "improve domestic product usage."

43 Foreign firms bidding on high-value government-sponsored projects report that they have been asked to purchase and export the equivalent value of selected Indonesian products.

44 Sanitary and Phyto-Sanitary Measures (the SPS Agreement) obliges each WTO member to be transparent. For example, countries are required to publish all sanitary and phytosanitary measures (SPS measures) and notify changes to SPS measures. In implementing the agreement, countries are required to identify a single central government authority to be responsible for the notification requirements of the SPS Agreement (the notification authority). Also, countries are required to establish an enquiry point responsible for answering questions from other countries about SPS measures and related issues (the enquiry point) (WTO, SPS Handbook Training Module) available at [http://www.wto.org/english/tratop\\_e/sps\\_e/sps\\_handbook\\_cbt\\_e/intro1\\_e.htm](http://www.wto.org/english/tratop_e/sps_e/sps_handbook_cbt_e/intro1_e.htm)

## Services barriers

There are 12 sectors which are classified as services. The focal point sectors included tourism (under Ministry of Tourism), health (Ministry of Health), transportation (Ministry of Transportation), construction (Ministry of Public Works). In relation to trade and employment works, the task of the Ministry of Trade is a coordinating ministry. This ministry has to coordinate with line ministries to make sure: how the position of Indonesia in trade negotiation in services with the partners to develop international trade. The Ministry of Trade does also the coordination with other stakeholders, private and academicians. From each line ministry, it has also specific private stakeholders. Before having coordination, the line ministries were assumed to discuss first with their own stakeholders. Prior to the negotiation, the ministry collected the materials to be discussed with the stakeholders by sectors. The specific line ministries may also collect themselves from their own stakeholders before delivering the material in the forum. Then, the Ministry of Trade invites all the stakeholders to have discussion in the forum (see Box 1).

### **Box 1. Trade and Employment: Stakeholders in the Services Sector and Policy Dialogue**

The government stakeholders in the services sector come from many different line ministries. There are 12 sub-sectors which are classified as services. The sub-sectors include tourism (under the Ministry of Tourism), health (under the Ministry of Health), transportation (under the Ministry of Transportation), and construction (under the Ministry of Public Works).

The Ministry of Trade has a special forum known as the Indonesia Services Dialogue (ISD) to gather all stakeholders: from ministerial lines, APINDO, academicians and other private stakeholders. The ISD was initiated by the private sector and has been supported by the Indonesian government. It convenes regularly for policy discussions. Labour issues are also discussed in relation to trade and competitiveness. An important recent recommendation of the ISD is that the government should establish a decision-making process on services issues.

The services sector is expanding fast, but the involvement of the overall stakeholders is still limited especially between the governments, company owners and workers. Academicians are expected to bridge the existing gaps between the workers, company owners as well as the governments, in which their relationships are not equal. Technical assistance programs for the stakeholders through conferences or seminars supported by international institutions are also expected to enhance participation and discussion of policy issues.

Since 1998, Indonesia has liberalized major services, notably financial services, telecommunications, and shipping. However, a number of policy set-back in these fields has been identified, and a number of trade and investment restrictions remain. Although the new negative lists explicated the areas where foreign investment could take place, they also added new scale of restrictions, and increased restrictions for many services sectors. These included rising foreign ownership restrictions and some scale limitations. Indonesia retains significant and extensive trade and investment barriers in many important services sectors, for example in legal services, health, and financial among others (see **Annex 2.1.** for more details). Indonesia now allows 99 percent foreign ownership in the banking sector, but has not revised its GATS commitment at the WTO, which remains bound at 52 percent (see Box 2).

If there are critical issues and problems, there is a forum called as Indonesia Services Dialogue (ISD) to discuss and share views on various critical and emerging issues in services. The ISD invites many stakeholders such as from the line ministries, business practitioners, entrepreneurs, academicians, and other stakeholders. The ISD is delivered to as a mean to create a more inclusive forum for government, business and individual stakeholders in services to developed the service sectors and find the improved regulation; strengthen the capacity of Indonesian government to establish and expand trade and investment, and develop regulatory policies relating to services; to help delegations to negotiate more pro actively in bilateral, regional and international trade agreements on the services sectors; and to establish an network so that Indonesia can be represented and voiced with more systematically in the bilateral and international forum.

### **Box 2. The Services Sector and Employment**

The services sector is important and expanding fast, but policy discussions on it are slow to involve its stakeholders. The stakeholders have to be involved to understand and realize how important and critical the services sector is and how to develop it. In the services sector, it is not known which sub sectors are the most affected by trade (liberalization).

The backbone of the services sector is finance, transportation and communication. Liberalization of these services sub sectors may result in a positive employment impact. An increased flow of these services will influence, for example, the expanding tourism industries (including the travel agents, hotels, and professional workers), transportation and construction. As the service sector expands, investment may follow. This will increase the flow of capital, best practices of management and professionals. However, to be able to take advantage of these positive effects, Indonesia will have to adapt and improve the skills profile of the country's workers.

The last event of ISD was convened in Surabaya on 19 April 2013. It came with the theme of “Competitive Services: Unlocking Value Added Potential for 21<sup>st</sup> Century”. The current dialogue highlighted the importance of trade in services by developing infrastructure in particular and connectivity in general. On connectivity issues, the forum talked about service provider and labor movements. It also developed the understanding of the new regional and global dynamics in trade and investment and the consequences that Indonesia may face. The ISD has not yet paid exclusively on trade related issues on labors. So, it is necessary to give a larger portion on the issues of trade and employment in the next agenda of the ISD (see Box 3).

### Box 3. Indonesia Services Dialogue

Indonesia Services Dialogue (ISD) is a forum to discuss and share views on various critical and emerging issues in services which is delivered to promote growth and greater efficiency in services. The ISD invites many stakeholders such as from the line ministries, business practitioners, entrepreneurs, academicians, and other stakeholders. The ISD is a means to create a more inclusive forum for government, business and individual stakeholders in services to develop the services sectors and improve regulation; strengthen the capacity of the Indonesian government to establish and expand trade and investment, and develop regulatory policies relating to services; to help delegations to negotiate more pro actively in bilateral, regional and international trade agreements on the services sectors; and to establish a network so that Indonesia can be represented and have a voice more systematically in bilateral and international forums.

The last event of the ISD was convened in Surabaya on 19 April 2013. It came with the theme of “Competitive Services: Unlocking Value Added Potential for 21st Century”. The current dialogue highlighted the importance of trade in services by developing infrastructure in particular and connectivity in general. On connectivity issues, the forum talked about services providers and labor movements. It also developed the understanding of the new regional and global dynamics in trade and investment and the consequences that Indonesia may face. The ISD has not paid attention exclusively to trade-related labor issues. So, it is necessary to give more space to issues of trade and employment in the next agenda of the ISD.

## Investment barriers

Indonesia’s investment climate is depicted by legal uncertainty, economic nationalism, and imbalanced influence of local business interests. An industry survey by **Norton Rose Group (2011)**<sup>45</sup> reveals that 95 percent of the respondents identify legal and regulatory risks to be the most significant barrier to investment. The majority of respondents revealed that all risk factors for successful investment in Indonesia to be significant.

In 2007, the government introduced a new Investment Act No. 25/2007 in its attempt to improve the country’s foreign investment climate, to improve transparency, and to provide a range of improved protections for foreign investors including non-discriminatory treatment, protection against confiscation, as well as to international arbitration in the event of disputes with the government. At the same time, nonetheless, the new act conspicuously increased the number of sectors in which foreign investment is restricted and increased foreign equity limitations in sectors of interest to investors (**USTR, 2011**).<sup>46</sup>

In addition, the implementation of regional autonomy, which is intended to reduce wearisome bureaucratic procedures by way of decentralizing investment-related decisions to provincial and district level governments, if on the one hand has led to some improvements, on the other hand has also resulted in new restrictive measures that appear to conflict with national laws. The Indonesian employers’ association (APINDO) appeals to the government for the coordination of regulations across different levels of government, which is the top priority among the set-forth 10 recommendations (**Jakarta Globe, 2009**).<sup>47</sup>

45 The survey was based on 109 respondents, the majority of which come from the infrastructure and energy sectors. The criteria of respondent’s inclusion in the survey were due to their previous investment or expected interest in Indonesia. The survey was conducted online, and respondents were given the opportunity to remain anonymous. Of the total number of respondents most were from organizations headquartered in Indonesia (23 per cent), followed by the United Kingdom (16 per cent) and USA (9 per cent). Japanese and Singaporean companies were also well represented at 9 per cent and 8 per cent respectively.

46 These sectors include telecommunications, pharmaceuticals, film and creative industries, and construction.

47 Yessar Rosendar. 2009. “Incoming Indonesian Government Urged to Untangle Business Regulations”. Jakarta Globe. September 30, 2009 available at <http://www.thejakartaglobe.com/business/incoming-indonesian-government-urged-to-untangle-business-regulations/332765>



Even though Indonesia continues to review the 2007 Investment Law and its negative list of restricted sectors,<sup>48</sup> various acts and regulations are imposed on investments according to main sectors. For instance, in the sector of energy and mining several regulatory changes have recently been introduced to increase government control in this sector and to generate higher royalties for the government. Indonesia enacted a new mining law in December 2008, replacing a “contract of work” practice with a system of licensing.<sup>49</sup> Moreover, the government also has made an effort to modify the terms of energy and mining contract unilaterally. Another example, in telecommunications, in October 2009, the Ministry of Communications and Informatics issued a new decree requiring all telecommunications operators to disburse a minimum of 40 percent of their total capital expenditures for network development on locally sourced components or services. The same ministry also issued a decree earlier in 2009 imposing local content requirements of 30 percent to 50 percent on operating and capital expenditures in the wireless broadband sector (USTR, 2011).

Ownership share permitted to foreign investor depends on sector. For example, it permits foreign companies to possess 67 percent of construction businesses, up from 55 percent. Meanwhile, foreign companies will be able to own 67 percent stakes in hospitals nationwide, up from 65 percent in specific health-related enterprises that were restricted to a few cities. Responding to a power shortage, the government has granted foreign investors the right to own up to 95 percent of joint ventures in power plants with a capacity above 10 megawatts. Concerning movie production, the government is allowing foreigners to own 49 percent of such companies, up from zero.<sup>50</sup> Not often, contradictory regulations might emerge causing some high concerns for investors. For instance, the BTS antenna controversy, the current DNI resolves the overlap by siding with the Communication Ministry by forbidding foreign investment in Telecom Towers.

One key area of difficulty in determining the Indonesian foreign ownership regime has been the existence of conflicting regulations issued by various different regulatory bodies. The most well known example is the telecommunications tower industry, which according to the BKPM 2007 negative list was opened to 100 percent foreign investment, but the Ministry of Communications’ regulation declared it closed to foreign investment. The revised negative list resolves this particular debate in favor of the Ministry of Communications by closing the telecommunications tower industry to foreign investment. Such conflict needs to be addressed through the reconciliation of all foreign ownership issues to a single administration.

---

48 On May 25, 2010, the Presidential Regulation 36/2010 revealed changes in the negative list delivering legal clarifications in conjunction with limited liberalization. The clarifications include protections from retroactive implementation and promise a continuous review of closed sectors for increased market access. The revisions include modest changes to investment limits in individual sectors including construction, health care, film technical services, and electricity generation, but the revisions also increase restrictions in other sectors such as postal services and the telecommunications tower sector, which is now closed to foreign investment.

49 Such legislation creates new risks and burdens for investors, as it affects investments in the sector to all changes in tax and royalties policy, which have frequently been inconsistent, and allows central and local governments to cancel licenses (USTR Report 2011).

50 Indonesia Law Report. “Still on Investment’s Negative List 2010”. June 16, 2010 view comments. Available at <http://indolaw.alafghani.info/2010/06/still-on-investments-negative-list-2010.html>

## Other barriers

Some other NTBs may inhibit importing countries to access Indonesia's market. For example, regarding pharmaceutical market access, the Decree of the Ministry of Health No. 1010/2008 on Drug Registration severely restricts imports of pharmaceuticals products.<sup>51</sup> Imports of drugs are only allowed on a "case-by-case" basis if they are needed for the national health program or if they are not manufactured locally. Registration of drugs is only allowed for companies that have manufacturing facilities in Indonesia.<sup>52</sup>

To import animal-based products firm needs an import permit which should be obtained from the Directorate General of Livestock Services. Salt imports are banned during the harvest season. It requires salt importers to be registered and to purchase domestic supplies as well as imports. Indonesia also maintains a seasonal ban on imports of sugar. Indonesia applies quantitative limits to imported wines and distilled spirits. However, companies can now apply to be designated as registered importers authorized to import alcoholic beverages with an annual quota set by the Ministry of Trade. Other limitation, mining firms operating in Indonesia are prohibited to exporting unprocessed ore. Under mining law, companies are required to process ore locally in Indonesia before shipping it abroad.

Although Indonesia has been taking enforcement actions against pirated optical, lacking in Intellectual Property Rights (IPR) protection and enforcement remain to represent barriers to exports and investment. It seems that cooperation and coordination between governments' agencies should be improved particularly in terms of enforcement. Following its 1994 ratification of the WTO Agreement, over the past decade Indonesia has shown a significant progress in the development of the intellectual property (IP) laws and the implementation of such laws by the Directorate- General of Intellectual Property Rights (DG IPR). As such it creates a better framework for protection of intellectual property rights and provides a better environment for the development of intellectual property and inventions. Nevertheless, less than 10 percent of all patents registered in Indonesia are domestic inventions, which is one reason for a need to focus on increasing awareness on the importance of intellectual property rights. Right holders consider that Indonesia has an acceptable legal framework largely in line with WTO TRIPS agreement and containing strong penalties for infringements, although some issues of concern remain.<sup>53</sup>

The formation and further strengthening of a National Task Force created in 2006 is expected to help improve this situation. The country has an interest in improving these matters not only in order to enhance innovation and protect its own IPRs, but also as a response to demands from the international community as a way of fulfilling international commitments and thereby better integrating into the global trading system. It is worth noting that Indonesia was placed on the Priority Watch List in the 2010 Special 301 report due to growing concerns about IPR protection and enforcement in Indonesia as well as new market access barriers on intellectual property products.<sup>54</sup>

---

51 Global Trade Alert. "Indonesia: regulating registration and imports of pharmaceutical products". Available at <http://www.globaltradealert.org/measure/indonesia-regulating-registration-and-imports-pharmaceutical-products>

52 Market access database, available at [http://madb.europa.eu/madb\\_barriers/barriers\\_details.htm?barrier\\_id=095258&version=2](http://madb.europa.eu/madb_barriers/barriers_details.htm?barrier_id=095258&version=2)

53 Firstly, Indonesia has not in its legislation on patents implemented TRIPS Article 39.3 on data exclusivity. Secondly, a well known trademark has to be registered in Indonesia in order to enjoy protection.

54 Key issues referred to in the report include inadequate enforcement against IPR crimes to address continuing widespread copyright piracy and trademark counterfeiting, inadequate numbers of criminal prosecutions, and non-deterrent penalties for those who are convicted.

In early 2008, the Indonesian government requires the approval of *halal* processes prior to their exporting to Indonesia. Indonesia's requirements to obtain these approvals are deemed not transparent and the approval process has not been conducted in a timely manner. With the requirement of the Indonesian government that *B POM* approve every shipment of processed food, food raw materials, and other food-related ingredients, it will add to the existing burdensome and costly procedure to exporters.<sup>55</sup>

In 2007, Indonesia notified its draft Decree concerning Food Safety Control for the Import and Export of fresh food of plant origin to the WTO.<sup>56</sup> The country has also established policies on biotechnology, although does not seem to own a unified science based framework to implement its regulations and there is little progress on biotechnology policy development. In 1999, Indonesia issued a regulation obliging a label and a special logo on packaging of food containing transgenic ingredients, but so far it has not enforced it.<sup>57</sup>

Illegal logging activity results not only in lost revenue and significant environmental damage to Indonesia, but also lost trade opportunities for foreign producers in Indonesia and third-country markets. Apart from that, Indonesia recognizes the gravity of the issue and is taking steps to address it, including by working with the United States under the auspices of a 2006 Memorandum of Understanding on Combating Illegal Logging and Associated Trade. Under this agreement, the two governments held three meetings last year and are developing a multi-year action plan to address the trade aspects of the illegal logging problem.<sup>58</sup>

## 2.4. Trade Development Strategy

One of Indonesia's main strategies in supporting its trade development is to promote trade facility by means of revitalizing licensing service to public, de bottle necking barriers, securing foreign market access, and developing special economic zones. Indonesia has launched its new online system called Indonesia National Single Window (NSW) for its export-import activities.<sup>59</sup> The ASEAN Single Window–Indonesia Single Window (ASW-INSW) is Indonesia's national commitment within ASEAN cooperation and also to fulfill World Customs Organization (WCO) recommendation.

The Indonesian government aims to increase the growth of non-oil/gas exports to 7-8 percent in 2010, and expected to gradually rise to 14.5 to 16.5 percent in 2014,<sup>60</sup> which will be done by ways of (a) promoting high valued added non-oil/gas exports products basing on natural resources and high market demand (b) promoting exports of creative product and services particularly those produced by SMEs (c) encouraging market diversification for exports (d) boosting efforts to expand market access,

55 Concerns have also been expressed due to the regulations that import packaged food products require testing and disclosure of information on product ingredients and processing that effectively forces them to reveal proprietary business information. Some US firms have discontinued or reduced sales to Indonesia due to such requirement enforcement.

59 The main purpose for having a Single Window for a country or economy is to increase the efficiency through time and cost savings for traders in their dealings with various government authorities for obtaining the relevant clearance and permit(s) for moving cargoes across national or economic borders.

60 Such goal is to be pursued through (1) promotion of export market diversification (2) promoting export product quality and diversification (3) increasing export flow and ease as indicated by (a) increasing number of users employing online export/import permit (INATRADE) (b) reducing exports/imports permit processing time lines and (c) growing number of online exports/imports permits

promotion and facilitation of non-oil/gas exports in Africa and Asia (e) encouraging the utilization of various trade schemes and international trade cooperation that is beneficial for national interest (f) encouraging the development of trade activities at the border area that can be utilized as the entry gate for economic activities and trade with neighboring countries and (g) strengthening foreign trade institution and funding that are driving the effectiveness of non-oil/gas export development.

## 2.5. Indonesia's Trade Cooperation

Indonesia plays an active role in its foreign trade policy. The country has participated in a number of trade cooperation: multilateral, regional and bilateral level. Indonesia's main integration agreement is the ASEAN Free Trade Agreement (AFTA). Indonesia has increased market access for goods and services through the free trade agreements (FTAs). Indonesia has negotiated the FTA as part of ASEAN. Although tariff elimination has progressed effectively, services liberalization among members has been less comprehensive.

ASEAN has FTAs with China, Japan, Korea, Australia, New Zealand, and, since August 2009 with India. The FTAs in goods with China and Korea were to be fully materialized by January 1, 2010. The FTA with Korea expands beyond goods, trade with the services agreement taking effect in May 2009, and an investment component signed in August 2009, completing four years of FTA negotiations. The FTA between ASEAN and South Korea for goods was signed in 2006 and for trade in services in 2007. The FTA has helped boost trade for both sides.<sup>61</sup> Also in August 2009, ASEAN and South Korea agreed to set up a special fund to support cooperation schemes including projects aimed at reducing the economic gap in Southeast Asia. The growth in trade has been so rapid in recent years and ASEAN has now been South Korea's third-largest trading partner, after the EU and China, surpassing the US and Japan.

South Korea is ASEAN's fifth-largest trading partner. The partnership has evolved from trade links to investments. South Korea's direct investments in the rest of Asia have multiplied five-fold over the past 10 years, amounting to \$10.8 billion in 2008. ASEAN was the second-largest recipient of these investments, with Vietnam one of the largest beneficiaries due to its low-cost base and skilled labor.

The implementation of the ASEAN-China FTA has been controversial, with domestic industries demanding for more time to implement tariff commitments as well as for the obligation of new non-tariff barriers to offset the reduction in tariff protection.<sup>62</sup> Indonesia also is currently negotiating bilateral agreements with Iran, India, and Australia (**USTR, 2011**). Following the India-Malaysia free trade agreement recently, the Association of Indonesian Palm Oil Producers (*GAPKI*) has called on the government to speed up negotiations of a free trade agreement with India to protect Indonesia's palm oil market, as such India-Malaysia FTA would allow Malaysian firms to get better concessions for palm oil and refined products.<sup>63</sup> The FTA between India and the Association of South East Asian Nations, which is currently restricted to goods, was signed on August 13th, 2009, implementation is to start from January 2010.<sup>64</sup>

61 ASEAN and South Korea FTA, available at [http://www.business-in-asia.com/asia/korea\\_fta.html](http://www.business-in-asia.com/asia/korea_fta.html)

62 See UPI Asia, 12 February 2010. "Indonesians discontent with free trade agreements"

63 The Jakarta Post, 22 February 2011. "RI should speed up FTA talks with India: Gapki" in [www.bilaterals.org](http://www.bilaterals.org)

64 The text of the agreement as well as the schedule of tariff commitments are available on the ASEAN web site (ASEAN-India FTA texts).

The ASEAN-Australia-New Zealand FTA (AANZFTA) signed in February 2009, and entered into force on 1 January 2010 for eight of the twelve countries that signed the Agreement: Australia, New Zealand, Brunei, Burma, Malaysia, the Philippines, Singapore and Vietnam. The AANZFTA is comprehensive, covering goods and services as well as investment and intellectual property issues.

In March 2008 ASEAN signed a FTA with Japan.<sup>65</sup> The agreement on Comprehensive Economic Partnership among Japan and Member States of the ASEAN cover fields such as trade in goods, trade in services, investment, and economic corporation. Under the agreement, tariffs on Japanese exports between ASEAN member countries will be removed and Japan will repeal tariffs on 93 percent of imports from ASEAN by value within 10 years of the deal taking effect.<sup>66</sup>

Indonesia has comprehensive preferential trade relations with some Asian countries. Under AFTA, import duties from ASEAN countries are applied at zero to five percent, except for products specified on an exclusion list. Likewise, Indonesia conforms preferential market access to Australia, China, Japan, Korea, India, and New Zealand (under ASEAN FTAs) and to Japan (under a bilateral Economic Partnership Agreement). Indonesia signed a more comprehensive bilateral agreement with Japan (its main export market) that took effect in July 2008.

### 2.5.1. Multilateral cooperation

In the WTO forum, the negotiation of Doha Development Agenda (DDA) is underway and in the intensive process to discuss the draft text prepared by the Chairman of Agriculture Group and Non Agriculture Group in Geneva. Indonesia remains the coordinator of G-33<sup>67</sup> and remains in its position to defend Special Products. The basic differences in the complicated DDA negotiations among others lie on three main issues (triangle issues), namely (i) Domestic Support, related to agriculture subsidy, and Market Access, related to tariff reduction; (ii) Special Product (SP) and Special Safeguard Mechanism (SSM) in agriculture; and (iii) the formula for tariff reduction in Non-Agricultural Market Access (NAMA). Of those issues, Indonesia's concern is to fight for the Special Product (SP) and Special Safeguard Mechanism (SSM) in the WTO forum because these two issues are directly related to poverty eradication, rural development and food security for Indonesian.

Indonesia has ratified the "International Coffee Agreement (ICA) 2007" through the issuance of the President of Indonesia's Regulation No. 63 of 2008, signed on 19 October 2008. This ratification aims to optimum benefits earned from coffee commodity for farmers and coffee producers' welfare.

65 [http://info.worldbank.org/etools/wti/docs/indonesia\\_brief.pdf](http://info.worldbank.org/etools/wti/docs/indonesia_brief.pdf) and [www.bilaterals.org](http://www.bilaterals.org)

66 See Japan/Asean: Japan signs free trade agreement with Asean. Available at <http://www.asialaw.com/Article/1970713/Channel/16715/JapanAsean-Japan-signs-free-trade-agreement-with-Asean.html>

67 The G33, composed of 44 member- countries as of October 2005, defines itself as an alliance of a large number of developing countries and LDCs which have joined efforts to guarantee that the food security, livelihood security and rural development concerns of the developing countries are put at the centre of the discussions on agriculture at the WTO (Global Issue Paper, November 2005).

### 2.5.2. Regional cooperation

The most principal commitment for Indonesia in international trade agreement based on regional basis is *ASEAN Charter* and *ASEAN Economic Community (AEC) Blueprint agreement*, which was signed by each head of state in the ASEAN Summit in November 2007. The AEC applies four (4) pillars as the strategies for its development, namely (1) single market and production basis (2) area with economic competitiveness (3) equitable economic development and (4) integration with global economy. Various conformities and agreements in the framework of AEC have been approved, particularly in the single market and production base pillars. Several important agreements have been signed covering (i) agreement in merchandise goods (ATIGA)<sup>68</sup> (ii) agreement in trade in services (AFAS package-7)<sup>69</sup> and agreement in investment (ACIA).<sup>70</sup>

Other economic cooperation is conducted in regional forum through APEC, which has assisted to resolve global economic crisis through the acceleration of regional economic integration and supporting the completion of WTO/DDA negotiation.

### 2.5.3. Bilateral cooperation

Indonesia's comprehensive bilateral agreement with Japan has been completed, which is reflected in the *Indonesia-Japan Economic Partnership Agreement (IJ-EPA)* signed by both head of states on 20 August 2007 and was effective on 1 July 2008.<sup>71</sup> The optimal result from such an agreement is the provision of capacity building for Indonesian.<sup>72</sup> Other bilateral negotiations whose feasibility studies have been completed are with EFTA (European Free Trade Association),<sup>73</sup> India and Australia.

Indonesia still faces obstacle on some issues in its bilateral agreement framework with other trading partners, which are rather burden some. For example, difficulties that Indonesia has to deal with the implementation of **Registration, Evaluation, Authorization and Restriction of Chemicals (REACH)** by the European Union.<sup>74</sup> Other constraints imposed by trading partners are legalization of export document, obligation of having a calling visa for Indonesian employer, and payment issue. Frequent delays in the L/C disbursement, and its disbursement rigid procedure also made Indonesian businessmen to receive the required funds in late manner, on top of there is no direct payment.

---

68 ASEAN Trade in Goods Agreement (ATIGA)

69 AFAS, ASEAN Framework Agreement on Services, is aimed at substantially eliminating restrictions to trade in services among ASEAN countries in order to improve the efficiency and competitiveness of ASEAN services suppliers.

70 Details on ACIA see <http://www.eria.org/research/images/pdf/PDF%20No.1-2/No.1-2-part2-7.pdf>

71 It encompasses assistance to build Indonesia's technological capacity and migration of Indonesian nurses.

72 Since the implementation of IJEPA on 1 July 2008, around 200 Indonesian nurses and caregivers have been sent to Japan for the first intake ([www.bilaterals.org](http://www.bilaterals.org)). Apart from that, Japan will transfer its Japanese training venue for nurse and caregiver candidates from Japan to Indonesia, available from [http://info.worldbank.org/etools/wti/docs/indonesia\\_brief.pdf](http://info.worldbank.org/etools/wti/docs/indonesia_brief.pdf)

73 Consisting of Norway, Iceland, Switzerland and Liechtenstein

74 REACH is the European Community Regulation on chemicals and their safe use. It deals with the Registration, Evaluation, Authorization and Restriction of Chemical substances. The law entered into force on 1 June 2007. Its aim is to improve the protection of human health and the environment through the better and earlier identification of the intrinsic properties of chemical substances. At the same time, REACH aims to enhance innovation and competitiveness of the EU chemicals industry. The benefits of the REACH system will come gradually, as more and more substances are phased into REACH.

## 2.6. The Impacts of Trade Cooperation on Employment: Government and Trade Unions Perspectives

It has been argued by the government that all of the above trade cooperation has given positive and negative impacts to the employment in Indonesia. With regard to FTA, for instance, it is argued that movement of natural persons (free movement of labor) is still risky for Indonesia. The reason is simply because of the fact of a huge number of unskilled and low level-educated workers. A special treatment for unskilled labor and efforts to develop their capacity are needed to solve this problem. One good example is on Indonesia-Japan relation under Indonesia Japan Economic Partnership Agreement (IJEPA) in which Indonesia has been given a particular quota to supply labor (e.g. nurses) with certain qualifications (see Box 4).

### **Box 4. Indonesia and Trade Negotiations**

An important function of the Ministry of Trade is coordination. It coordinates with line ministries to determine the position of Indonesia in trade negotiations. The Ministry of Trade also coordinates with other stakeholders, private actors and academicians. Each line ministry has its own specific private stakeholders. Before having inter-ministerial coordination on trade, the line ministries are assumed to discuss first with their own stakeholders. Prior to the negotiation, the Ministry of Trade collects materials to be discussed with the stakeholders by sectors. The specific line ministries may also collect themselves from their own stakeholders before delivering the material in the forum. Then, the Ministry of Trade invites all the stakeholders to have a discussion in the forum.

Indonesia's trade negotiations are multilateral, regional and bilateral. Multilateral negotiations are under the WTO, regional negotiations are under ASEAN, and bilateral negotiations are with individual countries such as Japan and Korea.

The Ministry of Trade has built a mechanism to perform negotiations with other countries. It has several levels of coordination, from technical officers, seniors, and ministerial levels. The results of the meetings are given to the government. The Ministry of Labor is also involved in the process of coordination.

Negotiations on services trade have been particularly challenging. Indonesia has a huge number of potential workers. The Ministry of Trade needs to recognize the level of workers' education and skills before going to the negotiation table. This is because any agreement will have an impact on workers' welfare. The Ministry of Trade must also pay attention to the balance of supply and demand in labour markets. For example, in the case of nurses, some may be sent overseas, but the stock of nurses in the domestic market must also be considered to meet domestic demand. Developed countries are reluctant to negotiate the movement of unskilled labor as these workers may stay permanently in the host country unlike professional workers who tend to be more mobile.

Besides the above problem, the role of sponsorship on expatriates gives a large opportunity for foreign workers to get jobs in Indonesia. This is the case due to the great number of foreign investors to bring their professionals to Indonesia. Meanwhile, a less number of Indonesian investors operating in overseas give less opportunity for domestic professionals and skilled workers in overseas. This condition leads to 'negative gain' for Indonesia (more quality foreign workers work in Indonesia compared with quality Indonesian workers work overseas).

To solve the problems, there should be a link between fiscal incentives and the use of domestic workers. Some incentives must be given to industries to encourage them to employ more local workers.

For instance, if a firm recruits all its workers domestically then this firm should be given some sort of fiscal incentives. Also, the country needs further investments to boost the economy and at the same time to create more employment. Promotion of export oriented industry is one way to generate employment. Labor intensive manufacturing sector is one of the options that can be promoted and invite investors to do their business. A better competitiveness level gives opportunity for the industries to absorb job seekers. Outsourcing system seems to be a common method for companies (including the ones producing exported products).

Regarding solution towards unskilled labors in which their numbers are dominant, there should be efforts to increase the number of skilled workers as well as for skilled labors to increase and maintain professionalism. The In-flow of capital and technology from abroad must be accompanied by the increasing numbers of qualified human resources. This is important to make that investments give positive impacts to increase the quality of workers. Also, the workers certification system must be developed. This is simply because we cannot say that we are expert and professional without having a certificate. Mutual Recognition Arrangement (MRA) is also one way to increase the ability and skills of Indonesia's workers (see Box 5).

#### **Box 5. Free Trade and Labor Movement: Government's Perspectives**

With regard to Free Trade Agreements (FTA), in which Indonesia has joined, movement of natural persons (free movement of labor) is still risky for Indonesia. The position of Indonesia is weak due to the fact the labor quality is relatively low and the huge number of unskilled and low level-educated workers. In the FTA negotiations, there is a need to have special treatment for unskilled labor and efforts to develop their capacity. A good example is the Indonesia-Japan relationship under the Indonesia Japan Economic Partnership Agreement (IJEPA) in which Indonesia has been given a particular quota to supply nurses with certain qualifications.

The role of sponsorship for expatriates gives a large opportunity for foreign workers to get jobs in Indonesia. This is the case due to the great number of foreign investors that bring their professionals to Indonesia. Meanwhile, the smaller number of Indonesian investors operating overseas results in fewer opportunities for domestic professionals and skilled workers overseas. This condition leads to a 'deficit' for Indonesia (more quality foreign workers work in Indonesia compared with quality Indonesian workers working overseas).

There should be a link between fiscal incentives and the use of domestic workers. Some incentives must be given to industries to encourage them to employ more local workers. For instance, if a firm recruits all its workers domestically then this firm should be given some sort of fiscal incentive.

Regarding trade and its employment effects, the country needs investments to boost the economy and at the same time to create more employment. Promotion of export oriented industry is one way to generate employment. Labor intensive manufacturing sector is one of the options that can be promoted by inviting investors to locate their businesses in Indonesia. A better competitiveness level will allow industries to absorb job seekers. The subcontracting system seems to be a common method for companies (including the ones producing exported products).

There will be also costs that Indonesia may face, especially related to unskilled labors whose numbers are dominant. Indonesia will have to bear the costs of upgrading their skills as well as the costs for skilled labors to increase and maintain professionalism. In-flows of capital and technology must be accompanied by increasing numbers of qualified human resources. The workers certification system must be developed. Mutual Recognition Arrangements (MRA) may be one way to increase the ability and skills of Indonesia's workers.



Similar arguments have also been given by the trade unions. It was argued that the negative employment impacts occur due partly to the fact of low labor quality. They argued that to minimize this problem, there is an increasing need for Indonesia to improve its labor skills. This, for instance, may be done by encouraging the labor to have a pool of labor certificate (e.g. for construction workers), especially in the case of the AEC agreement. This certificate is considered important for the labor to get access to mobile easily within the AEAN countries.

Apart from the quality of labor, there are other reasons why Indonesia is not yet ready to enter full competition under free trade with its trading countries. These reasons are as follows. First, it is because of uncertainty of the implementation of the laws/rules and regulations, especially those related to the protection of workers under the Labor Law No. 13/2003. It is argued that the Implementation and the enforcement of the Law are very weak and the regulators do not function well in applying the law. These problems may be due to limited budget and lack of staffs to enforce the law. Decentralization has also add up the problems in local-autonomy regions as the Ministry of Labor does not have the authority over the district level, which is leading to difficulty in law enforcement.

Second, it is because of the hidden costs that are still imposed to the firms or industries. Third, it is due to insufficient infrastructures. As the hidden costs, the lack of infrastructures lead to high production costs for firms and make them more difficult to compete internationally. The side effect of increasing production costs is that the firms are reluctant to increase wages. Fourth, it is because of the system of labor supply and demand is not well implemented. This particularly relates to the rules and regulations of outsourcing system (see Box 6).

#### **Box 6. Free Trade Agreements (FTA) and Employment: Trade Unions' Perspectives**

Globalization and free trade have come together to affect Indonesia's economy. Indonesia has joined a number of free-trade agreements, such as ASEAN Plus and the ASEAN China Free Trade Area (ACFTA). These agreements have influenced employment in Indonesia. FTAs and the ASEAN Economic Community (AEC) in particular, will result in positive and negative impacts on labors. In order to minimize the negative impacts of AEC, there is an increasing need for improving labor skills, especially to have a pool of certified labor (e.g. as construction workers) to encourage labor mobility across ASEAN. This is due to a fact that to be able to compete, a higher productivity is required for labors. The productivity may be raised through training for not only unskilled but also skilled labors.

There are several conditions in Indonesia that show that the country may not be ready yet to enter into full competition under free trade with its trading partners. The conditions are as follows:

- (1) Uncertainty of implementation of the laws/rules and regulations, especially those related to the protection of workers under the Labor Law No. 13/2003. The Implementation and law enforcement are weak. The regulators do not function well in applying the law. The low budget and lack of staff are some common reasons behind the facts. Decentralization has also added to the problems as the Ministry of Labor does not have the authority over the district level, which is leading to difficulty in law enforcement.
- (2) Hidden cost is still also a common problem of which the economy may face, which makes Indonesia less competitive in international markets.
- (3) Insufficient infrastructure leads to high production costs for firms and make them more difficult to compete internationally. The side effects of increasing production costs is that the firms are reluctant to increase wages.

- (4) In practice, labour rules and regulations are circumvented through the use of a subcontracting system.
- (5) With the increasing competition, not only for the firms but also for workers, ideally the firms have to improve the quality of their workers by conducting various practical training for the workers to increase their capacity and productivity as well as competitiveness level. As the vast majority of Indonesia's workers have low skills and education, it seems that the country is not ready to have a free-trade regime. High-income work opportunities will be filled by workers from other countries, for instance, other ASEAN countries.

To solve the problems above, the trade unions suggested the government to improve infrastructure and the quality of human resources. This is because poor infrastructure leads to high transportation and hidden cost. Then, finally all together cause the higher production cost. Also, there is a need for the government to give supports to domestic firms. However, the opening-up of certain domestic industries or sectors should be implemented gradually (step by step), sector by sector, starting from the sector in which Indonesia could benefit most, such as on migrant workers and tourism. It would be ideal, if countries could make agreements to have division of production and exports. For example, Indonesia may specialize to produce and export certain products, while other countries produce and exports different products. This policy may give significant impacts on employment if we are in the free trade agreement (see Box 7).

#### **Box 7. Trade Unions on the Solutions to Employment under Free Trade Agreements (FTAs)**

FTAs have positive and negative impacts on employment. It depends on whether the country has the necessary conditions to gain the potential benefits or not. In the ASEAN Free Trade Agreement (AFTA), for example, Indonesia will, most probably, not gain due to weaker position in terms of competitiveness. For example, Indonesia and some other countries compete in exporting electronic goods and other competitive products. One way to increase the competitiveness is by reducing production costs. The companies' policy is usually manifested by reducing labor costs.

It was suggested that the opening-up of certain industries or sectors should be implemented gradually (step by step), sector by sector, starting from the sector in which Indonesia could benefit most, such as on migrant workers and tourism. It would be ideal if countries could make agreements on production sharing and exports. For example, Indonesia may specialize in the production and exporting of certain products, while other countries produce and export different products. This policy may result in a significant positive impact on employment if we are in the free trade agreement.

To gain from free-trade, the two most significant factors which need to be resolved are poor infrastructure and the low capacity of human resources. Poor infrastructure leads to high transportation and hidden costs, which result in higher production costs. Labor costs are only around 10% of total costs. In a condition of abundant labor supply, the workers tend to have lower bargaining power than that of the employer in determining or negotiating the level of wages.

Dealing with infrastructure and improving the capacity of workers may result in significant potential gains from free trade. In addition, the lack of government support to domestic firms is a key reason for the lack of domestic competitiveness, which in turn, could create unemployment. So, the government needs to be more serious in assessing the possible negative consequences of free trade.

## References

- . April 2009b. “India-ASEAN; Japan-ASEAN. Japan-Indonesia.” Bilaterals.org. [www.bilaterals.org](http://www.bilaterals.org).
- . June 26, 2009c. “RI. NZ Bilateral FTA Arrangements To Conclude Within Months: FM.” Bilaterals.org. [www.bilaterals.org](http://www.bilaterals.org)
- . April 2009a. “AANZFTA.” Bilaterals.org. [www.bilaterals.org](http://www.bilaterals.org)
- Anonymous. 2010. “Still on Investment’s Negative List 2010 “. Indonesia Law Report. June 16, 2010. Available at [Http://Indolaw.Alafghani.Info/2010/06/Still-On-Investments-Negative-List-2010.Html](http://Indolaw.Alafghani.Info/2010/06/Still-On-Investments-Negative-List-2010.Html)
- Arnst, Randall. February 2009. “*Business as Usual: Responses within ASEAN to the Food Crisis.*” Occasional Paper 4. Focus on the Global South. <http://focusweb.org/pdf/occasionalpaper4.pdf>
- Asian Development Bank (ADB), International Labor Organization (ILO) and Islamic Development Bank (IDB). 2010. “*Country Diagnostic Studies: Indonesia Critical Development Constraints*”.
- BAPPENAS and LPEM University of Indonesia (2008)
- Basri, Chatib and Hal Hill. 2010. “*Indonesian Growth Dynamics*”. Working Paper No. 2010/10 on Trade and Development. Arndt-Corden Department of Economics Crawford School of Economics and Government, ANU College of Asia and the Pacific. Obtained from <http://rspas.anu.edu.au/economics/publications.php>
- Cainglet, Jayson and Robert Stemmler. 2005. “*Can Protective Trade Policy Instruments like Special Products (SP) and Special Safeguard Mechanisms (SSM) contribute to a more Sustainable and Fairer Multilateral System of Trade in Agriculture?*” Global Issue Paper, Nov 2005, English Version. Available at <http://www.globalalternative.org/downloads/GIP22-sm-en.pdf>
- Chemonics International. 2009. “*Export-oriented Investment in Indonesia*”, U.S. Agency for International Development I(USAID funded “Indonesia Trade Assistance Project /ITAP” Implemented by Chemonics International, Inc.) [http://pdf.usaid.gov/pdf\\_docs/PNADR350.pdf](http://pdf.usaid.gov/pdf_docs/PNADR350.pdf)
- Devarajan, Shantayanan, Hafez Ghanem and Karen Thierfelder. 1997. *Economic Reform and Labor Unions: A General Equilibrium Analysis Applied to Bangladesh and Indonesia*. The World Bank Economic Review 11 (1): 145-170.
- Economist Intelligence Unit (EIU). 2011. “Indonesia Trade Regulations.” Views Wire. Available at [http://www.eiu.com/index.asp?layout=VWPrintVW3&article\\_id=1597810344&printer=printer](http://www.eiu.com/index.asp?layout=VWPrintVW3&article_id=1597810344&printer=printer) 15 Feb 2011.
- Economist Intelligence Unit. “Trade policy: Overview “. Available at
- Food and Agriculture Association of the United Nations (FAO). 2009. “*Policy Measures Taken by Governments to reduce the Impact of Soaring Prices*” (As of 15 December 2008).” FAO. December 15, 2008. <http://www.fao.org/giews/english/policy/1.asp>.
- Global Trade Alert. 2009. “*Indonesia: Announced Intention to Unify Policies towards Domestic and Foreign Investments.*” <http://www.globaltradealert.org>

- Guntur Sugiyarto, Adam Blake, M. Thea Sinclair (undated). "Trade Liberalization With Labor Market Distortions: The Case of Indonesia". Presented at the Sixth Annual Conference On Global Economic Analysis, June 12-14, Scheveningen, The Netherlands. Available at <https://www.gtap.agecon.purdue.edu/resources/download/1491.pdf>
- International Financial Corporations and World Bank. 2011. "Doing Business 2011 Indonesia 2011: Making A Difference for Entrepreneurs". Washington DC. Available at <http://www.doingbusiness.org/~media/FPKM/Doing%20Business/Documents/Profiles/Country/DB11/IDN.pdf>
- International Monetary Fund (IMF). August 2009. International Financial Statistics (Country Tables).
- Magiera. Stephen L. August 21. 2008. "The Investment Negative List: One Year Later." United States-Indonesia Society. <http://www.usindo.org/publications/briefs/2008/Stephen%20Magiera%208-21-08.pdf>
- Market Access Database. [http://madb.europa.eu/madb\\_barriers/barriers\\_details.htm?barrier\\_id=095258&version=2](http://madb.europa.eu/madb_barriers/barriers_details.htm?barrier_id=095258&version=2)
- Norton Rose Group Survey. June 2011. "Indonesia inward investment: An industry survey." Available at <http://www.nortonrose.com/files/indonesia-inward-investment-june-2011-pdf-52492.pdf>
- Office of the United States Trade Representative. "2011 National Trade Estimate Report On Foreign Trade Barriers: Indonesia". Page 183-190. <http://www.ustr.gov/about-us/press-office/reports-and-publications/2011-0>
- Post Strategy. 2009. "Cutting the red tape". Available at [http://www.portstrategy.com/features101/area-survey/asia/south-east-asia/indonesia\\_poised\\_for\\_political\\_battle\\_on\\_port\\_reform](http://www.portstrategy.com/features101/area-survey/asia/south-east-asia/indonesia_poised_for_political_battle_on_port_reform)
- Republic of Indonesia. *Rencana Pembangunan Jangka Menengah* (Medium Term Development Plan) 2010-2014. Book I and Book II. Jakarta.
- Rina Oktaviani and Erwidodo. Undated. Managing the Challenges of WTO participation: Case Study 18 on Indonesia's Shrimp Exports: Meeting the Challenge of Quality Standards. World Trade Organization. Available at [http://www.wto.org/english/res\\_e/booksp\\_e/casestudies\\_e/case18\\_e.htm](http://www.wto.org/english/res_e/booksp_e/casestudies_e/case18_e.htm)
- The Economist, July 23<sup>rd</sup> 2011. "Indonesia's middle class: Missing BRIC in the wall."
- Vanzetti, David; Greg McGuire and Prabowo. 2005. "Trade Policy at the Crossroads – The Indonesian Story". Policy Issues in International Trade and Commodities Study Series No. 28, United Nations Conference on Trade and Development. United Nations. New York and Geneva, 2005 available at [http://www.unctad.org/en/docs/itcdtab29\\_en.pdf](http://www.unctad.org/en/docs/itcdtab29_en.pdf)
- World Bank. 1992. "Indonesia Growth, Infrastructure and Human Resources", Report No. 10470-IND.
- World Bank. 2009. "Philippines: Quick Measures to Boost Exports in Response to the Global Financial Crisis." World Bank. Washington. DC. June 6, 2009.
- World Bank. 2009. "Update on the Impact of the Financial Crisis on Trade and Trade Finance." World Bank. Washington. DC. January 14. 2009
- World Bank. 2009. "Update on Trade Measures and Sector-Specific Support." World Bank PREM Trade Group. April 21. 2009, Washington. DC.
- World Bank. 2009. *Indonesia Economic Quarterly*. World Bank. Washington. DC. June 2009.

- World Bank. 2010. "Indonesia Trade Brief." *World Trade Indicators 2009/10: Country Trade Briefs*. Washington, DC: World Bank. Available at <http://www.worldbank.org/wti>
- World Bank. April 2009. "East Asia And Pacific Update: Battling the Forces of Global Recession." World Bank, Washington, DC.
- World Trade Organization. 2007. "Trade Policy Review: Indonesia". Geneva.
- World Trade Organization. July 15. 2009. "Report to the TPRB from the Director-General on the Financial and Economic Crisis and Trade-Related Developments." Geneva.
- World Trade Organization. 2011a. "Protectionist pressures on the rise." (24 May 2011). Available at [http://www.wto.org/english/news\\_e/news11\\_e/igo\\_24may11\\_e.htm](http://www.wto.org/english/news_e/news11_e/igo_24may11_e.htm)
- World Trade Organization. 2011b. Speech DG Lamy: "Trade restrictions on the rise", Lamy, 21 June 2011. Available at [http://www.wto.org/english/news\\_e/sppl\\_e/sppl196\\_e.htm](http://www.wto.org/english/news_e/sppl_e/sppl196_e.htm).
- Yessar Rosendar. 2009. "Incoming Indonesian Government Urged to Untangle Business Regulations". Jakarta Globe. September 30, 2009 available at <http://www.thejakartaglobe.com/business/incoming-indonesian-government-urged-to-untangle-business-regulations/332765>

## Barriers to Services<sup>i</sup>

**Legal services:** only Indonesian citizen may be licensed as a lawyer in Indonesia. Foreign lawyers may only work in Indonesia as “legal consultants” upon approval of the Ministry of Justice and Human Rights. A foreign law firm seeking to enter the market must form a relationship with a local firm.

**Express delivery and logistics services:** in September 2009, the Indonesian legislature introduced a new law with restrictions on postal services, broadly defined to include courier, express delivery, and other logistics services. The law requires that postal service providers be majority-owned by Indonesians and that foreign providers limit their activities to provincial capitals with international airports and seaports.

**Health services:** the changes in foreign investment restrictions launched in 2010 permit for 67 percent foreign ownership in health services in all regions of Indonesia. This is in contrast to the previous regulation which confined foreign investors to the cities of Medan and Surabaya. The country restricts foreign health care professionals from practicing in Indonesia. Foreign trained physicians are only allowed to supervise and perform procedures in the course of educating Indonesian physicians.

**Distribution:** Indonesia’s market is generally closed to investment in the selling industry. Although Indonesia allows up to 100 percent foreign equity in the distribution and retail sectors, investors must enter into a “partnership agreement” with a small scale Indonesian enterprise.

**Shipping:** Indonesia’s new shipping law requires all vessels operating in Indonesia’s waters to be flagged domestically and manned by Indonesian crews. The new law does not provide for exceptions<sup>ii</sup> But the passage of a new Shipping and Port Act in May 2008 by Susilo Bambang Yudhoyono’s Democrat party, as part of its efforts to free up international trade processes, has the potential to open up Indonesia’s inefficient port system to new market entrants (Post Strategy, 2009).<sup>iii</sup>

**Financial services:** Indonesia allows 99 percent foreign ownership in the banking sector, however, financial service providers may not establish as a branch. The 2007 Investment Law introduced a new foreign equity cap of 80 percent for new investors in the insurance sector.

**Energy services:** In 2009, Indonesia’s upstream oil and gas regulator *BP MIGAS* began requiring bidders for energy services to have local content of at least 35 percent, although it is unclear whether Indonesia has the capacity to provide the level of domestic content required by the regulation. Foreign energy services companies are concerned that these local preference policies severely undermine their ability to make successful bids on contracts and to make decisions about sourcing and personnel that would allow them to function efficiently and profitably in the Indonesian market.

---

i This part unless stated is cited from the United States Trade Representative Report on “*Foreign Trade Barriers*” Available at <http://www.ustr.gov/about-us/press-office/reports-and-publications/2011-0>

ii As such it becomes a particular problem for foreign investors in Indonesia’s energy sector, who will no longer be permitted to bring in the sophisticated rigs and specialized equipment needed to develop large upstream projects. Because of such concerns, the Ministry of Transportation announced a suspension in implementation of the new law until May 7, 2011. Nevertheless, foreign investors continue to experience delays in long-term operational planning as it is customary for specialized equipment to be reserved many months in advance.

iii Post Strategy. 2009. “Cutting the red tape”. Available at [http://www.portstrategy.com/features101/area-survey/asia/south-east-asia/indonesia\\_poised\\_for\\_political\\_battle\\_on\\_port\\_reform](http://www.portstrategy.com/features101/area-survey/asia/south-east-asia/indonesia_poised_for_political_battle_on_port_reform)

**Audit and accounting services:** foreign firms are not allowed to practice under international firms' names, although terms such as "in association with" are permissible. Foreign accounting firms must operate through technical assistance arrangements with local firms. Only Indonesian citizens may be licensed as accountants. Foreign agents and auditors may act only as consultants and cannot sign audit reports. Foreign directors, managers, and technical experts/advisors are allowed a maximum stay of two years, with a possible one-year extension. Auditors practicing in the capital markets are prohibited from delivering specified non-audit services such as consulting, bookkeeping, and information system design.

**Film:** a September 2009 law provides for screen quotas permitting no more than 60 percent of screen time for foreign films, unspecified import restrictions to achieve that quota, prohibitions against the dubbing of foreign films, and prohibitions against foreign companies distributing or exhibiting films. In January 2010, the Minister of Culture and Tourism issued a two-year suspension of a regulation requiring all local and imported movies (both theatrical prints and home video copies) to be replicated locally, with penalties on exhibitors for failing to do so.

**Construction, architecture and engineering:** foreign construction firms are only permitted to be subcontractors or advisors to local firms in areas where the government believes that a local firm is unable to do the job. Apart from that, foreign companies must form joint ventures with local firms if they wish to participate for government-financed projects.

**Telecommunications services:** Indonesia permits up to 65 percent foreign ownership in value added and mobile telecommunications services and up to 49 percent for fixed networks. While this foreign ownership level goes beyond Indonesia's current commitments in its WTO-GATS schedule, the limits on fixed services represent a step backward from recent practice under which up to 95 percent ownership was permitted. A Ministry of Communications and Informatics decree issued in 2008 confines the construction, management, and ownership of cell towers to domestic companies and obliged existing investors to exit the market within two years. Such setbacks might damage Indonesia's investment climate that the government has tried to improve.

**Education:** Indonesia's law on education legal entities does not permit foreign investment in higher education in the form of a limited liability company, which conflicts with provisions of the existing Investment Law. Besides, foreign educational personnel require permits from both the Ministry of Education and the Ministry of Manpower and Transmigration. The permission is granted on a case-by-case basis and is only given when there are no Indonesian instructors capable of filling the position.

# Indonesia's Labour Market and Employment Policy

This chapter explains and discusses labour market and employment policy in Indonesia. The first section highlights the characteristics of Indonesian labour force, including the patterns of labour force participation rate, unemployment rate, and employment rate. In addition this section will provides a brief discussion on important employment policies, which will be followed by discussion of labour market policies in section two. These discussions aim to provide a background and general understanding of how labor and employment issues relate to the country's trade sector.

## 3.1. Characteristics of Indonesia's labour force

Indonesian working age population increased from 164 million people in 2007, to 172 million in 2010, and to 174 million in 2012. Consequently, the number of labor force also grew from 110 million people, to 117 million, and to 118 million respectively. In other words during the period of 2007 to 2012, Indonesian labour force has annual growth rate of 1.5 percent on average (BPS web site).

Although unemployment rate tends to decline, a large number of people remain unemployed. The number reaches 10 million in 2007, then reduced to 8.3 million in 2010, and further decreased by 6.14 percent to 7.2 million in 2012 (**Table 3.1**). ILO noted that Indonesia's unemployment rate continues to decrease even during the economic crisis, dropping from 8.4 to 7.1 percent between August 2008 and August 2010; reflecting strong growth of employment in the manufacturing, and in the social services sector (**ILO, 2011a**). In 2012, unemployment rate continue to drop to 6.1 percent. However, underemployment rate remains relatively high at 14 percent in 2010 (BPS, Sakernas 2010).<sup>75</sup> Meanwhile, the Indonesian labour force participation rate (LFPR)<sup>76</sup> remained constant at around 67 percent. This means around 67 percent Indonesians aged 15 years-old or older, were either employed or unemployed.

75 Underemployment rate is defined as a percentage of people working less than 35 hours per week and is currently looking for a job, or available for more work compares to the total number of employed persons.

76 LFPR is defined as the percentage of people who either employed or looking for work compared to the total number of working age population.



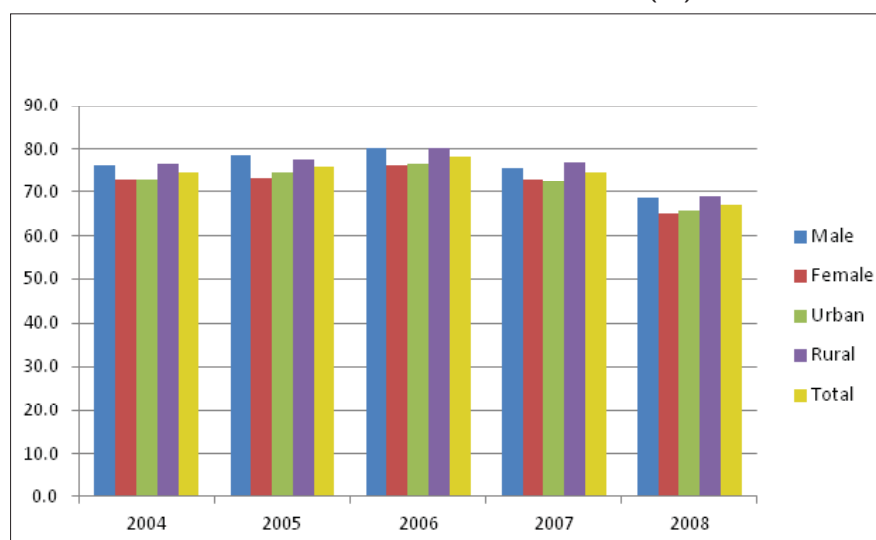
**Tabel 3.1. Working age, labour force and employed population, Indonesia, 2007-2012 (in million)**

Type of Activity	2007	2008	2009	2010	2011	2012
Population 15+	164.1	166.6	169.3	172.1	171.8	173.9
Labour Force	109.9	112	113.8	116.5	117.4	118.1
Employed	99.9	102.6	104.9	108.2	109.7	110.8
Labour Force Participation Rate (%)	67	67.2	67.2	67.7	68.3	67.9
Unemployment Rate (%)	9.1	8.4	7.9	7.1	6.6	6.1

Source: BPS website (based on August NLFS).

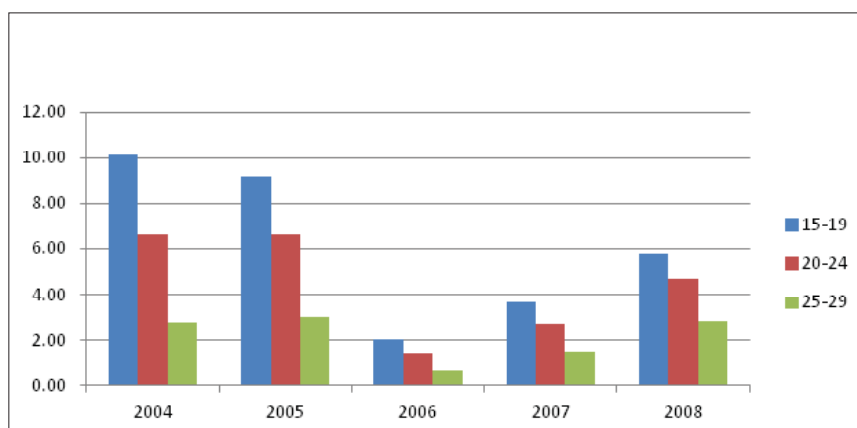
## Youth employment

Although youth unemployment in Indonesia seems to decline, it constituted a large proportion of the total unemployed population. In 2004, almost 75 per cent of unemployed individuals were 15 to 29 years-old youth. The number went up to almost 80 percent in 2006 (**Figure 3.1**). The ratio of unemployed youth to unemployed adult is very high. This condition serves as a good indicator in understanding the discrimination between younger and older worker in the labour market. In 2004 the ratio of unemployed youth to unemployed adult was 10 to 1. The number doubled in 2006 and continue to rise until it falls 5.7 times lower in 2008 (**Figure 3.2**). The data further displayed that the ratio of unemployed youth to unemployed adult decreases in line with the increasing age group. This pattern is understandable because older youth would have more experiences and better education compared to younger ones. The ratio of unemployed youth to unemployed adult between the age of 20 to 24 and 25 to 29 in 2004 was 6.6 and 2.8, respectively. The number declined in 2008 to 4.7 and 2.8, respectively (**Figure 3.2**). Like many other Asian countries, the condition of youth employment in Indonesia is quite alarming because data recorded in August 2010 stated that one of five youth was unemployed (**ILO, 2011a**).

**Figure 3.1. Share of unemployed youth (15-29) of the total unemployed by sex and residence, Indonesia 2004-2008 (%)**

Source: BPS, Sakernas, various years.

**Figure 3.2. Ratio of youth to adult unemployment by age group, Indonesia 2004-2008**



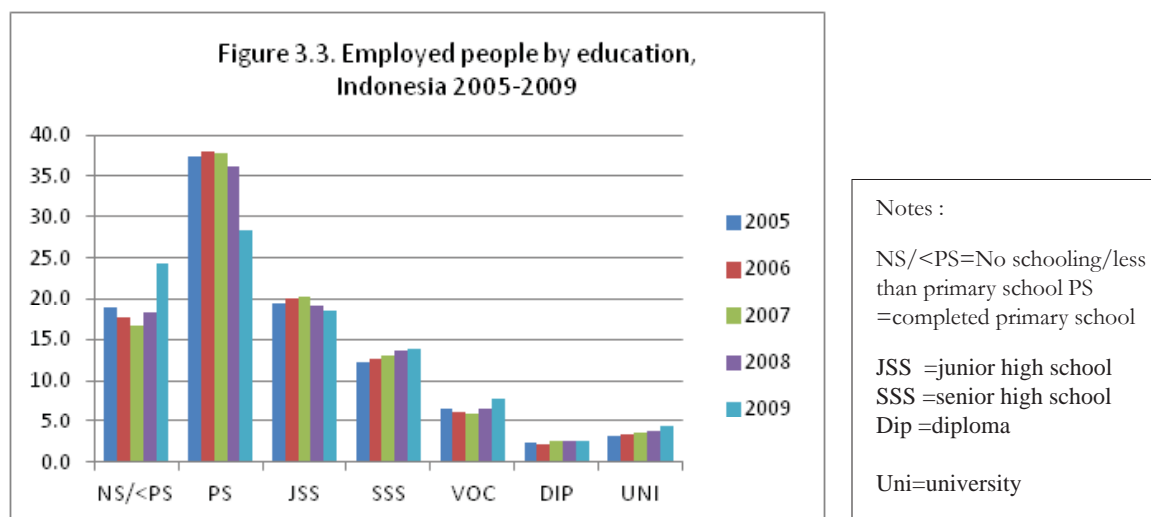
Source: BPS, Sakernas, various years.

It can be noted that an identifiable pattern has emerged where the rate of unemployed male and rural youth was higher compared to unemployed female and urban youth. The government should be concerned with this condition because without proper handling, a considerable number of the country's productive age would be wasted and might result in social unrest.

### Education of employed population

The majority of employed population in Indonesia only have low education level. In the period of 2005 to 2009, more than 50 percent of employed Indonesian was either never been to school, or only managed to attend primary school. However, the number of low-education employed population seemed to decline overtime (**Figure 3.3.**). Employed population with junior and senior high school education qualification constituted a substantially large portion of the total employed population. Meanwhile, employed population that has vocational education qualification was more than 5 percent of the total employed population. Although it steadily increasing, the number of employed population that has university education level is relatively small. In short, most of Indonesia's labor market, consisted of low-education individuals.

**Figure 3.3. Employed people by education, Indonesia 2005-2009**



Source: BPS.

Notes :

NS/<PS=No schooling/less than primary school  
PS =completed primary school

JSS =junior high school  
SSS =senior high school  
Dip =diploma

Uni=university

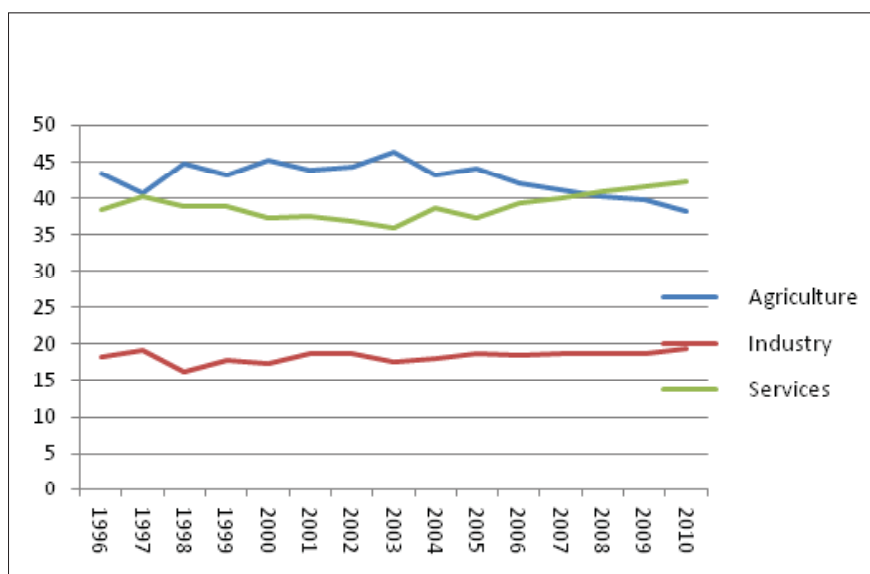
## Sectoral employment

The pattern of Indonesia's sectoral employment has experienced slight changes although the majority of Indonesians remains to find their livelihood in agricultural activities (**Figure 3.4.**). The percentage of individuals employed in the agricultural sector fluctuates despite its tendencies to decrease. In 1997, the percentage of individuals employed in the agricultural sector reached 40.6 percent. The number slightly decreases to 40.3 percent in 2008, and further lower to 38.3 percent in 2010. The large percentage agricultural workers was likely caused by a huge supply of low-educated labour force.

Meanwhile, a notable increase has occurred in the percentage of people employed in the services sector. In 1996, 43.1 percent of the employed population is employed in the services sector. The number increased to 47.7 percent in 2010 (**Figure 3.4.**).<sup>77</sup> Due to its nature that covers many branches of economic activities, jobs in the services sector depending on the skills that an employee possesses. The large portion of employed population in the services sector also can be considered as a reflection of employment in both traditional and modern sectors. Indonesia, like many other countries in Asia, relies heavily on the services sector to create more job opportunities. ILO also noted that productivity levels in the services sector in Southeast Asian countries like Indonesia, the Philippines, and Vietnam are approximately one half compared to the level of productivity possessed by the manufacturing industry sector (**ILO, 2011a**). Therefore, efforts are required to improve the productivity of the services sector, which could lead to higher wages. A relatively huge portion of employed population in the agricultural sector and - to a certain extent - in the services sector, also suggests higher employment rate in the informal sector.

The percentage of employed population in Indonesia who worked in the industrial sector was only less than 15 percent, with a slight fluctuation during 1996 to 2010 (**Figure 3.4.**). This condition seems to reflect the nature of Indonesia's manufacturing industry, which is most likely to be dominated by capital intensive establishments although at the same time, few manufacturing sub-sectors plays an important role in providing labour intensive jobs.

**Figure 3.4. Employment share by main economic sector, Indonesia 1996-2010**



Source: BPS, Sakernas various years.

<sup>77</sup> Services sector includes utilities (electricity, gas and water); transportation, storage and communication; wholesale/retail trade/hotel/restaurant; financial, real estate and business services as well as community, household and personal services.

## Employment Status

Table 3.2 demonstrates the distribution of employed people according to their employment status. The percentage of employed people working as an ‘employee’ fluctuates on a positive trend. In 2010, the number of ‘employee’ reached 30 percent of the total employed people, a number 2.8 percent higher from the previous 1996 figure. This roughly means that only around one third of Indonesians are working in a formal working relationship. In other words, a substantial portion of employed people are working in the informal sector. Employment in informal working relations includes working without a salary, which constituted 18 percent of the total employed population. Meanwhile, a large share of working people were ‘self employed with temporary/family worker’, followed by those who works as ‘own account worker’ (Table 3.2.). Such condition remains constant from 2001 through 2010.

The percentage of employed population working as casual worker both in agriculture and non-agriculture sector increased throughout 2001 to 2010. Such types of jobs are generally referred to as precarious employment, jobs that lack stability and security.<sup>78</sup>

**Table 3.2. Employed population by status in employment, Indonesia 2001–2010**

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
<b>Total</b>										
Own account worker	19.22	19.24	18.21	19.54	18.41	20.43	20.34	20.40	20.07	19.44
Employer assisted by temporary workers	22.39	24.03	24.05	22.95	22.34	20.90	21.04	21.23	20.91	20.04
Employer assisted by permanent workers	3.07	3.04	2.88	3.16	3.03	2.99	2.89	2.94	2.89	3.01
Employee	29.27	27.33	26.02	27.16	27.70	28.10	28.06	27.48	27.76	30.05
Casual employee in agriculture	4.00	4.92	4.96	4.75	5.89	5.80	5.92	5.84	5.61	5.37
Casual employee not in agriculture	2.69	3.88	3.54	3.98	4.60	4.84	4.46	5.16	5.41	4.74
Unpaid family workers	19.37	17.55	20.33	18.45	18.03	16.94	17.29	16.94	17.35	17.34
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
<b>Male</b>										
Own account worker	20.50	20.81	20.00	21.20	20.11	21.87	21.47	21.18	21.13	20.51
Employer assisted by permanent workers	27.99	28.72	30.06	27.89	27.50	25.28	25.16	25.44	25.25	24.55
Employer assisted by permanent workers	4.25	4.15	3.91	4.30	4.01	3.98	3.76	3.89	3.86	4.01
Employee	31.89	29.40	27.97	29.10	28.82	28.94	29.95	28.93	28.62	31.16
Casual employee in agriculture	3.72	4.80	4.91	4.69	5.93	6.01	5.97	5.99	5.74	5.62
Casual employee not in agriculture	3.60	5.11	4.68	5.33	5.92	6.24	5.88	6.80	7.25	6.45

78 See ILO, 2011b(, “Decent Work Country Profile of Indonesia”

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Unpaid family workers	8.05	7.02	8.46	7.49	7.71	7.68	7.81	7.77	8.14	7.70
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
<b>Female</b>										
Own account worker	17.04	16.47	15.02	16.49	15.18	17.78	18.40	19.11	18.33	17.65
Employer assisted by permanent workers	12.89	15.71	13.32	13.93	12.58	12.78	13.96	14.28	13.82	12.57
Employer assisted by permanent workers	1.08	1.08	1.04	1.10	1.19	1.15	1.38	1.37	1.30	1.37
Employee	24.82	23.67	22.53	23.63	25.59	26.54	24.82	25.09	26.36	28.22
Casual employee in agriculture	4.48	5.15	5.06	4.85	5.82	5.43	5.85	5.60	5.38	4.97
Casual employee not in agriculture	1.14	1.71	1.50	1.52	2.12	2.24	2.03	2.44	2.38	1.92
Unpaid family workers	38.56	36.21	41.53	38.48	37.52	34.08	33.56	32.11	32.43	33.30
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: BPS, Sakernas, various years.

## Informal employment

The most significant characteristic of Indonesia's labour market is its substantial share of informal employment. As the term denotes, informal employment suggested that a person is working without a formal working relationship, which means that he/she does not have the benefits of a formal worker. Such condition occurs because Law No. 13/2003 on Manpower stipulates rather vague provisions on employment and working conditions. It also excludes several category of workers from its scope.<sup>79</sup> In addition, although the law stipulates certain benefits for workers, in practice, many workers, especially those in the informal sector, are being denied of their rights. On one hand, the Manpower Law may not explicitly exclude informal workers, but on the other hand, it does not seem to have any specific provisions that address informal workers. If such provision does regulated, there is are possibilities that the provisions are not well implemented.<sup>80</sup>

Informal employment<sup>81</sup> is frequently associated with instability and insecurity. Informal sector usually exists beyond the boundaries of laws and regulations, and excluded from formal relations between the economic sectors. However, economic reforms that are driven by globalization and trade liberalization –to a certain extent –would affect informal sector's relation to labor markets. As globalization and trade liberalization increased the demands of high quality manpower, laborers who fail to qualify and forced to abandon their jobs in the formal sector, will inevitably turn their heads to the informal sector, and

79 See Manpower Act No. 13/2003

80 The government (Ministry of Manpower and Transmigration) acknowledges the existence of 'worker outside of employment relations', as reflected in the Ministry's portfolio.

81 There is no official national definition of informal employment in Indonesia. The Ministry of Manpower and Transmigration (MOMT) and BPS estimate informal employment based on the cross-tabulation of employment status and occupation. Meanwhile, the Indonesian Ministry of Industry estimates it through the size of firm's capital.

as a result, it will cause the formal sector income to suffer. Nevertheless, despite its negative effects, globalization and trade liberalization also have positive impacts on employment.<sup>82</sup>

Determining businesses that are engaged in the informal sector makes is not an easy task because in nature, it has a high turnover rate, and its assets are not separable from the assets of its owner. Consequently, recording the exact number of informal sector businesses requires more effort and costs higher. Recent survey conducted by BPS and ADB on informal sector and employment in Yogyakarta and Banten revealed that informal sector has quite a substantial contribution to the country's economic output and that informal employment is an integrated part of the labor market. The survey recorded that 81.9 and 75.9 percent of employment segment in Yogyakarta and Banten was originated from the informal sector (see **ADB-BPS, 2011**).<sup>83</sup>

Although it has less contribution to the gross regional domestic product (GRDP) compared to its formal counterpart, informal sector has an estimated portion of economic output of 34.1 percent and 20.2 percent in Yogyakarta and Banten respectively.<sup>84</sup> In addition, it should be noted that the survey results had also discovered that – to a certain extent – formal businesses sector also has its role in creating informal employment.<sup>85</sup>

During the period of 2001 to 2010, Indonesia's informal employment rate had experienced slight fluctuation. Despite being stable around the average of 60 percent, the number tends to decrease overtime. In 2001, there were around 61.5 percent of employed people in Indonesia who are working in the informal sector; the number decreased to 59 percent in 2010, experiencing a 2.5 percent decline (**Figure 3.5**). The number recorded in 2010, was the lowest percentage of informal employment for the last nine years; meanwhile the highest percentage was recorded in 2003 at 64.7 percent. Sources from *Sakernas* explained that percentage of informal employment is based on cross tabulation of employment status and type of jobs. The percentage represents economic situation that relates to the status of employment (informal or formal).

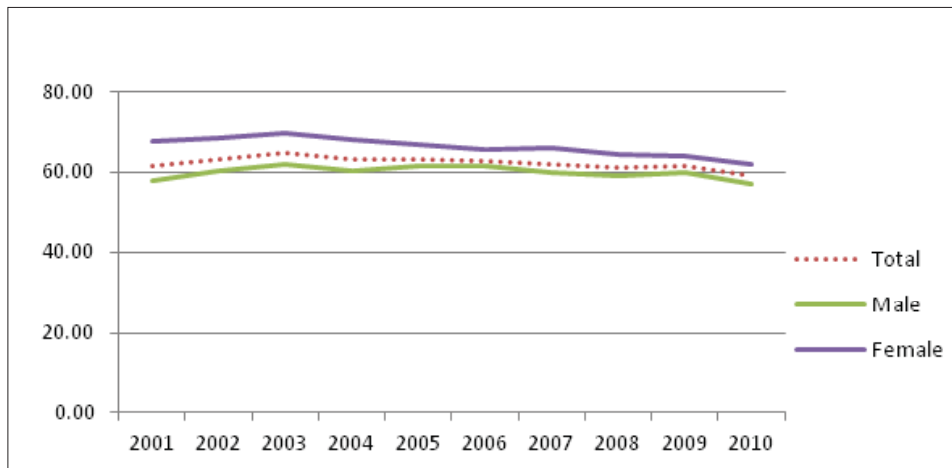
The level of gender disparity in informal employment also experienced slight fluctuation with a tendency of decreasing overtime. The number however, was increased in 2010 (**Figure 3.5**). Percentage of male workers in informal employment in 2001 was recorded at 57.9. The number decreases to 57.2 percent in 2010, showing a 0.7 percentage decline. Meanwhile, the percentage of female workers in informal employment was recorded at 67.5 and 61.8 percent in 2001 and 2010, respectively. (**Figure 3.5**). Higher percentage of female workers in informal employment was caused by the inclusion of unpaid family workers. The DWCP confirmed that in 2010, female informal workers were dominated by unpaid family workers (53.9 per cent) whereas the majority of male informal workers consist of either own-account workers (34.7 per cent) or employers assisted by temporary/unpaid workers (30.9 per cent) (**ILO, 2011b**).

82 For further details on the debate on trade and employment, see for example the joint ILO-WTO study by **Jansen and Lee** (2007) and by **Marc Bacchetta, Ekkehard Ernst and Juana P. Bustamantes** (2009).

83 This BPS-ADB study was based on the Informal Sector Survey (ISS) which is the first time applied for the social statistics.

84 Banten, the more industrialized of the two provinces, is the seat of many large-scale enterprises, both domestic and foreign. Hence, the larger extent of the manufacturing production and provision of services is from formal enterprises.

85 In Yogyakarta, for example, there were 103,642 out of 337,196 jobs (30.7 percent) under informal employment. Similarity was observed in Banten where as much as 32.7 percent of the jobs in formal enterprises were informal.

**Figure 3.5. Share of informal employment by sex, Indonesia 2001-2010**

Source : BPS, Sakernas.

## Work Security

In terms of work stability and security, Indonesian labour market has experienced flexible forms of employment and increased job insecurity. Although Indonesia is yet to ratify the ILO Convention 158 of 1982 on the Termination of Employment, Indonesia's Law No. 13/2003 on Manpower has stipulated the legal framework for termination of employment, provisions on severance payment. Over the last decade, a significant and increasing part of the employed population mostly consisted of individuals working in casual work (from 6 million in 2001 to almost 11 million in 2010). The increasing percentage of informal was inversely proportional to the declining rate of unemployment. The increase also suggested that more job opportunities have been created although most of the jobs were casual jobs that lack security. In addition, the increase has also resulted in a slow and steady increase of real wages for casual work despite the presence of gender-based wage disparities between male and female casual workers (ILO, 2011b).<sup>86</sup>

ILO suggested that wages can be used to measure the stability and security of certain works (Guide to decent work indicators, 2010). Relatively high number of casual workers with low wage rates can be considered to represent an economic condition that is unable to provide decent jobs for its people.

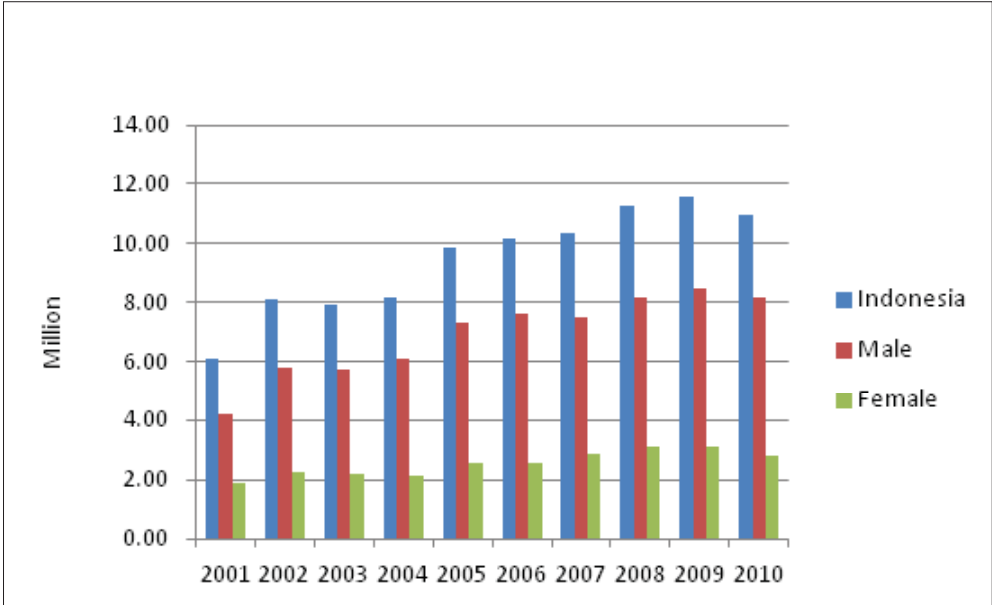
The WSM report (2009: 19) stated that 75 percent of Indonesian workers are employed under a fixed-term contract. Although this issue is considered to be present in all industrial sectors, the garment industry seemed to be one of several industries that are being majorly affected by this matter. It should be noted that Law No. 13/2003 on Manpower had already stipulated several provisions on fixed-term contracting. However, most workers constantly claimed that they are feeling threatened about their rights and protection.<sup>87</sup> Labor unions argued that the government has an intention to implement more flexible forms of employment by issuing less stringent provisions on fixed-term contracts in behalf of promoting economic growth and improving foreign investment (WSM, 2009).

<sup>86</sup> ILO, 2011b. "Decent Work Country Profile for Indonesia."

<sup>87</sup> The more detailed information on the implementation of the fixed-term contracts is presented in the Ministerial Decision of the Indonesian Minister of Manpower and Transmigration No. Kep.100/MEN/VI/2004.

During the period of 2001 to 2009, the number of casual workers in Indonesia has experienced an average annual increase of 10 percent, from 6 million in 2001, to 11.6 million in 2009. However, due to the declining number of women working as casual workers, the number managed to decrease in 2010 (Figure 3.6.). The majority of casual workers in Indonesia were dominated by male. In 2001, 68.8 percent of casual workers were male while the other 31.2 percent were female (Figure 3.6.). With the increasing number of males working as casual workers, the number of available casual jobs for females was consequently decreases.

**Figure 3.6. Number of precarious workers by gender, Indonesia 2001-2010**



### Wages

Despite an extreme downturn of wage in 2005, which is caused by 200 percent increase of fuel price, the average wage for workers have increased since 2000.<sup>88</sup>The pattern of all workers average wage for both male and female was similar (Figure 3.7.). During the period of 2000 to 2004, average wage had increased from Rp 481,000 (US\$49.06) to Rp 562,000 (US\$57.32) for male, and from Rp 326,000 (US\$33.25) to Rp 408,000 (US\$41.61) for female. In 2005, average wage decreased by Rp 50,000 for male and Rp 39,000 for female. After the decrease in 2005, average wage for male workers grew from Rp 512,000 (US\$52.22) to Rp 575,000 (US\$58.64) in 2005 and 2010, respectively. Meanwhile, average wage from female workers for the same period was increased from Rp 369,000 (US\$37.63) to Rp 455,000 (US\$46.41).

Despite the increasing average wage for both male and female workers, a gap between the wage for both genders remains apparently large. This gap however, was steadily closes overtime (Figure 3.7.). In 2001, wage gap between male and female workers was recorded at 32.3 percent. By 2010, the gap decreased to 20.8 percent.

88 According to BPS, all employees consist of regular employees and casual employees.



**Figure 3.7. Average monthly real wages of employees, Indonesia 2000-2010 (Rupiah '000)**



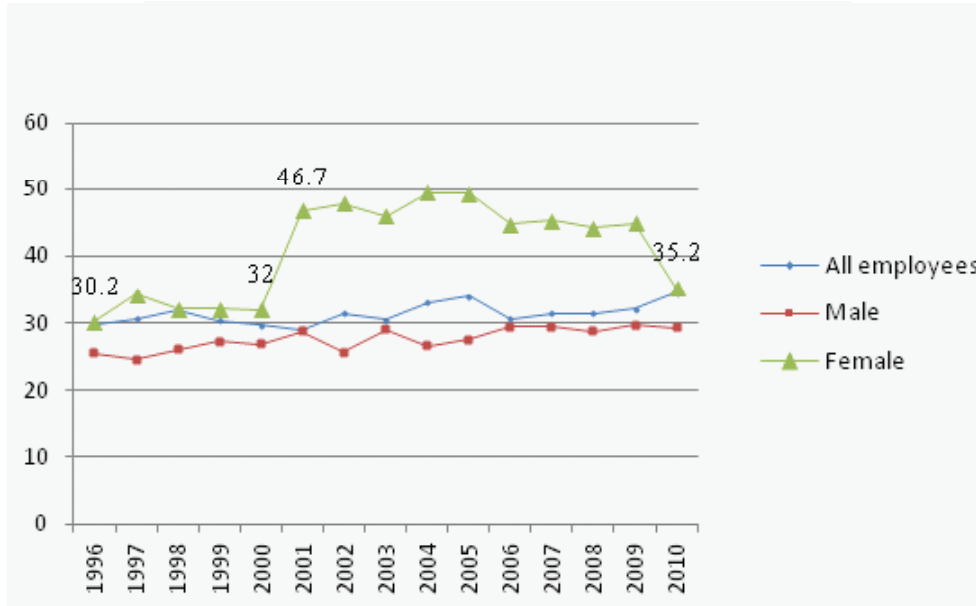
Despite the rapid increase of average wages, the percentage of low wage employees, especially those working as casual workers, had increased over the past 15 years. It seemed that the government's minimum wage policy is inadequate to protect workers, particularly casual workers and female workers. Minimum wage that has been determined by the government is considered to be inadequate to compete with the increasing cost of living. Therefore, workers argued that the Minimum Physical Needs (*Kebutuhan Fisik Minimum* – KFM) that usually serve as the basis of determining minimum wage, are no longer viable. Workers claimed that minimum wage must be determined based on decent living needs in order to prevent further social problems on the long run.

In addition to the above mentioned problem, the government claimed that issues regarding the implementation of minimum wage were caused by several cases of non-compliance with minimum wage provisions (ILO, 2011b).<sup>89</sup>

The percentage of low wage employees has been increasing for the last 15 years, from 29.7 percent in 1996 to 34.5 percent in 2010. The increase appears to be quite significant for female employees, which is from 30.2 percent in 1996 to 49.5 percent in 2004. The numbers gradually started to decline in 2005. In 2009, the percentage of low wage female employees was recorded at 44.9 percent. The percentage decreased sharply to 35.2 percent in 2010 for unknown reasons (Figure 3.8.).

89 ILO, 2011b. "Decent Work Country Profile of Indonesia"

**Figure 3. 8. Percentage of low paid employees by sex, Indonesia 1996-2010**



### Labour productivity

In terms of productivity, Indonesian laborers displayed a slow and steady increase despite the 1997/1998 economic crisis. In 1996, prior to the economic crisis, Indonesian labour productivity had reached Rp17,222 thousand with a 2 percent growth rate. However, when the economy experienced an extreme downfall of minus 15.4 percent in 1998, laborers’ productivity growth rate was recorded at -0.9% in 1999. In line with the economic recovery, Indonesia’s laborer productivity increased from Rp 15,5 million in 2000, to Rp 21 million in 2009 with an average annual growth rate of 3 percent (Figure 3.9).

**Figure 3.9. Labour productivity (Rp ‘000) and growth (%), Indonesia, 1996-2010**



## Migrant workers

Relatively high unemployment, underemployment and poverty rate has encouraged many Indonesians to work overseas. The number of Indonesian workers working abroad had been on an upward trend until the global economic crisis worsened. In 2007, there were 697,000 Indonesian legal migrant workers while the number of illegal migrant workers was estimated to be twice as much. The National Agency for the Placement and Protection of Indonesian Migrant Workers (*BNP2TKI*) estimated that the number of Indonesian migrant workers, including illegal migrant workers, stood at 5,8 million in December 2008.

Around 65 per cent of the Indonesian migrant workers, mostly females, are working as housemaids in 41 countries. Around half of the total migrant workers were employed in Malaysia while the rest are scattered in the Middle East, Singapore, Hong Kong (China) and Taiwan (China). Plantations and construction sites were also the most common workplaces for Indonesian migrant workers. Some Indonesian migrant workers were known to be employed in the manufacturing sectors in other Asian countries.

In terms of illegal Indonesian migrant workers, Malaysia is known to host a sizable number of such workers likely due to several reasons, including its geographical proximity, cultural and linguistic similarities, and existing business networks. In the past few years, state remittance generated by Indonesian migrant workers has increased and is estimated to have reached US\$12 billion in 2008.

Cases of abusive treatment on Indonesian migrant workers, mainly female, have frequently been reported (**Jakarta Post, 30 June 2011 and 24 August 2011**).<sup>16 17</sup> In order to address the issue, the government must provide stringent provision for migrant worker recruiting agencies, and establish an efficient migrant workers administration agency to ensure better management and protection of migrant workers rights.

## Industrial Relations

Development of trade unions in Indonesia has been moving forward since the end of Soeharto's New Order governmental regime. Prior to 1998, organizing labor unions is considered to be an illegal activity, except for the government-sponsored All-Indonesia Workers' Union (SPSI).<sup>92</sup> After the 1998 period, the number of established labor unions was rapidly increasing. Currently, Indonesia has at least 70 national level labor unions and thousands of labor unions established in factories spread across the country (**Asian Labour News 2004**). Such condition means that there could be more than one labor union in one company. As a result, laborers may find difficulties in conveying their demands to the company.

Independent labor movement was mainly driven by the Reformation era that brought changes in the government and on political issues. The ratification of the International Labour Organization (ILO) Convention 87, which stipulates the rights to organize for workers, was introduced. Businesses expressed its complaint on the increasing number of labor unions and the new Manpower Law (Law No. 13/2003) that requires companies to conduct a negotiation with laborers and stipulates a high amount of severance payment. Businesses argued that the Manpower Law is providing laborers with

90 The Jakarta Post, 24 August 2011. "Autopsy shows Ernawati died from abuse".

91 The Jakarta Post, 30 June 2011. "Another RI migrant worker on death row in Saudi".

92 SPSI was formed in 1985, it did not really engage in collective bargaining (La Botz 2001).

too many benefits and freedoms by allowing them to organize and held a strike. The law has since been widely criticized and some said that has severely lowered Indonesia's overall competitiveness. In recent years, industrial disputes have often ended with violence, either its workers taking out their frustration on employers for failing to meet their demands, or employers enlisting additional security forces to disband protests.<sup>93</sup>

Despite the rapid increase of labor unions following the reformation era, data showed that from 2005 to 2009, the numbers of labor unions in Indonesia have fluctuated and generally displayed a negative trend. The condition of labor unions in Indonesia is currently unstable and vulnerable because it has transformed from only having one labor union that was organized by the government, to having a rather confusing number of different labor unions, federations and confederations (**ICTUR, undated**). Records showed that in 2005, there are 18,352 labor unions in Indonesia and in 2007, the number was decreased to 11,467. Meanwhile in 2009, there are 11,852 labor unions recorded (**Table 3.3**). Rapid growth of labor unions was also caused by the development of Indonesia's political perspective towards democracy.

High numbers of labor unions in Indonesia have attracted more than 3 million members and slightly increasing over time. In average, a labor union in 2005 would have somewhere around 185 members, while in 2009, a labor union would have 288 members (**Table 3.3**).

Compared to the total number of employees in Indonesia, labor union density rate can be considered relatively low (**Table 3.3**). In 2009 labour union density rate was recorded at 11.7 percent, slightly decreasing from 13 percent in 2005. In addition, the low and declining labor union membership rate represents the rather disintegrated structure of labor unions in Indonesia. In 2005, the rate of employed people who were also member of labor unions was 3.6 percent, which means that only 3.6 out of 100 employed people were members of labor unions. From 2006 onwards, labor union membership rate has been steadily declining.

**Table 3.3. Social dialogue, workers' and employers' representation**

Union density	2005	2006	2007	2008	2009
Union net density rate, % of total employment <sup>1</sup>	3.6	3.5	3.4	3.3	3.3
Union net density rate, % of total employees <sup>2</sup>	13	12.6	12.1	12.1	11.7
Trade union membership, total	3,388,587	3,388,587	3,388,587	3,405,615	3,414,455
Registered trade unions, total	18,352	18,352	11,467	11,786	11,852
<b>Collective bargaining<sup>3</sup></b>					
Company regulations, total	36,543	37,228	38,654	41,252	42,265
Collective labor agreements, total	9,168	9,291	9,756	10,501	10,683
Workers' coverage by CLA <sup>4</sup>	0.27	0.27	0.29	0.31	0.31
Strikes and lockouts, total incidences	96	282	147	146	207
Workers involved	56,082	586,830	135,297	211,504	37,581

93 Bill Guerin. Apr 25, 2006 . "Labour pains in Indonesia". Online Asia Times. Available at [http://www.atimes.com/atimes/Southeast\\_Asia/HD25Ae02.html](http://www.atimes.com/atimes/Southeast_Asia/HD25Ae02.html)

Union density	2005	2006	2007	2008	2009
Working hours lost	746,465	4,665,685	1,161,413	1,544,400	480,586
Working days lost	389	2,430	605	804	250
Membership of APINDO5	9,537	9,537	9,537	9,537	9,537
Number of firms registered at the MOMT	...	...	186910	207518	208737

Notes:

1. Percentage of trade union membership to total employment
2. Percentage of trade union membership to total employees
3. Company regulations represent enterprise-level agreements; collective labour agreements represent sector-level agreements.
4. Percentage of CLA coverage on trade union membership
5. APINDO = Indonesia employers' association

Source: Ministry of Manpower and Transmigration administrative records, referencing Directorate General of Industrial Relations and Social Insurance by the Centre of Manpower Information, MOMT.

The declining rate of union density was caused by the recruitment system applied in Indonesia, which in the past several years, tend to apply contract-based work system.<sup>94</sup> Contract-based work system is considered to has a non-permanent working relations that appears to prevent workers from becoming a member of labor union. Another possible reason was that not many trade unions are really searching for new members despite the relatively simple requirements to establish labor unions.<sup>95 96</sup> In addition, informal workers who have low awareness of their legal rights as workers may also lead to low union membership rate because they are not aware of the importance of being a member of a labor union.

The establishment of employers' associations was mainly caused as a reaction to the rapid growth of labor unions. Employers' associations were also established based on the fundamental reason that a dialogue must involve two respective parties, which in this case, the parties are represented by employers and its employees. The existence of employer's association was considered to restore balance over labor union's influence. In addition, employers' association may also ensure that government intervention in the labor market in forms of implementing policies and regulations, does not provide any adverse effects on its business activities and development. This has been particularly true because in many Asian countries, major aspects of economic development and social policies were managed by the government (de Silva, 1997). Furthermore, ILO state members have also contributed not only in terms of the establishment of trade unions, but also in the establishment of employers' association.

In accordance with the Law on Freedom of Association, employers also have the rights to organize. However, the number of employers belonging to an employers' association tends to remain constant. From 2005 to 2009, there had not been any development on the number of companies that have become members of the employers' association, which is called APINDO (Table 3.3.). Although the

94 The Manpower Act No. 13/2003 stipulates that firms may outsource their job as long as they are not main activities.

95 A trade union is to be formed by at least 10 workers/labourers, and a trade union federation could be formed by at least 5 trade unions. Meanwhile, a trade union confederation is to be established by at least 3 trade union federations (see Chapter III Articles 5, 6 and 7 in the Indonesian Act No. 21 of 2000 on Trade Unions). The Act defines a worker/labourer is any person who works for a wage or other forms of remunerative exchange thus informal worker should by definition be covered by legislation.

96 The Manpower Act No. 13/2003 and Trade Unions Act No. 21/2000 exclude civil servants, police and military, as well as private security guards trained by the police or the military from the application of the Manpower Act and the Trade Union Act. The right to organize has been granted to civil servants although not specifically regulated.

number of companies that were registered at the Ministry of Manpower and Transmigration showed an increasing trend, the percentage of those companies that have become a member of APINDO showed no increase. In an effort to expand its network, APINDO has established branch offices several provinces and districts in Indonesia. In 2007, 5.1 percent of the registered companies were members of the employers' association. However, by 2009, the number had decreased to 4.6 percent (**Table 3.3.**).

Collective bargaining<sup>97</sup> coverage represents the number of workers whose wage and/or conditions of employment is determined by one or more collective agreement(s) as part of all respective parties eligible to arrange a collective agreement. Although 'collective bargaining coverage rate' may provide several indicators related to the implementation of collective bargaining rights, these indicators cannot be considered as perfect (**Ishikawa and Lawrence, 2005**). Collective bargaining coverage rates do not necessarily reflect the outcome of negotiations. Instead, it reflects certain characteristics of industrial relationship system and type of labor regulation a country adopts. The percentage includes the number of collective agreements that have been reached, the bargaining structure, and interactions between collective bargaining process with administrative regulations and labor-related law. For example, centralized collective bargaining structures tend to be associated with high coverage rates. Meanwhile, in countries with extension mechanisms, coverage may include enterprises and workers who may not have participated in actual collective bargaining negotiations.

Data on collective labour agreements in Indonesia are collected from administrative records kept by the Ministry of Manpower and Transmigration. However, the presented data should be interpreted with caution because the reliability of data depends not only on the registration of collective agreements, which is not mandatory, but also on data availability from respective regions. Since the implementation of regional autonomy in Indonesia, central government offices have been facing difficulties in updating and maintaining their regular records. In addition, due to the varied time line of different collective agreements, collective agreements that have been registered in previous years but currently still in force may exist.

The numbers of collective labor agreements (CLA) in Indonesia have been increasing. In 2005 and 2009, there were 9,168 and 10,683 CLAs recorded, respectively. This means that during the four year period, there had been a 16 percent increase of CLA number with a 4 percent annual growth rate (**Table 3.3.**).

Despite the increasing CLA numbers, the percentage of workers covered in collective labor agreements is very low. Similar to the ratio of trade union density rate to the total number of employees, the percentage of workers covered in collective labor agreements was recorded at 13 percent in 2005 and decreased to 11.7 percent in 2009. On the other hand, the ratio of the number of CLAs compared to the number of workers covered by CLAs was recorded at 0.27 percent in 2005 and was increased to 0.31 percent in 2009.<sup>98</sup> The number implies that there were only 27 out of 100 employees in Indonesia covered by collective labour agreement in 2005. In addition, low percentage of workers covered in collective labor agreements

---

97 For the purpose of this indicator, collective bargaining encompasses "negotiations which take place between an employer, a group of employers or one or more employers' organizations, [...] and one or more workers' organizations, [...] for determining working conditions and terms of employment" (Article 2, ILO Promotion of Collective Bargaining Convention, 1981 (No. 154).

98 CLA coverage ratio is calculated by dividing the number of CLAs with the number of trade unions membership, while trade union density is calculated by dividing the number of trade unions membership with the number of either total employed people or total employees.

is also in line with low rate of union density in Indonesia, which partly represents the low percentage of Indonesian workers incorporated in the formal employment relationship. As previously noted, more than 60 percent of employed people in Indonesia are working under informal employment. Another possible explanation is that the requirements stipulated by Article 119 of the Manpower Law could not be fulfilled.<sup>99</sup> It should be noted that companies not covered by CLA are obliged to draft company regulations.

In terms of company regulations, its numbers had increase during the period of 2005 to 2009. In 2005, there were 36,543 company regulations while in 2009, the number went up to 42,265, increasing approximately 4 percent annually. The increase was closely related to the issuance of the Manpower Law. Article 108 of the Manpower Law mandates every company that employs at least 10 workers to have a set of company regulation registered to the respective government authority.

Despite an increasing trend, the number of bipartite cooperation institution (*LKS Bipartit*) established in Indonesia is relatively low. Although the obligation for a company that employs at least 50 workers to establish a bipartite cooperation council seems to have a positive impact on the number LKS Bipartit,<sup>100</sup> LKS Bipartit percentage remains low. In 2007, there were 8,984 LKS Bipartit in Indonesia. The number had increased to 11,943 in 2009, meaning that in 2009, only 11,943 or equals 5.7 percent out of 208,737 companies registered at the Ministry of Manpower and Transmigration (MOMT) have established an LKS Bipartit. Such low percentage represents the fact that more than 70 percent of companies registered at the MOMT are small scale establishments (employing less than 10 workers (based on MOMT data) although they are not obliged to establish LKS Bipartit.

Labor strike was often considered as an indicator of the failure of social dialogue although **Anker et al (2002: 57)** warn that in certain circumstances, the absence of strike may indicate the absence of the rights to strike and lack off social dialogue. In other word, there is an uncertainty whether more strikes can be considered as an indication of stronger or weaker collective bargaining rights and social dialogue. Therefore, a feasible measurement system or indicator must be formulated cautiously in order to study and observe trends surrounding labor strike activities.

An increasing number of labor strikes and lockouts were mostly notable during 2005 to 2009 with a relatively high increase in the 2005 to 2006 period. In 2005, there were 96 labor strikes and lockouts recorded in total. The number significantly increased to 282 in 2006, approximately three times the number recorded in 2005. The increasing number of labor strikes and lockouts consequently multiplies the number of workers involved in labor strikes, the number of working hours lost, and the number of working days lost by 10.5, 6.3 and 6.3 times, respectively (**Table 3.3.**). According to the MOMT, the underlying cause of such a high increase of labor strikes and lockouts in 2006 was the increasing number of workers that demand employers to respect their rights. Such condition might be related to the country's economic condition at that certain period of time.<sup>101</sup>

99 The legislation stipulates that a registered trade union has the right to negotiate a binding collective agreement with the enterprise if more than 50 percent of the workers of that enterprise are members of the trade union or if more than 50% of the workforce supports the trade union in its endeavour to conclude an agreement.

100 Article 106 of Law No. 13/2003 on Manpower stipulates that (1) every company that employs 50 (fifty) workers or more must form a LKS Bipartit (2) LKS Bipartit referred to in paragraph (1) serves as a forum for communication, and consultation on labor issues within the company (3) membership of LKS Bipartit referred in clause (2) consists of representatives from employers and workers appointed by the union's to represent the interests of workers in the respective company.

101 As the Indonesian Statistics Office recorded that the CPI inflation rose to 17.1 percent (year-on-year) at the end of 2005. The high CPI inflation was primarily due to the administered price adjustments i.e. fuel price hike in March and October 2005 and volatile food price increase. This was further exacerbated by the higher inflation expectation post fuel hike in October 2005 and sharp depreciation of exchange rate (BPS web site).

One of the prominent difficulties in analyzing data on labor strikes and lockouts in Indonesia was that the data gathered by governmental institutions do not distinguish between strikes and lockouts. Instead, the number of both incidents are summed up and referred collectively as either ‘industrial disputes’ or ‘work stoppages’.

During 2005 to 2009, there have been a declining number of workers who experienced lost working hours and lost working days due to strikes and lockouts. Despite an increasing trend in the number of strikes and lockouts, the number of workers involved in strikes and lockouts were declining. Looking at the data on the number of strikes and lockouts compared to the number of workers involved, data collected in 2005 stated that there were 584 workers participating in each strike on average. The number increased sharply and reached its highest point at 2081 workers in each strike in 2006 and continues to fluctuate until it reached an average of only 182 workers per strike in 2009.

The number of working hours and working days lost were declined. Throughout the period from 2005 to 2009, an annual average of 205,459 workers was involved in strikes and lockouts (**Table3.3.**). Despite the fact that number of working days lost could be the most prominent indicator of work stoppages, the data does not provide details on what sector has the highest level of strikes.

In conclusion, over the period of 2005 to 2009, the number of trade unions in Indonesia is not the only thing that was declining, the rate of union density was also relatively low. As a result, the percentage of companies belonging to employers’ associations tend to remain constant. On the contrary, the number of collective labour agreements and company regulations has the tendency to grow.

The existence of LKS Bipartit as the means of social dialogue was considerably low although it showed an increasing trend. Similarly, number of labor strikes and lockouts were also on the rise while the number of workers involved in strikes and lockouts tended to decrease.



## 3.2. Labour market policies in Indonesia

Development strategy implemented by the government, as stated earlier, is based on ‘pro-poor’, ‘pro-jobs’, ‘pro-growth’ and ‘pro-environment’ policy. In terms of employment, the government promotes a ‘decent work agenda’, which becomes the ultimate goal of employment development in Indonesia that represents the common goal of other ILO member countries.<sup>102</sup> Creating more job opportunities obviously has become a major concern for Indonesia. This task however, can frequently be accomplished by the informal sector, particularly during the time of crisis. The mandate of creating more work opportunities has been well introduced across all economic sectors and through development programs (see Box 8).

### **Box 8. Labour Policy and Policy Coherence: A View from the Business Sector**

Labour policy and regulations in Indonesia suffer from insufficient integration with related line ministries. Coordination among line ministries is considered to be difficult. The business sector supplies information, data and ideas. It has also participated together with the Ministry of Trade, Ministry of Manpower, and Investment Coordinating Board in organizing a monthly forum to discuss business and trade-related issues for the past three years. The business sector has close relationships with the respective line ministries. Despite having committed to invite investors to Indonesia, the line ministries seem to be reluctant in expressing their commitment until the investment has been successfully carried out (i.e, a plant is built).

Achieving high economic growth and increasing the volume of trade and investments are the strategies applied by the government in an effort to stimulate the creation of jobs in the country. This strategy is important particularly for the upcoming establishment of the 2015 ASEAN Economic community (AEC) that likely to bring negative impacts on labor-related issue. Therefore, efforts to create a favourable investment and business climate as well as labour market flexibility have been constantly administered (see Box 9).

102 Decent work agenda covers four strategic objectives, namely promoting employment creation, enhancing social protection, promotion of fundamental principles and rights at work and social dialogue.

### **Box 9. The Importance of Labour-Intensive Industries**

Labour-intensive industries are considered to be the most fragile in relation to free trade agreements. Some of these industries (such as footwear and textile industries) have relocated their plants to other regions (in Indonesia) or even to other countries. Consequently, these relocations have increased the number of unemployed in Indonesia. In addition, with under-developed skills and capacities, workers do not have the ability to move to other sectors.

The country's inability to compete will inevitably result in increasing unemployment. How can a country compete when – for example, in the footwear industry – the costs for raw materials and laborers still account for around 60% of total production cost? In addition, debates on the implementation of subcontracting (also known as outsourcing) continue to take place although some companies have ceased to utilize the system in procuring laborers. The minimum wage policy is still considered an administrative nightmare.

Under these uncertain conditions, domestic firms, instead of producing will move towards to becoming traders, which will imply lesser labor absorption. Economic growth has been supported mostly by domestic consumption. Therefore, failing to fulfill domestic demand with domestic products will result in more imported products. Such conditions require the attention of all stakeholders who are responsible for providing a proper solution..

In order to create decent jobs, the government has implemented a number of programs, including the establishment of various governmental institutions from wage council, productivity council, training council, and the implementation of National Skills Certificate System that evaluates and certifies the workers to enable them to work both in the country and in foreign countries. The establishment of a training council has been considered to be important because previous experience indicated that training programs organized by the Ministry of Manpower and Transmigration (MOMT) was not going as well as expected. Out of hundred of thousand laborers, only around 5,000 were successfully trained. Meanwhile, a skill certificate system is needed in order to improve laborer's skills, especially to maintain an ample supply of certified laborers (e.g. construction workers) and to improve labor mobility across ASEAN. Furthermore, the government has also taken several measures in an effort to improve the economy. Low interest loans were distributed to industries for the purpose of replacing old machines with new machines. The government is also trying to attract investors to tap in to one of the world's largest geothermal resources in the country.

Creating job opportunities through Export Promotion Zones was also seen as a feasible strategy. Two of the most important Export Promotion Zones are Jakarta and Batam. The two areas have attracted quite a reasonable number of investment and have been one of the causes of successful industrialization in Indonesia. Over the past three decades, export processing zones (EPZs) have become a popular instrument of trade policy that offers free trade conditions and liberal regulatory environment. Like many countries, Indonesia perceived export promotion as an important policy for economic growth in developing countries that helps to generate more jobs.

In order to promote export competitiveness, the government has adopted various measures. As one of the policies applied to improve such competitiveness, the concept of EPZs has become notably significant in recent years.<sup>103</sup> EPZs offer streamlined administrative services, especially to facilitate import and export, and provide the much needed infrastructure for production, transport and logistics activities (Milberg, 2007). Indonesia currently has the opportunity to push for export oriented industrialization using EPZ's as its main tool to provide access to formal employment for a larger number of workers.

Despite having provide social assistance for its susceptible population, Indonesia is still lacking of unemployment insurance scheme. The most prominent survival strategy of the labor force during a time of crisis is to admit themselves to the informal sector that is easily accessible and can be easily abandoned. Generally, to prevent laborers from depending on the informal sector during a time of crisis, the government would respond by launching labor intensive infrastructure development programs, which is a quick and easy way of instantly create jobs. However, some laborers may be excluded from such program because their financial status does not entitle them for social assistance program intended for underprivileged people. It should also be noted that infrastructure development-related jobs are usually considered to be a job for male workers, thus women are excluded from the opportunity and the number of workers admissible for the program is further reduced. In view of the above-mentioned conditions, the most essential policy that can bring out the most benefits for such excluded laborers will be the establishment of an unemployment insurance program.

Through the issuance of Law No. 40/2004 on National Social Security System, Indonesia has made some progress in promoting social security for its citizens. However, the Law is yet to be implemented effectively. The Law replaces the existing social protection programs by establishing a universal social security system that covers risks associated with old age, illness, work-related injury and death, particularly for workers in the informal economy; coupled with other social elements including social assistance programs for the underprivileged, labor intensive approaches for infrastructure development and unemployment insurance and/or employment insurance schemes.

The government also adopted active labour market policies such as organizing training, job seeker assistance and career guidance that can support to susceptible labor forces. Enhancing labour market information (LMI) services is also critical for better decision making ability and may serve to facilitate social dialogue between the government, employers and workers. LMI will also aid the government in monitoring the labour market, detecting changes in the labor market trend, and to make better labor-related policies. Furthermore, LMI will assist employers in making technical operational decisions and help job seekers to make decisions about their future career.

---

103 The term such as EPZs, frequently interchanged with such terms as free trade zones (FTZs), special economic zones (SEZs) and export processing factories (EPFs), which refer to similar concepts, with variations in policy prescriptions and objectives. EPZs provide customs-free and tax-exempt, export-oriented manufacturing facilities, investment incentives and streamlined administration, cheap utilities, and better infrastructure. According to Jayanthakumaran (2002), most enterprises in EPZs are engaged in processing intermediate imports for exports. Also included are labour-intensive light manufacturing such as garment production, assembly of light electrical goods and electronics. Among the benefits offered are exemption from: some or all export taxes; some or all duties on imports of raw materials or intermediate goods; direct taxes such as profits taxes, municipal and property taxes; indirect taxes such as VAT on domestic purchases; national foreign exchange controls. Foreign companies also benefit from free profit repatriation.

### **Box 10. Policy to Increase Skills, Competence and Productivity of Indonesian Workers**

In addition to paying attention to currently employed workers, the government should pay particular attention to new job seekers. As a result of heavily focusing on employed workers, workers will continue to demand higher wages without any intention of improving their productivity. Prosperity is important; but the government must also encourage all stakeholders to improve the skills, competence and productivity of Indonesian workers. The government should promote workers' productivity and competency. The government-owned training center, also known as *Balai Latihan Kerja* (BLK), is underdeveloped. Training centers have never been promoted and integrated with companies' corporate social responsibility (CSR).

Competency of new job seekers is neglected and the number of skilled job seekers are constantly decreasing. The increasing number of low-skilled job seekers cannot be absorbed by industries. There is also unequal income distribution between the country's regions. In fact, there are many business opportunities in areas outside of Java, but somehow workers or job seekers are reluctant to explore new areas and tend to be centralized in Java.

The production of small-scale industries and farmers has been constantly suppressed by uncontrolled import of products. For agricultural products, prices tend to decrease during the harvest seasons. In addition, the livelihood of farmers continues to decline as imported products flood domestic markets. The government should develop an integrated system that can create employment. The "informal sector" should be given the access to training programs and overly-bureaucratic administration processes should be eliminated.

Another key policy on labor and employment issues in Indonesia is the promotion of social dialogue. Tripartite dialogues can help stakeholders to identify and negotiate solutions in dealing with long-term challenges. Furthermore, dialogues and collective bargaining are expected to prevent social unrest, reducing the number of industrial disputes, promote better wages, and to some extent, strengthen social bonds between respective stockholders. Law No. 13 of 2003 on Manpower mandates the establishment of Tripartite Cooperation Institutions (*LKS Tripartit*) at the district, provincial, and national levels in addition to bipartite councils. These institutions will serve as forums to communicate, consult, and deliberate issues between the government and other stakeholders. However, issues related to outsourcing and work contract highlighted in Law No. 13 of 2003 must be resolved because it have direct impacts to laborers' welfare. Some suggested that, to ensure workers retirement benefits companies must set aside about 10% of funds for workers retirement insurance program organized by an independent institution. Other issues that must be discussed and resolved is the need for certification that could help to improve laborers' wage, including wage of Indonesian migrant workers (*Tenaga Kerja Indonesia di Luar Negeri – TKI*).

## References

- A. Sivananthiran (undated). "Promoting Decent Work in Export Promotion Zones in Indonesia." ILO. <http://www.ilo.org/public/french/dialogue/download/epzindonesie.pdf>
- Anker, Richard et al. 2002. "Measuring Decent Work with Statistical Indicators"
- Asian Development Bank. 2001. *Social Protection in Asia and the Pacific*.
- Bacchetta, Marc; Ekkehard Ernst and Juana P. Bustamante. 2009. "Globalization and Informal Jobs in Developing Countries". A joint study of the International Labour Office and the Secretariat of the World Trade Organization. Geneva.
- Badan Pusat Statistik (BPS) website. [www.bps.go.id](http://www.bps.go.id)
- Central Board of Statistics Indonesia and Asian Development Bank. 2011. "Country Report 2010 on the Informal Sector and Informal Employment in Indonesia". Asian Development Bank, BPS-Statistics Indonesia. Jakarta.
- de Silva, S.R. 1997. "Employers' organizations in Asia in the twenty-first century". Paper presented at the ILO Workshop on Employers' Organizations in Asia-Pacific in the Twenty-First Century. Turin, Italy, 5-13 May 1997. Bureau for Employers' Activities International Labour Office. Geneva.
- Guerin, Bill. 2006. "**Labour pains in Indonesia**". Online Asia Times. Available at [http://www.atimes.com/atimes/Southeast\\_Asia/HD25Ae02.html](http://www.atimes.com/atimes/Southeast_Asia/HD25Ae02.html)
- International Labour Organization (ILO) website. [www.ilo.org](http://www.ilo.org)
- International Labour Organization. 1972. "Employment, Incomes and Equality: A Strategy for Increasing Productive Employment in Kenya". ILO Geneva
- International Labour Organization. 2002. Decent work and the informal economy. International Labour Conference 90th Session 2002 Report VI Sixth item on the agenda International Labour Office Geneva.
- International Labour Organization. 2011a. "Asia Pacific Labour Market Update". ILO-ROAP. Bangkok. Available at [http://www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/documents/publication/wcms\\_154215.pdf](http://www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/documents/publication/wcms_154215.pdf)
- International Labour Organization. 2011b (forthcoming). "Decent Work Country Profile: Indonesia". Geneva.
- Ishikawa, Junko and Sophia Lawrence. 2005. "Social Dialogue Indicators: Trade Unions membership and collective bargaining coverage: statistical concepts, methods and findings". Paper No. 10. International Labour Organization. Geneva.
- Jansen, Marion and Eddy Lee. 2007. "Trade and Employment: Challenges for Policy Research". A joint study of the International Labour Office and the Secretariat of the World Trade Organization.
- La Botz, D. 2001. *Made in Indonesia: Indonesian Workers Since Suharto*. Cambridge, Massachusetts: South End Press.

- Milberg, W. 2007. Export Processing Zones, industrial upgrading and economic development. International Labour Organization.
- Ministry of Manpower and Transmigration website. [www.depnakertrans.go.id](http://www.depnakertrans.go.id)
- Raihan, S. (2008). Trade liberalization and poverty in Bangladesh. In UNESCAP (Ed.) *Emerging trade issues for policy makers in developing countries in Asia and the Pacific*. Bangkok: UNESCAP.
- Republic Indonesia. “Act No. 2 of 2004 concerning Industrial Dispute Settlements”. Ministry of Manpower and Transmigration. Jakarta.
- Republic Indonesia. “Act No. 21 of 2000 concerning Trade Unions”. Ministry of Manpower and Transmigration. Jakarta.
- Siggel, Eckhard. 2010. “The Indian informal sector: The impact of globalization and reform”, in International Labour Review No. 1, Vol. 149, pp. 93-105.
- The International Centre for Trade Union Rights (ICTUR). available at <http://www.ictur.org/TURCIndonesia.htm>
- Wereldsolidariteit Solidarite Mondiale (WSM). 2009. “Policy Paper on Short Contract in Garment Industry in Asia”. Thematic Report from Asia No. 1. December 2009. Available at <http://www.socialalert.org/k/images/STC/policy%20document%20on%20stc%20.pdf>
- World Bank. 2010. “Indonesia Jobs Report,” World Bank, Jakarta.
- Jayanthakumaran, Kankesu, 2002. “An Overview of Export Processing Zones: Selected Asian Countries,” Economics Working Papers wp02-03, School of Economics, University of Wollongong, NSW, Australia.



# Effect of International Trade on Indonesia's Labor Market

## 4. 1. Introduction

The impact of free trade on the labor market has been one of the biggest empirical questions as well as concerns as Indonesia started to engage various Free Trade Agreements. Standard international trade theories postulate that net gains from conducting international trade would be positive. However, the net gains may not be enjoyed by everyone in the country (and we have no reason to argue that it will). The Hecksher-Ohlin and Stolper-Samuelson theories predict that the intensity of several factors in country will affect how net gains will be distributed. Countries with abundant labor, relative to capital, will produce more labor-intensive products. Opening trade access will increase demand for such products, which eventually will affect demands for labor, and increase relative wages. Other trade theories argue that other factors such as preferences, economies of scale, transaction costs and other variables will determine net gains acquired from trade and how the gains will be distributed. From industrial organization theories point of view, open access to international economy through globalization and trade will bring some adjustments in the structure of domestic industries. Some sectors and firms will gain from this process while the other will lose. The net impact is, at the end, ambiguous. Empirical studies, not just theoretical prediction, would be needed to assess the true impact of trade.

How globalization, trade, and economic liberalization has affected labor market variables have also been one of the most popular economic studies. The topic has become more popular especially since a set of economic liberalization policies was introduced in the mid-to-late 1980s. In response to the 1982 oil price shock, the Indonesian government decided to introduce a set of economic liberalization policies. The decision significantly changed the direction of Indonesia's economic policy. In the 1970s, during the oil boom period, economic policies tend to be domestic-oriented and government-directed. The liberalization policies, especially after the government introduced a series of trade and banking 'deregulation' packages in 1986, brought progressive access in trade, investment and finance. These policies has then accelerated the pace of economic transformation and led to massive structural changes in the Indonesian economy. The economy was growing rapidly at around 7-8 percent annually, while



single digit inflation has been maintained. Trade balance also increased significantly although large capital inflows also led to the widening current account deficit in the mid-1990s.<sup>104</sup>

The liberalization policies and its associated high economic growth have also brought positive structural transformation in the labor market. Employment in the formal sector has grown more than twice of the growth of labor force. Within the formal sector, employment in modern sectors such as manufacturing and services grew faster than that in the agriculture sector. From 1971 to 1997, prior to the Asian economic crisis, employment in the manufacturing sector grew by 12 percent while trade and services grew by 10 percent, much higher compared to the employment in the agricultural sector which only grew by 1.4 percent annually for the particular period. Workers have also enjoyed higher real income during the same period. From 1989 to 1997, average real wage in the formal sector has increased by 5.6 percent annually, an increase similar to the agricultural sector. Income distribution among workers in different production sectors, and different levels of education has also improved. At the same time Indonesia was able to avoid two extreme outcomes of economic development experienced by some developing countries: concentration of persons in low productivity employment and the widening urban-rural income gaps (Feridhanudsetyawan and Aswicahyono 2001:3, Manning 1998:112).

This chapter reviews a number of previous studies that have tried to simulate and provide empirical findings on the impact of international trade on the Indonesian labor market. The common outcome variables of interest are employment, wages, wage distribution and household income or revenue. Studies reviewed in this chapter are classified into three categories. First, studies that provide no further than observational or descriptive analysis using aggregate or macro-level data. Second, studies that simulate the impact of trade on the labor market, mainly using the Computable General Equilibrium (CGE), and micro-level analysis using econometrics or other techniques based on firm or household survey analysis.

There has been numerous literature on the impact of international trade on the Indonesian economy. Nevertheless, not too many of them have analyzed the impact of international trade or free trade arrangements on the labor market; at least not in the sense of providing evidences of causality. Most of the studies have been observational, only showing a trend over time and show what changes have occurred before and after a certain period of 'liberalization.' This is understandable as it is difficult to find a good 'counterfactual' for a trade policy. Moreover, in many cases the impact of international trade on the labor market may occur in medium or long-term. Employing econometrics does not necessarily solve these problems. In some ways, CGE studies can offer a different framework as it can simulate the impact of a trade policy before it actually happens. The problems with CGE model are it is mostly static; it provides the result before and after a policy is introduced, but does not show the dynamics that occur over time. Another problem is that CGE studies are based on a set of assumed parameters and depend on specific scenarios, which may not be the actual scenarios found in reality.

---

104 Further discussion see Feridhanudsetyawan (2000a and 2000b), Hill (1996) and Pangestu (1996).

## 4.2. Sources for Indonesian Trade and Employment Data

The main source of data on Indonesian labor market and employment situation is the National Labor Force Survey (SAKERNAS, *Survey Angkatan Kerja Nasional*). SAKERNAS data are annually collected by Statistics Indonesia (BPS, *Badan Pusat Statistik*) every August since 1976, and biannually since 2005 every February and August. A typical SAKERNAS surveys around 220 thousands individuals from almost 70,000 household across Indonesia.

Another BPS survey, the National Socio-Economic Survey (SUSENAS, *Survey Sosial Ekonomi Nasional*) also provides some labor market information such as participation, employment, wages and working hours. SUSENAS is a larger and more comprehensive survey. SUSENAS is a series of large-scale multi-purpose socio-economic surveys initiated in 1963-1964 and carried out every one or two years since its initial survey. Since 1993, SUSENAS surveys cover a nationally representative sample typically composed of 200,000 households. Each survey contains a core questionnaire which consists of a household roster listing the sex, age, marital status, and educational level of all household members, supplemented by modules covering about 60,000 households that are rotated over time to collect additional information such as health care and nutrition, household income and expenditures, and labor force experience. There are three types of Susenas: (i) Core, which has bigger data set but a smaller set of questions (ii) Modules that have more detailed questions but contain only 60,000 households. (iii) Panel Susenas that was initially introduced in 2005.

BPS also conducts surveys at firm level: the Industrial Survey of Large and Medium Establishments (SI, *Statistik Industri Perusahaan Besar dan Menengah*). The SI was initiated in 1975 to encompass all manufacturing firms with twenty or more employees on an annual basis. The data set provides comprehensive establishment level data covering over 22,000 establishments in 1996, including number of workers and wages. Another firm-level survey is the Survey of Cottage and Small-scale Firms (SUSI, *Survei Usaha Terintegrasi*). SUSI is an establishment survey that collects data of small (non-directory) and cottage/household firms in all (non-agriculture) sectors. SUSI was conducted in 1982 and 2002. In 2002, it covered around 59 thousand cottage/small-scale firms. In addition to the above mentioned surveys, BPS also collects and publishes monthly data on rural farm workers and urban construction workers.

Another data set available for free is the Indonesian Family Life Survey (IFLS).<sup>105</sup> The Indonesian Family Life Survey (IFLS) is an on-going longitudinal survey in Indonesia. The sample represents about 83% of the Indonesian population and contains over 50,000 individuals living in 13 of the 27 provinces in the country. IFLS covers an exhaustive list of socio-economic variables, including labor market indicators. The first wave of the IFLS (IFLS1) was conducted in 1993/1994 by RAND in collaboration with *Lembaga Demografi*, University of Indonesia. IFLS2 and IFLS2+ were conducted in 1997 and 1998, respectively, by RAND in collaboration with UCLA and *Lembaga Demografi*, University of Indonesia. IFLS2+ covered a 25% sub-sample of the IFLS households. IFLS3, which was carried out in 2000 and covered the full sample, was conducted by RAND in collaboration with the Population Research Centre, University of Gadjah Mada. The fourth wave of the IFLS (IFLS4), conducted in 2007/2008 covering the full sample, was conducted by RAND, the Centre for Population and Policy Studies (CPPS) of the University of Gadjah Mada and Survey METER.

---

105 See <http://www.rand.org/labor/FLS/IFLS/> for more detailed explanation and datasets.

Trade (export and import) data is gathered from trade statistics compiled by the BPS. The data is collected on a monthly basis from the customs office, compiled and edited by the BPS, presented up to 5-digit ISIC code. The data is also available from the Bank Indonesia statistics. Other source of trade statistics is the Trade Data International web site ([www.tradedata.net](http://www.tradedata.net)). The World Trade Organization web site (WTO) provides complete and updated data on tariff schedule ([wto.org/english/tratop\\_e/tariff\\_e/tariff\\_data\\_e.htm](http://wto.org/english/tratop_e/tariff_e/tariff_data_e.htm)). See Appendix Table A1 for detail list of data sources.

### 4.3. Trade, Economic Liberalization and the Labor Market: an Overview

#### 4.3.1. Liberalization and the structural transformation of the economy<sup>106</sup>

Between the 1970s and 1990s, the Indonesian economy has been transforming from an agriculture-based to an industrial-based economy – a process which is often called ‘industrialization’. The most popular indicators to represent the industrialization process are the share of manufacturing industry value added in GDP, and the share of manufacturing exports in total exports. When the New Order government started the economic development in the early 1970s, value added of manufacturing industry accounted for 7.5% of the GDP, while the agriculture sector contributed more than 35%. The share of manufacturing industry in the GDP doubled in 1980s. In the 1990s, prior to the economic crisis, the share of manufacturing industry continues to increase to more than 20%, exceeding the share of agriculture in the GDP. On the composition of exports, the share of manufacturing exports also growing from less than 3% in the 1970s, to almost 60% in the 1990s.

A cross-country comparison suggests that although Indonesia has experienced an industrialization process, the level of industrialization is still relatively low compared to other Asian emerging markets. In 1965, the share of manufacturing industries in the Indonesia’s GDP was 8%. The number placed Indonesia on the same level with Malaysia (9%), and slightly lower than Thailand (14%), India (16%) and South Korea (18%). China and the Philippines had reached the level of 20% or more at that time. But in 1980, manufacturing share of Indonesia’s GDP only raised to 13%, trailing far behind other selected developing countries. The gap of industrialization level with the other developing countries was narrowed in the 1990s. In 1997, before the Asian crisis, Indonesia’s share of manufacturing industries in the GDP was 26%, already exceeded India (19%) and the Philippines (22%).

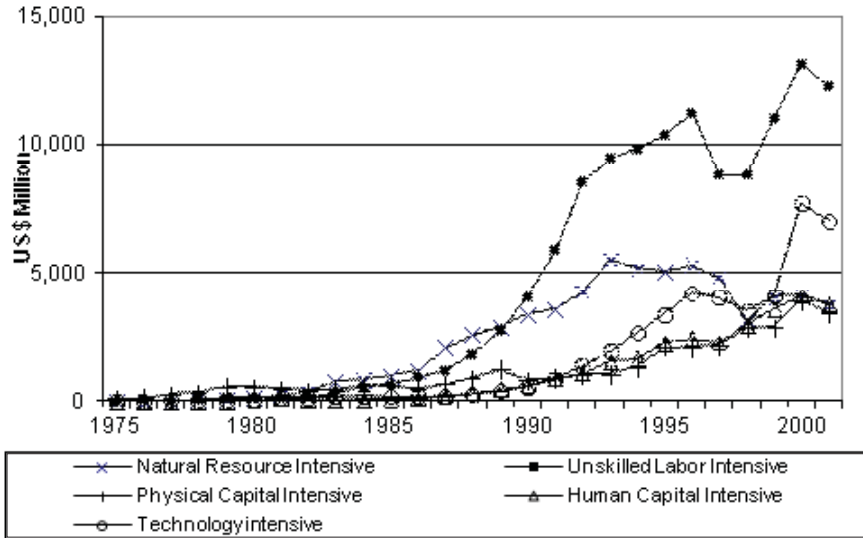
Comparison of the share of manufacturing in total exports also illustrated that Indonesia was falling behind most developing countries. When Indonesia started the economic development in 1965, the level of share of manufacturing products in total exports was 4%, relatively similar with that of the neighboring ASEAN countries: Thailand (3%), Malaysia and the Philippines (6%). But in 1997, Thailand and Malaysia’s manufacturing exports had reached 71% and 76% of total exports, joining the club of developing countries that have high share of manufacturing exports such as India (72%), South Korea (92%), and later China (85%). Indonesia and the Philippines had only able to increase their share of manufacturing exports to total exports to 42% and 45%. Part and the most significant explanation for the condition was the oil-boom in the 1970s that results in the so-called “Dutch disease” phenomena. In mid-1970s, Indonesia gained the oil windfall profit from the rapid increase of the world oil price.

106 This section was mainly drawn from Perdana (2003).

However, as most of the revenue was then translated into domestic spending, the price of non-traded goods increased faster than traded goods. The relative price change led to a shift of resources from traded to non-traded goods.

A breakdown analysis of exports by factor-intensity suggested that the exports from unskilled-labor intensive industries have experienced the fastest growth (Figure 5.1). The trend and pattern of exports growth in Figure 1 has, to some extent, shown a pattern predicted by the Hecksher-Ohlin-Samuelson (HOS) theory. The theory stipulates that under international trade, countries or regions would specialize in sectors employing more factor of production that is mostly available in each countries or regions. As a country rich of natural resources and unskilled labor, after the mid-1980s liberalization, the two industries has experienced the fastest growth in export. From 1985 to 1992, the value of exports of unskilled-labor intensive industries has grown to more than five-fold. It continued to increase from 1992 to 1997 albeit in a smaller rate. Exports of natural-resource intensive industries also jumped after 1985 but with a much more modest rate. Technology, capital and skilled-labor intensive exports started to experience sharp increases in export growth later in the 1990s.

**Figure 4.1.**  
**Indonesia: Manufacturing Exports by Factor-Intensity, 1975-2001**



Source: Central Board of Statistics (various years)

**4.3.2. The labor market transformation**

After the oil 1982 shock and the introduction of a series of liberalization packages in the mid-1980s, Indonesia has enjoyed a period of high growth that was mainly driven by production and import growth in non-oil, labor-intensive industries. As labor demand is the derived demand of product, economic liberalization also had several impacts in transforming the labor market. The labor market impact of the economic liberalization period was characterized by three important transformations: industrialization, urbanization and formalization of the labor market, which is illustrated in Table 5.1.

**Table 4.1. Sectoral share and rate of growth in employment by major sector**

	Number of workers, million					Annual Growth Rate (%)			
	1971	1980	1986	1997	1998**	1971-80	1980-86	1986-97	1997-98
Urban	6.1 (15)	9.7 (19)	13.5 (20)	29.6 (34)	30.3 (35)	6.7	6.4	10.9	2.4
Rural	35.2 (85)	41.8 (81)	54.7 (80)	57.5 (66)	57.4 (65)	2.1	5.1	0.5	-0.2
Wage workers*)	13.3 (32)	14.5 (28)	17.5 (26)	30.5 (35)	28.8 (33)	1.1	3.4	6.7	-5.5
Non-wage	28.0 (68)	37.0 (72)	50.7 (74)	56.6 (65)	58.9 (67)	3.6	6.2	1.1	4.0
Agriculture	26.5 (64)	28.8 (56)	37.6 (55)	35.9 (41)	39.4 (45)	1.0	5.1	-0.4	9.9
Manufacturing	2.7 (6)	4.7 (9)	5.6 (8)	11.2 (13)	9.9 (11)	4.2	3.3	9.1	-11.4
Trade	4.3 (10)	6.7 (13)	9.8 (14)	17.2 (20)	16.8 (19)	6.3	7.7	7.0	-2.4
Services	5.2 (13)	7.1 14	10.2 (15)	17.4 (20)	17.2 (20)	4.3	6.7	6.7	-1.5
Other	2.7 (6)	4.2 (8)	5.2 (8)	5.4 (6)	4.3 (5)	6.4	3.8	0.3	-19.0
All	41.3 (100)	51.5 (100)	68.2 (100)	87.1 (100)	87.7 (100)	2.8	5.4	2.5	0.7

Source: Central Board of Statistics, Sakernas (various editions), quoted from Feridhanusetwawan and Aswicahyono (2001).

Note: Wage-workers are mostly employee in the formal sectors, while non-wage workers are mostly those in the informal sectors, including self-employed, family workers, agricultural workers, and temporary workers.

### *From agriculture to industry.*

After a dip in the early '80s, employment growth in the manufacturing sector recovered and almost tripled from an annual average growth of 3.2 percent in 1980-86, to 9.1 percent in 1986-97. The growth of labor intensive export-oriented industries, especially in textiles, footwear, clothing, wood products, and furniture, was the major factor that contributes to this new growth in manufacturing employment. In contrast, for the first time, agricultural employment fell from 37.6 million in 1986 to 35.9 million in 1997.

### *From urban to rural.*

Since the mid-1980s, the growth of employment in urban areas far outpaced that of rural areas. During the export boom period, urban employment grew at the rate of 10.7 percent, whereas rural employment only grew by 0.5 per cent during the same period. As a consequence, the share of rural employment in total employment has fallen from 80 per cent in 1986 to 65.4 per cent in 1998.

### *From informal to formal.*

The definition of formal and informal sector is somewhat unclear. In some countries, informal sector is defined using the information on tax status or business registration, which is not possible in Indonesia due to the poor record of such information. Statistics Indonesia is using a combination of employment type and sector to define formal-informal sector. However, sector and employment type has been re-classified for several times, so a consistent definition over time may not be available. In this chapter I would use 'wage worker' as a proxy for formal sector employment.

From 1986 and prior to the economic crisis, employment in the formal sector has grown at about 6.7 percent annually, compared to 3.4 percent between 1980 and 1986. As a result, employment in the formal sector has expanded from 26 percent in 1986, to 35 per cent in 1997. In contrast, employment growth in the informal sector declined from 6.2 percent during 1980 to 1986, to 1.1 percent during the export boom. The share of informal sector employment fell from 74 percent in 1986 to 65 percent in 1997.

In 1997 to 1998, Indonesia and some other neighboring countries were struck by a financial crisis that later turned into a deep economic crisis. The initial impacts of the crisis translated into massive output contractions in the various sectors. These contractions initiated massive layoffs in the modern sector, prompting concerns of serious unemployment problems. These concerns over immediate increase in unemployment, however, did not materialize because the labor market adjusted well enough to allow inter-sector mobility from modern to more traditional sectors. Instead, the labor market adjusted by depressing real wages accompanied by an increase in labor participation, perhaps to compensate for reductions in real incomes.

The early labor market adjustment that resulted from the crisis was the reverse of that in the high growth period. It can be characterized by the "three D's" – de-industrialization, de-formalization, and to some extent, de-urbanization (Gaduh and Perdana 2003). These characteristics are somewhat intuitive once we recognized that the sharp depreciation of the Rupiah paralyzed industries in the formal sector that relied heavily on import and foreign money – the bulk of which, such as manufacturing and construction, were built in major urban areas. Immediately after the crisis hit and massive layoffs

occurred, workers that needed to find substitute employment found them in traditional and informal sectors – the bulk of which were located in the rural areas.

#### 4.3.3. From Liberalization to the Labor Market Performances: Some Observations

As mentioned earlier in the introduction, associating labor market performance and economic issues, especially trade liberalization, has been one of the most popular research topic since the 1990s. A large number of literatures, nevertheless, have relied on mainly observational studies. Observational or macro-level studies are those that describe the trends and changes in some key labor market variables over time. To infer the ‘impact’ of globalization or trade liberalization, these studies compare the trend before and after a certain period. Most studies chose 1986 to 1987 as the year when significant trade liberalization took place. During that period, the government introduced some measures of trade policy and macroeconomic reform (see Pangestu 1996 and Feridhanusetyawan 2000a and 2000b for discussions of the reforms).

There is a long list of observational studies. Some key references are Hill (2000) and Manning (1998), and a number of other studies, but most of them conclude the same thing. Trade liberalization in 1986 to 1987 has been associated with increased non-oil exports, especially manufacturing products, in particular (unskilled) labor intensive goods, and to some extent skilled labor products. The composition of export growth has also brought changes in the labor market structure.

Feridhanusetyawan and Aswicahyono (2001) showed that from 1986 to 1997, structure of employment has become more urbanized, formalized and industrialized. During the period, urban employment increased by 10 percent annually, compared to 0.5 percent in the rural areas; salary workers increased by 6.7 percent annually while non-salary workers only increased by 1.1 percent; and employment in the manufacturing sector grew at the rate of 9.1 percent annually, trade and services by 7 percent while agricultural employment experienced negative growth.

Earlier, Aswicahyono, Atje and Feridhanusetyawan (1999) has pointed out that the benefit of economic growth for Indonesian workers is also reflected by the increase of monthly wages, especially for women. The average nominal monthly wages in the manufacturing sectors, for example, doubled from Rp 89,000 in 1990, to Rp 193,000 in 1996. Real wages has also increased sharply. Real wage in the manufacturing sector has increased by 33 percent, or if calculated annually, the annual growth rate was 4.9 percent. Wage in the agricultural, hunting, and forestry sectors increased by 52 percent from 1990 to 1996, while that of the community, social, and personal services sectors increased by more than 70 percent. The growth of real wages for women has been impressive. In agricultural, manufacturing, services, and even construction sectors, monthly wages for women grew at faster rate compared to monthly wages for men. In manufacturing sectors, for example, real wage of female workers in 1996 was 62 percent higher than that of in 1990. These high growth figures for women have been driven by the increasing participation of women in the formal sectors and more working hours.

There has been concern over uneven distribution of benefit originated from the rapid economic growth among different groups in the society. But both studies show that the increase in wages was distributed across workers in different sectors, different level of education, and different provinces. The distribution of wages in different sectors of the economy is more balanced in 1996 compared to 1990. Partly because of fewer working hours, wages in the agricultural sectors are still the lowest in

1990 and 1996. However, the difference between the wages in the financial services sectors (highest), and that of the agricultural sectors (lowest), became smaller in 1996 compared to 1990.

Data from labor force survey also showed that the benefits of growth in Indonesia have indeed been widely distributed among workers in different levels of education. From 1990 to 1996, workers monthly earning grew by around 15 percent annually, and the highest growth was among those who have lower education. Previous study by Agrawal (1996) also shows that between 1987 and 1994, the earnings of workers grew at an average of 12 percent annually, and that the distribution of wages among workers with different education levels was also more even. The data, however, do not capture the extreme discrepancy between wages among university graduates within the modern sectors. It is not uncommon for foreign educated managers and other professionals to earn Rp 10 million a month or more in 1996, which was 20 times higher than the average monthly income for university graduates in Indonesia (see Manning 1994 and 1995).

On geographical disparity, Manning (1997) looked at how the regional labor market performed after the mid-1980s deregulation and before the Asian economic crisis. He argued that real wages have risen not only in more developed Java-Bali areas, but also in the outer regions, most notably in Northern Sumatra and poorer Eastern Indonesian islands. He added that the export-led industrialization concentrated in Java and Bali has helped labor market and income growth in the outer regions. The Kalimantan provinces, however, have lagged in manufacturing employment and wages. Labor market performance has been less favorable in land-abundant regions that received many assisted migrants ('transmigrasi') during the oil boom period.

Distribution of benefits from accessibility and economic integration is also the concern of Suryahadi (2001a). Based on the data from Sakernas from 1985 to 2000, the paper examines the trend of output, employment, wages and skills of workers from different sectors. The author argued that during this period, the Indonesian economy has become more open and integrated with regional and global economy. The study concluded that increased economic integration has been associated with growing output, higher employment and wages for both skilled and unskilled workers, especially in the trade, services and industrial sectors. Employment of skilled workers grew faster, but wages for unskilled workers have had higher rate of growth, resulting in lower wage inequality between skilled and unskilled workers. In another study, Friawan and Mangunsong (2008) aim to identify the 'disadvantaged workers'. Using data from Sakernas, 1986 to 2008, they argued that young, female and less educated workers, especially those from underprivileged households, are most vulnerable. Not only they had not got the gains from trade and accessibility as much as other types of workers, in some cases, they may be considered as the potential losers from trade liberalization.

The summary of recent labor market trends can be found in World Bank (2010). Since 2000, although the economy recovers and the GDP has been steadily increasing, employment fell from 64 percent to the low 59 percent in 2005-06. Share of non-agricultural employment, which was 60 percent in 1997, fell suddenly after the crisis, but has yet to return to the pre-crisis level until 2007. Similarly, the growth of formal sector employment has been stagnated since the crisis until it showed some recovery sign in 2003 to 2004.<sup>107</sup> The report attributed this trend to several things, mainly a less flexible labor market and changes in the structural composition of the economy. However, it did not make any relations to trade policy, especially AFTA that became effective in 2003.

---

107 Perdana and Gaduh (2003) described the phenomena as "3-d's: de-industrialization, de-formalization and de-modernization" of the labor market.



Observational studies are, to some extent, adequate to deliver general narration or ‘the big picture’. However, the ‘conclusions’ drawn from such studies must be interpreted very carefully as they, at best, only provides indirect association between liberalization and labor market variables. The next two sections will discuss results from two other groups of study: general equilibrium simulations and micro-level or econometric analysis.

#### 4.4. General Equilibrium Simulations

There has been an extensive CGE studies simulating the impact of various trade liberalization scenarios on the Indonesian economy since the mid 1990s. Despite the long list of trade-related CGE literature on Indonesia, only a small subset have paid particular attention on the labor market impact. There are different CGE models that have been used. CGE can be compatible for several countries or built specifically for a particular country. Regardless of how many countries included, the CGE models differ from each other on how the economy is being disaggregated, for example how many goods and factors of production, or types of producer and household. They may also differ in terms of structural parameters of production and utility functions.

One of the most popular CGE model used to simulate the impact of trade is GTAP (Global Trade Analysis Project). GTAP is a multi-region CGE (see Hertel 1997 for a complete explanation of the GTAP model). Suryahadi (2001b) used GTAP model to simulate the impact of trade liberalization on wage inequality between skilled and unskilled labor. He used two different scenarios for trade liberalization:

1. The actual change in the Indonesian tariff structure from 1987 to 1992. Under this scenario, the tariffs for primary goods import increased from 18 to 19 percent, unskilled manufacturing remained at 14 percent, and skilled manufacturing was cut from 40 to 14 percent.
2. The AFTA scheme (1992-2003), cutting the primary import tariffs to 4 percent and all manufacturing tariffs to 3 percent.

Under the first scenario, trade liberalization practically took place only in skilled manufacturing sector. As skilled workers lost their protection (but the other factors of production did not), their return declines by 0.2 percent.<sup>108</sup> On the other hand, unskilled workers gain 1.2 percent increase in their real rate of return. Wage inequality between skilled and unskilled workers is reduced by 1.4 percent. In addition to the isolated impact of trade liberalization, Suryahadi also simulated the impact of a combined shock: what happens if trade liberalization also brought capital accumulation and technological changes? Under the combined shock scenario, unskilled labor gains 31 percent increase in their rate of return. Skilled labor, however, gains more by 33 percent, hence the overall real wage inequality increases by 1.4 percent. Meanwhile, under the AFTA tariff cut scheme, both unskilled and skilled workers gain 2.8 and 2.9 percent increase in real rate of return, so the wage inequality is practically unchanged. For the AFTA scheme, Suryahadi only analyzes the isolated trade liberalization shock, not the combined one.

---

108 The return to land owners increased by 6.2 percent, return on simple capital increased by 1.3 percent but sophisticated capital declined by 0.6 percent.

A CGE models that was specifically built for the Indonesian economy is WAYANG (developed by Warr and Aziz 1997, and further adapted by Wittwer 1999). Crosser (2003) used this model to analyze the trade impact on the labor market. The main purpose of her study is to simulate the impacts of removing all trade barriers (tariff and non-tariff) on income distribution and poverty. Since labor market is the channel from trade policy reform to income and poverty, the study also analyze changes in skilled and unskilled employment following the removal of trade barriers.

She compares the results under two different labor market assumptions: fixed total aggregate employment with variable wage rate, and variable total employment with fixed unskilled wage. Under the first scenario, unskilled wage increases by 0.2 percent while skilled wage increases in a much larger magnitude of 1.8 percent. Unskilled labor did not yield good results because the structure of protection protects unskilled labor in manufacturing industries, and such sectors experiences the biggest decline in output when protection is removed. Under the alternative scenario, interestingly, removing all trade protection leads to a decline in total employment by 2.4 percent. Those who remain employed, nevertheless, will enjoy increase in real wages, with unskilled labor gains more at 2.8 percent, compared to a 1.8 percent increase in skilled wages.<sup>109</sup>

While Suryahadi's work did not look deeper into the impact on employment, and Crosser's only looked briefly on it, Sugiyarto, Blake and Sinclair (2003) developed their own CGE model for the Indonesian economy to simulate the impact of some tariff reduction scenarios on employment. They – unlike the other CGE studies discussed here – treat labor as homogenous, without disaggregating workers by skill or location, which is the most significant weakness of the study. However, they analyze three different possible labor market characteristics: fully competitive (flexible), rigid and fully rigid. The tariff cut simulation is analyzed under four different scenarios:

1. A 20 percent cut across the board and the government does not compensate the revenue loss.
2. A 20 percent cut across the board but the government maintains its level of revenue.
3. Applying a lower, uniformed tariff with the government maintains its level of revenue.
4. Applying the optimal tariff level for each sector, where the revenue from tariff is maintained and welfare loss is minimized.

All simulations are done under two further different assumptions: fixed exchange rate with endogenous Balance of Payments (BOP) deficits, and flexible exchange rate with fixed BOP deficits.

Under the fully competitive labor market, the net impact of employment will be zero since an increase in demand for output in one sector will be responded by a movement of labor across sector. In both BOP-exchange rate regimes, the biggest employment gain is achieved when the tariff is cut by 20 percent across the board but the government maintains the revenue level, and the labor market is fully rigid. Under the fixed exchange rate and endogenous BOP deficits, employment will increase by 0.8 percent, and 2.1 percent under the flexible exchange rate. However, the assumption that the government can maintain its revenue level when import tariffs are cut may imply higher taxes or other fiscal policy measures. This requires further discussion, and this chapter was not specific in this issue.

Robilliard and Robinson (2005) applies a slightly different approach is by combining CGE (macro) model with micro simulation. The study aims to simulate the impact of WTO agreements on socio-economic variables, including labor market and poverty. They describe the approach as 'micro-macro

---

109 This study concludes that trade liberalization in the end reduces poverty and improves overall welfare of households.

simulation', in which the employment and earnings impacts generated from CGE simulation are used to do micro simulation of income distribution.<sup>110</sup> The study compares the results under four simulations: unilateral trade liberalization by Indonesia, full liberalization excluding Indonesia, full liberalization including Indonesia, and the Doha-WTO agreement of tariff reduction. They then compare the scenarios under different labor market characteristics: fixed total aggregate employment (but allowing mobility across sectors), flexible employment and sector-specific employment.

When total employment is fixed but workers can move across sectors, labor market adjustment only takes place in real wages. The net benefit from the Doha scenario is apparently zero. Full liberalization of all countries including Indonesia gives the biggest gain in terms of real wages; with skilled workers in urban and rural areas enjoy higher wage increase (1.3 percent in urban and 1.2 percent in rural areas) than the unskilled workers (1 percent increase in real wage). Wages still increase, but with much lower magnitude, when all countries except for Indonesia liberalize, and skilled workers still benefit more (0.3 percent for skilled urban workers, 0.6 for skilled rural workers and 0.1 percent for all unskilled workers). The pattern is different when Indonesia liberalizes its economy unilaterally; both skilled and unskilled urban workers enjoy higher wage increase by 1 percent, while rural unskilled and skilled workers experience wage increase by 0.8 and 0.6 percent.

If the labor market is more flexible – total employment is not fixed – the labor market gains are bigger. Full liberalization of all countries lead to 1.4 percent increase in employment, mostly due to increase in urban and rural unskilled workers (1.5 and 1.7 percent, and 1 percent more employment for both urban and rural skilled workers). The benefit in terms of wage increase is also larger, with unskilled rural workers experience the biggest wage increase by 1.5 percent. Skilled rural workers enjoy 1 percent real wage increase, while both types of urban workers enjoy 1.3 percent under. When employment is fixed and sector-specific employment, net employment gain is zero. Overall real wage will increase with lower magnitude compared to the flexible labor market situation, but urban skilled workers will take the biggest benefit.

Comparing the results of different CGE studies is not a straightforward task, as each studies use different scenarios of shock (or combination of shocks), disaggregation of worker types, and labor market assumptions (see at The Appendix Table A.2 in the appendix for a summary of results). The general pattern from the four studies above is trade liberalization will increase overall real wage, but how the gains are distributed across skilled and unskilled workers varies under different assumptions. The gain in terms of employment is less clear, however. Total employment will decline under one scenario (as suggested by Crosser), and increase under the others.

---

110 The mechanics of the micro-macro simulation will not be discussed here. Instead, we will jump to the scenarios and findings. See the paper for a full explanation of the micro-macro simulation.

## 4.5. Micro-level Studies

Most of the micro-level studies are also based on indirect evidences to speculate about the causal impact of trade on the labor market. Like the observational studies, most of these studies compare the trend before and after a certain period to conclude the impact of trade. Some studies, nevertheless, have attempted to estimate a direct link between trade openness and labor market outcomes through econometric estimations. A summary of studies cited in this chapter is presented at the Appendix Table A.3.

Suryahadi, Chen and Tyres (1999) used two different measures of openness: nominal and effective rates of protection. They estimated the change in both measures from 1975 to 1993 on labor demand using establishment-level data from *Survey Industri*. They found that increasing economic openness has been associated with higher participation or influx of foreign capital. The capital influx has transferred labor-intensive industrial technologies from the NICs where increased wage had rendered competitiveness. This then led to the increase of demand for skilled labor. The authors argued that it was the ‘newness’ of capital, not because they are of foreign owners that have increased demand for skilled labor. But the inter-linkage of production function had also increased demand for unskilled workers. Therefore, both skilled and unskilled workers had benefited from openness in terms of higher employment. Nevertheless, the benefit in terms of wage was not distributed equally. Unskilled workers are supply elastic – small increase in wages was responded by much higher increase in manufacturing workforce. On the other hand, supply of skilled workers was less elastic, so the response to higher wage was smaller compared to that of the unskilled ones. Hence, while skilled workers have been benefited from openness in terms of higher employment and workforce, they have faced smaller bargaining position in terms of wage increase.

Another study by Kis-Katos and Sparrow (2009) offers an interesting method to examine the direct impact of trade liberalization on child labor. Their estimation strategy identifies geographical differences in the effects of trade policy to district level exposure to reduction in import tariff barriers. They use a balance panel of 261 districts using four rounds of Susenas from 1993 to 2002 to analyse how geographic variation in relative tariff exposure affects workforce participation of children aged from 10 to 15 years-old.

To calculate district-level tariff exposure, they use two measures of ‘effective’ tariff. The first one is calculated as the sum of share of sector  $b$  in the GDRP of district  $k$  in 1993, weighted by the national tariff for sector  $b$  in each time:

$$T_{kt}^{GRDP} = \sum_{h=1}^H \left( \frac{GRDP_{hk,1993}}{GRDP_{k,1993}} \times T_{ht} \right)$$

A second measure is similar in terms of calculation but using share of labor force ( $L$ ) in each sector:

$$T_{kt}^L = \sum_{h=1}^H \left( \frac{L_{hk,1993}}{L_{k,1993}} \times T_{ht} \right)$$

The authors tested the hypothesis using several different estimation strategies: OLS with pooled district data, random effects, fixed effects estimation, difference estimation and GMM. In all estimations using the two different tariff exposure measures, they consistently find that lower tariff exposure is associated with a decrease in child labor participation. For every 1 percent reduction of tariff exposure, child labor participation rate decreases by 0.8 to 1.7 percent depending on which method is employed.

Although the above two studies still at best only provides indirect evidences of the impact of trade openness on labor market outcomes, the methods they employ are relatively ‘advanced’ from other studies. Most other studies based the arguments on a simple “before and after comparisons” or comparison of certain indicators over time.

Bourguignon and Goh (2003), based on the study by Alatas (2002) looked at a different question: does openness to trade increase individual worker’s earning vulnerability? Vulnerability is defined as the probability of being below the earning poverty threshold in year  $t+1$  conditional on earnings in year  $t$ . The strategy is to calculate the correlation of variance ( $r^2$ ) of residual earnings from a panel data. Since the individual-level panel data is not available on a yearly basis,  $r^2$  is estimated using a “pseudo-panel” of a group of individuals from the same cohort over time since the early 1990s. To get the estimation of  $r^2$  first they estimate a wage equation:

$$\ln w_{it}^j = X_{it}^j \mathbf{b}_t^j + \mathbf{x}_{it}^j$$

where  $X_{it}^j$  is a set of characteristics apart from age, gender and education or other variables used in the definition of cohort group  $j$ . The unobserved residual term  $\mathbf{x}_{it}^j$  is assumed to follow a first order auto regressive process AR(1):

$$\mathbf{x}_{it}^j = r^j \mathbf{x}_{it-1}^j + \mathbf{e}_{it}^j \text{ which implies that: } \mathbf{s}_{\mathbf{x}_{jt}}^2 = r^{2j} \mathbf{s}_{\mathbf{x}_{jt-1}}^2 + \mathbf{s}_{\mathbf{e}_{jt}}^2$$

where  $\mathbf{s}_{\mathbf{x}_{jt}}^2$  is the variance of the residual term of the earning equation. Higher  $r^2$  means greater vulnerability. Alatas (2002) estimated  $r^2$  for male and female workers in manufacturing and non-tradable sector, with primary, secondary and tertiary educational attainment. The estimated  $r^2$  can be translated into vulnerability measure as defined above, which is the probability of worker’s earning fall below a certain threshold, which ranges from 1 percent (male with tertiary education in the manufacturing sectors) to 41 percent (female with primary education in the non-tradable sectors). Based on the result, Bourguignon and Goh argued that “there is no firm evidence to support a correlation between workers’ vulnerability to sinking into poverty and periods of greater economic openness.”

A study by Narjoko, Kartika and Hapsari (2008) uses firm-level survey data (Survey Industry) to assess the impact of globalization on employment and wages in the Indonesian textile and garment industries. They argued that globalization affects labor market through two channels. First, the relation between small and large firms. One of ways for firms to become more competitive is to create the

effective production method that is efficient in producing high quality products with competitive price. Business relation between small and large firms is known to have the potential to propel the business sector into a new level of competitiveness.<sup>111</sup> Second, the presence of industrial clustering. Industrial cluster is also one of the ways for industries to adjust towards liberalization in order to improve competitiveness through reduced transportation cost and production time.

These industrial cluster or so called industrial districts achieved their success through flexible specialization and adjust themselves to respond to market demands and to fill the market with a quality and controlled quantity of products. Through each of these channels, they assumed that globalization affects labor market by affecting – beforehand – the industrial adjustment and competitiveness. To measure industrial adjustment process, they used four indicators: job creation rate, job destruction rate, expansion rate and contraction rate (see the original paper for explanations). Competitiveness is measured using unit labor cost and real labor productivity. The outcome variables are growth in employment and wages.

The authors did not employ fancy statistical or econometrics method apart from examining the trends of the indicators. They divided the observation into three periods: pre-crisis (1992-1996), crisis (1997-2000) and post-crisis (2001-04). As the conclusion, they argued that:

The empirical evidence, surprisingly, is mixed. There are part of the empirical results that indicate a positive impact of globalization, such as when the impact was examined for the small-large firm linkage, but there are also other part of the results that indicate a negative impact, particularly when the impact was examined – in general – through clustering channel and in terms of competitiveness. Therefore, we could take an inference that the impact of globalization on labor market performance cannot be generalized. It tends to be industry- or sector-specific, and in some cases, as in the Indonesian example, it could depend also on the time (i.e., whether the economy is in a boom, recession, or some recovery period) and also some external factors. As for the case of Indonesian textile and garment, much of the globalization impact post the 1997/98 economic crisis could be attributed to the dramatic change firm competition in global market (p.29).

Feridhanusetyawan, Aswicahyono and Perdana (2001a) employ three most common micro econometric and statistical methods in the field of labor economic: the Mincerian function, Heckman selection and Blinder-Oaxaca decomposition. The study is concerned with the male-female wage differentials and how has trade liberalization in the late '80s affected the outcome. They used the household-level data from Sakernas, and compared the estimation results between 1986, the period that reflects the situation prior to the trade liberalization, and 1987, the year reflecting the conditions after liberalization and before the economic crisis. The study has several findings. First, the *observed* or actual female-male wage ratios tend to increase from 1986 to 1997, which means that female wages have increased relatively faster than male wages, and that female-male wage differentials tend to decline overtime.

Second, a similar trend is also shown by the female-male *potential*<sup>112</sup> wage ratio (wages calculated for the whole population, not just those working for wages, after performing the Heckman correction technique). But the potential wage ratios are much lower than the observed ones; the female/male wage

---

111 Outsourcing is one of the well-known forms of small-large firm linkage.

112 Actual wage is the wage reported by the respondent in the survey. Potential (sometimes called predicted) wage is the wage an individual is supposed to receive given his or her characteristics, based on the regression coefficients.

ratios calculated from the whole population at around 0.3 to 0.4 is lower than the ratios derived from the predicted wages of the wage workers at around 0.7 to 0.8. This means, when we evaluate the wage for the whole population, female are supposed to receive much lower. But in reality, in the labor market, their earning is just slightly less than their male counterparts. Third, Blinder-Oaxaca decomposition analysis shows that the main factor contributing to the smaller actual wage gap was the reduction in discrimination, especially for uneducated women. Education continued to be an important factor contributing to the closing of wage gap. However, in rural areas wage gap between men and women only declined slightly in the same period. Unlike in urban, in rural areas smaller discrimination effect has been offset by the widening endowment gap.

Feridhanusetyawan, Aswicahyono and Perdana (2001b) also employ similar techniques on labor force participation (LFP). Apart from the outcome variable (labor force participation), the main methodological difference with the previous paper is the first stage, where the authors used *probit regression* with a binary dependent variable, one for participating in the labor force and zero if otherwise.<sup>113</sup> The study shows that during from 1986 to 1997 there has been a tendency for female to stay longer in the labor market. The value of age in which the LFP reaches the peak was generally smaller for women in 1986 and 1990. But in 1997, these peak-ages for women and men were similar, and therefore women seemed to stay longer in the labor force in recent years, and there was no significant difference between male and female LFP in this aspect.

Blinder-Oaxaca decomposition suggests that the urban labor market has been less discriminating against female. This is shown by the evidence that the narrowing urban female-male LFP gap during 1986-97, has been explained more by the decline of structural factors. Important structural factors that contributed to the closing were age, household head wage, and household head education. However, the closing of the gap due to the structural effects has been off-set by almost equally widening LFP gap due to the endowment effects. Therefore, LFP gap between men and women in urban area has not been narrowing much during 1986 to 1997 period. In rural areas, however, the LFP gap has been widening during the 1986 to 1997 period, as male LFP has been relatively constant while women's LFP has declined considerably. Both endowment and structural factors contributed to the widening of the gap, but the role of endowment effects is greater. One reason is because role of 'education as 'equalizer' does not appear in rural areas, given the nature of rural labor market which is more unskilled-labor intensive.

The main weakness of both studies by the authors is trade or other measures of economic openness did not enter directly in the equation. The authors draw their conclusion only indirectly by comparing the results in two or three different years. Siegmann (2009) applies similar techniques, Mincerian wage estimation and Oaxaca decomposition for male-female wage differential, but includes Foreign Direct Investment (FDI) as one of the explanatory variables. The data was gathered from the 2001 Susenas, Survey Industri 1999, and the 2000 Hotel and Other Accommodation Inventory also collected by the BPS. Focusing on the rural areas, the author finds that FDI has positive impact on female employment in the estates sector, but negative in the manufacturing and hotel sectors. Oaxaca decomposition suggests that FDI brings down the male-female wage differentials.

113 Which also implies that Heckman correction is not needed.

Somewhere else, Wicaksono and Hirawan (2008) argued that trade liberalization will be associated with expansion in some industries, and ‘churning’ in some others. Industrial churning will be associated with job destruction and turnover, meaning some workers will be unemployed, either temporarily until they find a new job, or for a longer period. The authors did not provide direct empirical evidence on how those channels work, or to empirically test the hypothesis that trade liberalization will affect workers. However, using Sakernas 2006 data that provides the information of workers who has lost their jobs in the past 12 months, the authors found that if the reason for losing job was ‘dismissal’, the workers will be less likely to be re-employed; 63 percent workers who were dismissed still have not found a new job within 12 months. As a comparison, if the reason for losing job was ‘business stopped’, 61 percent workers will find a new job within 12 months. Job-shifting has welfare implications. Even if they are re-employed within 12 months, most workers are forced to have lower salary than they had earned in their previous jobs. Furthermore, using *log it regressions*, the authors found that female, young workers with high school diploma and working in industries with medium growth rate are more prone to be dismissed, as well as having the least chance to be re-employed.



## References

- Agrawal, Nisha. (1996). "The Benefits of Growth for Indonesian Workers." World Bank Policy Research Working Paper No. 1637, August 1996.
- Alatas, Vivi (2002). "Labor Market Vulnerability in Indonesia: A Synthetic Cohort Panel Simulation Exercise." World Bank, mimeo.
- Aswicahyono, Haryo, Raymond Atje and Tubagus Feridhanusetyawan (1999). "Gender Dimensions of Globalization and Modern Sector Employment in Indonesia." SEAPAT Working Paper No. 5 (ILO Manila).
- Burguignon, Francois and Gor-Ching Coh (2003). "Trade and Labor Market Vulnerability in Korea, Indonesia and Thailand." Paper presented at the conference on 'Frontiers in Social and Economic Mobility', March 27-29, 2003, Cornell University, Ithaca, New York.
- Croser, Johanna (2002). "Impacts of Trade Policy Reform in Income Distribution and Poverty in Indonesia." In Kym Anderson, Randy Stringer, Erwidodo and Tubagus Feridhanusetyawan (eds.), *Indonesia in a Reforming World Economy: Effects on Agriculture, Trade and the Environment*. Adelaide: Adelaide University Press.
- Feridhanusetyawan, Tubagus (2000a). "Globalization, Poverty, and Equity in Indonesia." Background paper for the OECD conference on Poverty and Income Inequality in Developing Countries: A Policy Dialogue on the Effects of Globalization in Paris, November 30 - December 1, 2000.
- (2000b). "The Social Impact of the Indonesian Economic Crisis" a chapter in *Social Impacts of the Asian Economic Crisis in Thailand, Indonesia, Malaysia, and the Philippines*, published by Thailand Development Research.
- Feridhanusetyawan, Tubagus and Haryo Aswicahyono (2001). "Gender Assessment on the Indonesian Labor Market." CSIS research project report for EADN.
- Feridhanusetyawan, Tubagus, Haryo Aswicahyono and Ari A. Perdana (2001a). "Some Determinants of the Female and Male Labour Force's Participation in Indonesia", *The Indonesian Quarterly* XXIX/4.
- Feridhanusetyawan, Tubagus, Haryo Aswicahyono and Ari A. Perdana (2001b). "The Male-Female Wage Differentials in Indonesia", CSIS Working Papers No. WPE 059.
- Friawan, Deni and Calos Mangunsong (2008). "Globalization, Growth and the Face of the Disadvantaged Labor in Indonesia: Analysis and Policy Implications." CSIS Jakarta, Paper submitted to the DLSU-Angelo King Institute.
- Arya B. Gaduh and Ari A. Perdana (2003). "Social Implications of the Indonesian Economic Crisis", *The Indonesian Quarterly* XXXI/2.
- Hill, H. (2000). *The Indonesian Economy*, 2<sup>nd</sup> ed. Cambridge: Cambridge University Press.
- Kis-Katos, Kristina and Robert Sparrow (2009). "Child Labor and Trade Liberalization in Indonesia." IZA Discussion Paper No. 4376, August 2009.

- Manning, Chris (1998). *Indonesian Labor in Transition: An East Asian Success Story?* Cambridge: Cambridge University Press.
- (1997). “Regional Labor Market during Deregulation in Indonesia: Have the Outer Islands Left Behind?” World Bank Policy Research Working Paper No. 1728, February 1997.
- (1995). “Fringe Benefits in Manufacturing: Efficiency or Welfare?” *Bulletin of Indonesian Economic Studies* 16(2), p.54-82, July.
- (1994). “What has Happened to Wages in the New Order?” *Bulletin of Indonesian Economic Studies*, Taylor and Francis Journals, vol. 30(3), pages 73-114, August.
- Narjoko, Dinonisius A., Pratiwi Kartika and Indira Hapsari (2008). “The Impact of Globalization on Labor Market Performance: a Case Study of the Indonesian Textile and Garment Industry.” CSIS Jakarta, Paper submitted to the DLSU-Angelo King Institute.
- Pangestu, Mari E. (1996). *Economic Reform, Deregulation and Privatization: The Indonesian Experience*. Jakarta: CSIS.
- Perdana, Ari A. (2003). “Industrial Policy and Competitiveness in Indonesia.” Paper presented on the 3rd Asian International Forum in Fukuoka, Japan, September 9-10, 2003.
- Robilliard, Anne-Sophie and Sherman Robinson. “The Social Impact of a WTO Agreement in Indonesia.” World Bank Policy Research Working Paper No. 3747, October 2005.
- Siegmann, Karin Astrid (2006). “Globalisation, Gender, and Equity – Effects of Foreign Direct Investment on Labour Markets in Rural Indonesia.” *Journal of Economics*, Vol. 3(1), pp. 113-30.
- Sugiyarto, Guntur, Adam Blake and M. Thea Sinclair (2003). “Trade Liberalisation with Labor Market Distortions: The Case of Indonesia.” Paper presented at the 6<sup>th</sup> Annual Conference on Global Economic Analysis, June 12-14, 2003, Scheveningen, The Netherlands.
- Suryahadi, Asep (2001a). “International Economic Integration and the Labor Market: the Case of Indonesia.” East-West Center Working Papers, Economic Series No. 22, May 2001.
- (2001b). “Globalization and Wage Inequality Indonesia: a CGE Analysis.” East-West Center Working Papers, Economic Series No. 26, May 2001.
- Suryahadi, Asep, Paul Chen and Rod Tyers (1999). “Openness, Technological Change and Labour Demand in Indonesia.” *Asian Economic Journal* 15(3).
- Warr, Peter .G. and MarpudinAzis (1997). “INDOSAM: A Balanced and Disaggregated 1993 Social Accounting Matrix for Indonesia,” ACIAR Indonesia Project Working Paper 97.06. Adelaide: Centre for International Economic Studies.
- Wittwer, G. (1999). “WAYANG: A General Equilibrium Model Adapted for the Indonesian Economy,” ACIAR Indonesia Working Paper 99.10. Adelaide: Centre for International Economic Studies.
- Wicaksono, Teguh Y. and Fajar B. HirawanHapsari (2008). “Industry Churning, Labor Market, and Workers Welfare.” CSIS Jakarta, Paper submitted to the DLSU-Angelo King Institute.
- World Bank (2010). *The Indonesia Jobs Report*. Wasington, D.C.

## Appendix

**Table A.1.**  
**List of data sources**

<b>Data</b>	<b>Unit of observation</b>	<b>No. of observations</b>	<b>Period</b>	<b>Published by</b>
National Labor Survey (SAKERNAS)	Household	~70,000 households ~220,000 individuals 15 years and above	Bi-annually	BPS
National Socio-Economic Survey (SUSENAS)	Household	~200,000 households ~900,000 individuals	Annually	BPS
Medium-large establishment survey (Survey Industri)	Establishment, medium and large	~22,000 establishments	Annually	BPS
Cottage and small-scaled enterprise survey (SUSI)	Establishment, cottage and small-scaled	~59,000 establishments	1982, 2002	BPS
Wages	Individuals, urban construction and rural farm workers	Varies	Monthly	BPS
Indonesian Family Life Survey (IFLS)	Household, panel	~12,000 households ~55,000 individuals	1993, 1997, 2000, 2007	RAND
Export-import statistics	Commodity, origins and destinations		Monthly	BPS, Bank Indonesia, Trade Data
Tariff	Sector, commodity			WTO

**Table A.2.**  
**Summary of CGE studies**

Author(s)	Shock	Wage	Employment
Suryahadi (2001b)	<ul style="list-style-type: none"> <li>• Tariff reduction only in skilled manufacturing</li> <li>• AFTA scheme</li> </ul>	<p>Overall increase. Skilled workers gain more if only tariff cut takes place. Unskilled workers gain slightly more if trade shock is combined with capital accumulation and technological change.</p>	
Crosser (2003)	<ul style="list-style-type: none"> <li>• Removal of all trade barriers</li> </ul>	<p>Overall increase. Skilled workers gain more if total employment is fixed. Unskilled workers gain more</p>	<p>Less employment if the labor market is flexible.</p>
Sugiyarto, Blake and Sinclair (2003)	<ul style="list-style-type: none"> <li>• 20 percent tariff cut with different fiscal impact</li> <li>• Applying uniform tariff</li> <li>• Applying optimum tariff</li> </ul>		<p>Overall increase. Highest increase under 20 percent tariff cut with neutral fiscal impact and flexible exchange rate.</p>
Robilliard and Robinson (2005)	<ul style="list-style-type: none"> <li>• Doha scheme</li> <li>• Unilateral liberalization</li> <li>• Full liberalization, including and excluding Indonesia</li> </ul>	<p>Overall increase (zero under Doha scheme). Biggest gain under full liberalization including Indonesia, but different distributional impacts.</p>	<p>Increase when the labor market is flexible.</p>

**Table A.3.**  
**Summary of micro-level studies**

Author(s)	Level of analysis and data	Variables of interest	Summary of results
Suryahadi, Chen and Tyres (1999)	Firm-level, survey industry	Changes in effective and nominal rate of protection on labor demand	Increasing economic openness has been associated with high growth of output in manufacturing sector, which stimulated an increase in demand for both skilled and unskilled workers.
Kis-Katos and Sparrow (2009)	District average, Susenas and GRDP statistics	The impact of effective rate of tariff on child labor	Lower tariff exposure is associated with a decrease in child labor participation.
Bourguignon and Goh (2003), based on Alatas (2002)	Pseudo-panel of a group of individuals from the same cohort over time, Sakernas	Economic openness on vulnerability of earnings	No firm evidence to support a correlation between workers' vulnerability to sinking into poverty and periods of greater economic openness
Narjoko, Kartika and Hapsari (2008)	Firm-level, survey industry	Globalization on job creation rate, job destruction rate, expansion rate and contraction rate	Mixed evidence: globalization has both positive and negative impacts, and the results can not be generalized across sectors
Feridhanusetyawan, Aswicahyono and Perdana (2001a)	Individual level, Sakernas	Liberalization on wages and male-female wage differential	After 1986 female wages have increased faster than that of male, reducing the male-female wage gap
Feridhanusetyawan, Aswicahyono and Perdana (2001b)	Individual level, Sakernas	Liberalization on male-female labor force participation	After 1986 female labor participation have increased faster and the gender gap has been narrowed
Siegmann (2006)	Individual level, Susenas	FDI on wages and male-female wage differential	FDI has narrowed the gender wage gap for all sector. But the impact on relative employment varies across sectors
Wicaksono and Hirawan (2008)	Individual level, Sakernas	Probability of losing jobs and re-employment	Trade liberalization is associated with expansion in some industries, and 'churning' in some others, creating winners and losers in the labor market

# Conclusions and Policy Recommendations

## 5.1 Conclusions

Indonesia is an active participant in international trade and the country has signed many trade agreements with other countries to ease the flow of goods and services. Indonesia has promoted trade through an *inward-supportive approach* (i.e., a strategy that aims to strengthen the domestic market) and an *outward-friendly approach* (i.e., a strategy that aims to promote exports). To increase and maintain the country's positive trade balance with respect to its trading partners, Indonesia's main trade policies and strategies rely on (1) promoting the competitiveness of non-oil/gas exports products to diversify its export markets and increase diversity, quality and the image of export products; (2) improving the business climate for external trade by improving services in licensing and non-licensing related to external trade; (3) increasing Indonesia's role and capacity in international trade diplomacy to minimize tariff and non-tariff barriers in exports markets by increasing participation at various international forums and negotiations, and (4) improving distribution networks to support the development of the national logistics system, strengthening the internal market and the effectiveness of the goods market, and improving the effectiveness of monitoring the business climate.

Despite Indonesia's economic achievements and trade reforms over the recent years, many problems and challenges remain. Of these problems and challenges, employment has been sluggish and hardly keeping up with the pace of labour force growth. Also, there has been an increase of employment in the informal sector. This is partly because of the limitations of manufacturing sector to absorb the expanding labour force. The manufacturing sector used to contribute the biggest share to Indonesia's GDP at about 28.4 percent of GDP in 2004, but its share has slowly been declining, recorded at 26.8 percent in 2008 and 26.2 percent in 2009. Exports of textiles, electronics, footwear, pulp and paper, and wood products have stagnated even as the world market has expanded, suggesting that Indonesia is becoming less competitive. The country's exports have, in fact, become more dependent on volatile world markets for mineral and agricultural commodities.

Further, although the unemployment rate has tended to decline, a huge number of people are unemployed. The number of unemployed was recorded at about 10 million in 2007, 8.3 million in 2010, and 7.2 million in 2012 (or 6.14 percent of the labour force). Meanwhile, the Indonesian labour

force participation rate (LFPR) remained at around 67 percent. Also, there have been problems with youth unemployment. This problem was considered alarming since almost one in every five youth in the labour force in August 2010 was unemployed. Note that the share of unemployed youth was higher for male and rural youth than of female and urban youth. Other problems are that the majority of the employed population in Indonesia has a low educational level. In the period from 2005 to 2009, more than 50 per cent of employed Indonesians either had never been to school or had only less than the primary-school level. The employed population with a university education, although increasing, is relatively small. In sum, Indonesia's labour supply is generally lowly-educated.

In order to generate both direct and indirect employment opportunities, the Government launched an integrated economic policy package, aimed to strengthen investment services, harmonize central and regional regulations, improve customs, excise, and taxation services, create jobs, and support small- and medium-sized enterprises. In addition, Government programmes were designed to tackle unemployment, such as the National Community Empowerment Programme (*PNPM*) for block grants, disbursement of Grass roots Business Credit (*KUR*), the Unemployment Reduction Movement and distribution of Direct Cash Transfers, all of which had some positive influence in the improvement of welfare indicators.

## 5.2 Policy Recommendations

Learning from the facts and experiences as stated in this report, it can be said that the impact of trade liberalization on employment in Indonesia has not been clear. In other words, the employment problems that are still faced by Indonesia cannot be explained solely as a consequence of trade liberalization policies. The poor supply-side capacity of the country, particularly its inadequately-trained labour force, has been an important factor in preventing Indonesia from maximizing the benefits of trade liberalization.

Of the many policy recommendations that need to be considered by the government, the following are the most important. At the micro level, there are least three policies and programs that are needed to be directed at improving the quality of the labour force and working conditions. First, there should be special treatment for unskilled labour and efforts to develop their capacity. One good example is the Indonesia Japan Economic Partnership Agreement (IJEPA) in which Indonesia has been given a particular quota to supply labour (e.g., nurses) with certain qualifications. Also, trade agreements may contain provisions to harmonize labour certification for certain types of workers (e.g., construction workers). This would apply especially in the case of the ASEAN Economic Community agreement, where such certification would be important for worker mobility between the ASEAN countries.

Second, there should be certainty in the implementation of the laws, rules and regulations, especially those related to the protection of workers under the Labour Law No. 13/2003. The implementation and the enforcement of this law are still very weak and the regulators do not function well in applying the law. These problems may be due to a limited budget and lack of staff to enforce the law. Decentralization has also added to the problems of the Ministry of Labour as it does not have the authority over the district level, which is leading to difficulty in law enforcement.

Third, the government should minimize the hidden costs of doing business that are imposed on firms or industries. These hidden costs arise from the complexity of regulations and regulatory procedures, which are often administered arbitrarily. Uncertainties in the regulatory framework of business in the country have hampered enterprises from being established, becoming formal, and operating efficiently. Business regulation is burdensome, and success tends to depend more on whom a business owner knows than on what he or she can produce. These failures have had a negative impact especially on small and medium-size enterprises, which are key drivers of job creation.

Fourth, there is a need for the government to provide hard (e.g., transport and energy) and soft infrastructure (e.g., governance, financial rules, and employment services) in support of domestic firms that are exporting or have the potential to export. By ensuring that the market access gained from trade agreements is complemented with the provision of infrastructure, Indonesia could stand to benefit more from engaging in global markets.

Last but not least, trade and labour policies should not only be effective but also coherent in addressing the adjustment challenges that workers and employers face and in expanding opportunities for the creation of decent employment in Indonesia. This can be achieved by promoting greater social dialogue on trade and labour policies and actively involving the social partners in the implementation of these policies.



