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**Labour Standards under Decentralisation and
Globalisation: The Impact of the Minimum Wage
Policy in West Java, Indonesia**

**A thesis presented in partial fulfilment of the requirements for the
degree of**

**Doctor of Philosophy
In
Development Studies**

**at Massey University, Palmerston North,
New Zealand.**

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2005

ABSTRACT

This study explores the importance of the minimum wage policy in West Java, Indonesia, within the overall framework of development and in the face of globalisation and decentralisation. A holistic approach to the minimum wage policy is applied. Generally, the study assesses the impact of decentralized minimum wage fixing processes on employment and participation of trade unions. In addition, it explores whether the minimum wage policy assists workers in coping with the negative effects of globalisation. It also explores the link between minimum wages and *decent work*.

This study reveals that while there is some evidence of employment losses due to increases in wage levels in West Java, it did not find conclusive evidence that minimum wage levels were the main factor responsible for the employment decline. It is likely that a combination of factors such as a decrease in global demand for Indonesian manufacturing products and the current macro-economic conditions in the country, are also responsible for the employment decline.

This study finds that the process of minimum wage fixing at local level has a positive impact on trade union participation in wage bargaining. The empowerment of trade unions through new legislation has enabled independent trade unions to flourish, which allows workers to join any trade unions. Consequently, minimum wage bargaining at district/city level is more dynamic than the centralized system of minimum wage bargaining in the past. Trade unions are able to express their views on what the minimum wage levels should be.

Moreover, the minimum wage fixing processes at local level have the potential to promote *decent work*. The minimum wage fixing processes are an alternative to wage bargaining and can accommodate even sectors where trade unions are least active or non-existent. The minimum wage processes at district/city level are already established and

they are in position to expand to a wider framework of providing welfare for workers. However, decent work objectives will not be achieved without the full cooperation of both central and local governments. Under the current decentralisation process, where central and local government views are still not in agreement, it is difficult to see how *decent work* can be applied nationally.

Thus, the minimum wage policy and trade union development are important in the overall development paradigm. Both ensure the existence of a rights based approach to development where workers are given rights to organize as well as earn a basic living. Nevertheless, the development of trade unions in developing countries is under threat from flexibilisation of the workplace in which jobs have become less and less secure. The minimum wage policy, however, is still viable because it covers all types of workers. At the very least, minimum wages provide a safety net wage that can prevent real wages from falling.

The writer suggests that more studies should be conducted on the extent and effectiveness of trade union participation in minimum wage bargaining. In addition, further studies should be conducted on the effect of minimum wages and trade unions on non-standard or flexible workers. Flexible workers, whether they are fixed-term contract and outsourced workers, are becoming an important part of the global labour market and increasingly pose a challenge to the increasingly important role of trade unions in developing countries.

ACKNOWLEDGMENT

This thesis would not have come to fruition without the support and assistance of many people and institutions. I am greatly indebted for the guidance these people have provided, and for the facilities and resources given to conduct the research.

A very special appreciation is extended to my supervisors, Professor John Overton, Professor Hans-Jürgen Engelbrecht, and Dr. Donovan Storey for their encouragement, insights and guidance in conducting this research. I thank Professor Overton's invaluable inputs for the thesis, especially on the subjects of globalisation and decentralisation. I extend my appreciation to Professor Engelbrecht for his suggestions and feedbacks, particularly on the quantitative methodology. I am indebted to Dr. Storey for his advice in the development of, and general direction of, the contents of the research.

I would like to thank all the respondents, whether they are officials of trade unions, government offices and managers of manufacturing firms in West Java and Jakarta for their participation in the study and for allowing me to conduct interviews and survey during the fieldwork. The interactions with the above respondents have been very fruitful and cordial.

I would like to thank the School of People, Environment and Planning, Massey University, and the World Bank in Jakarta who provided me with additional funding for the fieldwork. I would like to thank Statistics Indonesia, the World Bank and the Asian Development Bank for allowing me to participate in their survey and use some of their data for analysis.

I am deeply indebted to NZODA for providing me with a scholarship to pursue this doctoral degree in Development Studies and to the invaluable assistance given to my family and I by Ms. Sue Flynn and Ms. Sylvia Hooker of the International Student Office, Massey University.

Special gratitude is extended to my friends and colleagues in Statistics Indonesia, particularly in the large and medium industry sub-directorate, for their assistance and support during my fieldwork, and to the statistical offices of West Java and Jakarta for their assistance in providing information valuable to the fieldwork.

I would also like to extend my sincere thanks to my research assistant, Mr. Supardi Yasmuarto and Mr. Harya Bharata, for their abundant assistance during the fieldwork in Indonesia. Supardi and Harya helped in collecting data and information, setting-up interview appointments, providing transportation to and from the fieldwork area, and assisting in the interviews, survey and data entry.

I thank Robert Thompson and Christine Beach for helping proofread my thesis and improving the quality of my writing. Their assistance gave me valuable lessons in the English language.

Last but not the least, I would like to accord a special thank you to my wife, Maria Jacinta Arquisola and my son, Armand Faris, my parents and brothers for their love, inspiration, and support while I was completing this study. My wife was my unofficial advisor and critic. Her knowledge and insights on several aspects of the thesis have been very helpful to me. I thank her for putting-up with my antics during the development of this thesis. Finally, I would like to dedicate this thesis to my son, Armand Faris, who was born prematurely in New Zealand. His strength and will to live gave me the immense motivation to finish this thesis. My son has been my greatest inspiration.

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LIST OF ABBREVIATIONS

- 2SLS** – Two-stage least squares estimation method, also known as TSLS.
- AFTA** – Asian Free Trade Area
- APINDO** – *Asosiasi Pengusaha Indonesia* (Indonesian Employers Association)
- APEC** – Asia Pacific Economic Cooperation
- ASEAN** – Association of South-east Asian Nations
- Bappenas** – *Badan Perencanaan Pembangunan Nasional* (Indonesia’s Development Planning Board)
- BGDC Method** – Birth, growth, death and contraction of firms method to calculate net employment change
- BPS** – *Badan Pusat Statistik*, Indonesia’s statistical agency. Also referred to as Statistics Indonesia
- CAFTA** – China and ASEAN Free Trade Area
- EJIP** – East Jakarta Industrial Park
- EOI** – Export Oriented Industrialisation
- FNPBI** – Front Nasional Perjuangan Buruh Indonesia
- FDI** – Foreign Direct Investment
- FKTU** – Federation of Korean Trade Unions
- FSP-LEM** – *Federasi Sekerikat Pekerja – Logam, Elektronik dan Mobil*.
- Gasbiindo** – *Gabungan Serikat Buruh Industri Indonesia* – Federation of Industrial Trade Unions of Indonesia
- GDP** – Gross Domestic Product
- GDRP** – Gross Domestic Regional Product
- GSBI** – *Gabungan Serikat Buruh Indonesia*
- GSP** – Generalised system of Preferences
- HDI** – Human Development Index
- ICFTU** – International Confederation of Free Trade Unions
- IMF** – International Monetary Fund
- ILO** – International Labour Organisation
- IOE** – International Organisation of Employers
- ISIC** – International Standard Industrial Classification

IV – Instrumental Variables

JABOTABEK – Jakarta, Bogor, Tangerang and Bekasi Regions

JAMSOSTEK – *Jaminan Sosial Tenaga Kerja* – Workers' social security benefit

KBN – *Kawasan Berikat Nusantara* (Bonded Industrial Zones)

KEPMEN – *Keputusan menteri Tenaga Kerja* – Manpower Ministerial Decree

KFM – *Kebutuhan Fisik Minimum* (Minimum Physical Need)

KHM – *Kebutuhan Hidup Minimum* (Minimum Subsistence need)

KSPI – *Konfederasi Serikat Pekerja Indonesia* (Confederation of Independent Workers Union of Indonesia)

KSPSI – *Konfederasi Serikat Pekerja Seluruh Indonesia*

MERCOSUR – *Mercado Común Del Sur* (South American Free Trade Agreement)

MM2000 – Bekasi Industrial Park

MNC – Multi-national Corporations (also see TNC)

NAFTA – North American Free Trade Area

Nakertrans – *Tenaga Kerja dan Transmigrasi* (Manpower and transmigration)

NGO – Non-governmental Organisation

NIC – Newly Industrialised Countries

OECD – Organisation of Economic Cooperation and Development

OLS – Ordinary Least Squares estimation method

PERMENAKER – *Peraturan Menteri Tenaga Kerja* – Manpower Minister's Regulation

PIR – *Pancasila* Industrial Relations

PJP – *Pembangunan Jangka Panjang* (Long Term Development)

PPHI – *Penyelesaian Perselisihan Hubungan Industrial* (Industrial relations dispute resolution)

REPELITA – *Rencana Pembangunan Lima Tahun* (Five Year Development Plan)

Sakernas – *Survei Tenaga Kerja Nasional* – The National Labour Force Survey

SBM – *Serikat Buruh Merdeka* (Freedom Workers Union of Indonesia)

SBSI – *Serikat Buruh Sejahtera Indonesia* (All Indonesia Workers' Welfare Union).

SMERU – Smeru Research Institute

SOBSI – *Sentral Organisasi Buruh Seluruh Indonesia* (All Indonesia Central Organization of Trade unions)

SPMI – *Serikat Pekerja Metal Indonesia* (Indonesian Metal Workers Union)

SPSI – *Serikat Pekerja Seluruh Indonesian* (All Indonesia Workers union). Currently known as *KSPSI or Konfederasi Serikat Pekerja Seluruh Indonesia* (Confederation of All Indonesia Workers Union)

SPSI-Reformasi – *Serikat Pekerja Seluruh Indonesia Reformasi* (Reformed All Indonesia Workers Union)

SPTSK – *Serikat Pekerja Tekstil, Sandang dan Kulit* (Textile, footwear and leather industrial workers' union)

TGF – Textile, Garment and Footwear

TNC – Trans-national Corporations, also known as Multi-national Firms (see MNC)

UNDP – United Nations Development Programme

US – United States of America

UU – *Undang-undang* (law or legislation)

WB – The World Bank

WTO – World Trade Organisation.

Chapter I

Introduction

While it has been claimed that economic globalisation poses a threat to many less-developed countries, it appears that other countries, especially in Asia, have pursued economic globalisation via export-oriented industrialization (henceforth EOI) to achieve high economic growth¹. In these cases development strategy depended on a marriage of cheap, disciplined local labour with international technology, capital and markets (Deyo, 1987). In Asia, primary EOI development has been characterized by labour-intensive manufactured exports, such as electrical and electronics components, footwear and garments, for which the primary source of competitive advantage is the low costs of labour and production (Kuruvilla, 1996, p. 49). Unfortunately, it has arguably been achieved at the cost of democracy and the well-being of society, including basic labour rights and standards (Martin and Schumann, 1997). Attempts to suppress wages by autocratic governments have played a role in holding back labour standards (Manning, 1998). One of the most controversial and highly contested labour standards is the minimum wages.

There have been attempts to find alternative solutions to the perceived dangers posed by globalisation. Two of the most talked about coping strategies, in relation to the labour market, are *decent work* and decentralisation. *Decent work* is the International Labour Organisations' (ILO) development program which aims at increasing the quality and quantity of employment. *Decent work* means work which is carried out in conditions of freedom, equity, security and human dignity (ILO, 1999, p. 3). Decentralisation, defined as the transfer of significant degrees of authority and responsibility for governmental expenditures and revenues from the central government to lower levels of government, is a recent development in developing countries (Alm et al, 2001, p. 84). In the context of this thesis, the two concepts are interconnected via minimum wages. In Indonesia, in particular, minimum wage setting is being decentralised to local level and is being implicitly debated under the *decent work* concept.

¹ The term globalisation refers to growing international economic integration, based significantly on the activities of multi-national corporations. Although globalisation is not a new phenomenon, the 1980s and 1990s witnessed a surge of international trade and investment, mostly centered around advanced industrial economies (Frenkel and Kuruvilla, 2002). See Chapter II for more explanation.

This chapter introduces the overall objective of the thesis as well as a summary. The chapter starts by presenting the justification of choosing the minimum wage policy as the central issue of the thesis. Then it continues with the objective, a summary of theoretical background and the methods used to achieve that objective. Subsequently, the chapter also introduces the fieldwork area. Finally, it concludes by introducing the main chapters of the thesis.

The Impact of Globalisation on Indonesian Workers

Workers in Indonesia have faced the challenges posed by economic globalization. Economic growth was achieved in the 1980s and the 1990s at the expense of human development and organized labour. Even though Indonesian workers have enjoyed substantial gains in employment and wages due to high economic growth in the 1980s and 1990s, they remain far from achieving the same goals in social welfare. Economic development during these periods was not followed by comparable overall human development. While it has been argued that Indonesian workers have enjoyed more employment and better jobs, together with other working conditions and labour protection, these gains were achieved at the expense of the more fundamental needs of workers, such as limited workers' rights and they fell short of achieving a decent way of living (Manning, 1993). Some blamed Indonesia's high cost economy which prevented employers from paying workers fairly and in accordance with the law (*The Jakarta Post*, 2003)². Even though the government attempted to remedy the situation by significantly increasing and seriously enforcing minimum wages in the 1990s (Levine, 1997; Manning, 1998), these gains were abruptly interrupted by the economic crisis which was triggered by the devaluation of the Thai Baht in 1997 (Hill, 2000; Das, 1999).

For these reasons, the minimum wage policy has become a crucial yet complex issue. Studies on the minimum wage policy in Indonesia have been few and focused mainly on its economic impact. Freeman argues that to understand the role of minimum wages in

² Bomer Pasaribu, a former manpower minister who chairs the Center for Labor Development Studies (CLDS) revealed that most companies allocated between 20 to 30 percent of their total budgets for labor cost, half of which was spent on invisible cost (*The Jakarta Post*, 2003). Invisible costs are costs not associated with production, such as illegal payments to government officials, political parties and hoodlums. In economic terms, invisible cost is called rent seeking.

an economy, it is important to go beyond economic analysis to consider the basis for public support for, and opposition to, minimum wages (1994, p. 17). Nonetheless, excessive wage increases have the potential of harming economic recovery as well as creating political instability which could then hamper other development programs. Thus, it is felt that the current condition of the country warrants a more comprehensive study on the impact of the minimum wage. The ongoing decentralisation process, which devolves many central government functions to local governments, includes the authority to fix local minimum wages. In addition, the democratic transition has ushered in a new era in industrial relations by allowing independent trade unions to flourish. Therefore, this study argues that a combination of greater workers' involvement in industrial relations and decentralized minimum wage fixing will have far-reaching implications on Indonesia's economic development.

Indonesia's Economic Crisis and Political Transformation

The economic crisis of 1998 transformed Indonesia in many ways. It exposed Indonesia's fundamental weaknesses in economic development and created a multi-dimensional crisis from which Indonesia has yet to completely recover. The economy shrank by as much as 13 percent (Hill, 2000). The Indonesian currency lost as much as 70 percent of its value in that same year and created a nightmare for Indonesia's export-oriented economic development (Hill, 2000). The economic crisis also spilled into Indonesia's political and social landscape. The crisis created political instability which culminated in the ousting from power of the then President Soeharto.

Fortunately, the fall of the Soeharto regime has transformed the political landscape into a more democratic environment. One of the most important steps in that process is for the central government to allow regional authorities greater autonomy. Decentralisation of central government functions had been on the agenda before, but the democratic transformation appeared to accelerate the process. Under the new Law Number 22, 1999 on decentralisation, the central government had devolved many previously centralized functions as well as deconcentrated many central government offices to provincial and district/city governments. This means that regional governments are allowed to implement their own local development and generate own income. The decentralisation process, however, complicates the minimum wage setting process because the authority

of determining local minimum wage levels has now shifted to provincial governments. Several provinces, such as West Java have gone so far as to decentralize minimum wage fixing to district/city level.

The issue of minimum wage is a crucial development issue because of its relationship with the key goals of the country's recent development policies, i.e. increasing overall employment and increasing wages. Economists have argued that the Indonesian labour market tends to resemble the traditional economic model of labour demand and any attempt to increase minimum wage levels significantly would create detrimental effects on employment and wages (Manning, 1998; SMERU, 2001; Suryahadi et al., 2003). Nevertheless, minimum wages are not merely about numbers; they have a symbolic meaning, ethical and socio-political dimension. For instance, the public overwhelmingly supports the policy, and any attempts by the government to reinforce it can be seen as a genuine attempt to improve the welfare of workers. After all, it can be reasonably argued that a substantial improvement in factory working conditions and wages (and the realization of workers' rights to the free and active self-organization that is likely to be the precondition for this) are - besides being important development goals in themselves - also in the best interest of maintaining the attractiveness of Indonesia to foreign manufacturing investors (White, 1993, p. 138). Political and social stability, as a result of more freedom of association, is perhaps a more crucial precondition for foreign investment. Another reason is that foreign-owned firms make use of aspects of labour organizations and democratic institutions that improve the efficiency characteristics of their factory operations (Brown et al., 2004, p. 322). Consequently, minimum wages as well other labour standards are not just about its impact on overall employment. The ethical and economic aspects of labour standards are, according to Sapir (1995, pp. 802-803), development issues which require development policies to resolve. It is this point of view that the thesis attempts to address.

Background of the Problem

The minimum wage policy in Indonesia has been transformed from merely a symbolic gesture in the early 1970s to an attempt by the government to appease critics in the 1990s, and to a seemingly genuine attempt by the government to improve the welfare of workers. Although minimum wage setting started in 1956, only in 1969 did the

government decided to form an official institution, the National Research Council on Wages to study minimum wage levels based on the minimum physical needs or *Kebutuhan Fisik Minimum* (KFM). However, the government only started to actively increase minimum wage levels in 1989 when political pressure from within Indonesia and abroad forced the government to address the allegedly appalling workers' conditions as well as low wages, especially in low-skilled manufacturing firms.

The minimum wage policy underwent another transformation after the fall of the autocratic New Order Government in 1998. Firstly, the minimum wage policy was elevated from a 'mere' ministerial decree and was included in the new Employment Law Number 13, 2003. Secondly, based on the new Law Number 22, 1999 on Regional Autonomy, minimum wage fixing is now under the authority of provincial governments. Even more so, some provinces, particularly West Java, have gone a step further by allowing district and city governments to set their own minimum wage levels. Thirdly, the transformation to a more democratic society means that workers are now allowed to freely express their views regarding government policies that can affect their welfare. In 1999, Indonesia ratified the International Labour Organisation's Convention Number 87 on the Freedom of Association, allowing workers to join or form any trade unions. This meant that the support base for the minimum wage policy was strengthened, as it was argued that trade unions wholly supported the existence of the policy.

The combination of events and policy presented a whole new development challenge for the government, still reeling from the effects of the economic crisis and political change of 1998. One of the most positive actions which can be taken, by those concerned with the plight of workers in developing countries, is to help support better labour market policies at home and ensure that the international trading system is not increasingly threatened by domestic labour market problems (Manning, 1998, p. 142). As the Indonesian government's development policies also wholly embrace economic globalization and still emphasize EOI development, the challenge is to apply appropriate labour market policies, including the minimum wage policy, that do not result in a significant trade-off with other development policies, such as employment creation. Although the minimum wage policy is not specifically stated in the central government's development goals, increasing wages were noted as a goal in Article 18 of

the 2000-2004 development programs or *PROPENAS (Program Pembangunan Nasional)*, together with expanding overall employment and the recognition of the workers' freedom of association (Bappenas, 2004).

The application of the minimum wage policy presents a challenge to local governments. Firstly, the complicated nature of minimum wage setting has created a major dilemma for local governments, who must be less dependent on the central government in implementing their own development agenda. On the one hand, local governments strive to improve workers' meagre wages, as well as appeasing them. On the other hand, increasing minimum wages to an unsustainable level may prove fatal for local governments which rely on the manufacturing sector to spur economic development and generate their own income. Secondly, local governments also lack the expertise of central governments to implement policies and will have problems enforcing the results of the minimum wage setting. Thirdly, the increasing political influence of trade unions, especially with regards to setting minimum wage levels, also creates a major constraint to local governments. Trade unions have the collective power to destabilize the local economy by staging strikes and mobilizing protests if things do not go their way.

The Role of the Minimum Wage Policy in Indonesia

By definition, minimum wages refer to various legal restrictions on the lowest wage rate payable by employers to workers (Eatwell et al., 1987, p. 476). The minimum wage referred to is called a 'statutory minimum wage', which is a minimum wage set by a tripartite institution within the regional government in Indonesia called the 'wage council' at district level or 'commission' at city level³. The minimum wage is supposed to be the lowest paid remuneration a single worker receives per month. The calculation of the minimum wage is based on the value of the minimum subsistence need. There are five factors that determine the level of minimum wage: the minimum subsistence need, inflation, economic growth, state of the labour market, business environment, and last but perhaps the most crucial, minimum wages in neighbouring districts. The changes in minimum wages set by the institution have potential implications on various economic variables.

³ Both institutions have the same primary role of establishing new minimum wage levels for a given year. The composition of the institutions is also more or less the same: equal number of tripartite members from workers, employers and government representatives.

The benefits of effective minimum wage policy are manifold. Simanjuntak stated that the minimum wage policy is seen as an appropriate policy instrument to achieve sound industrial relations (1995, p. 65). Failure to comply with the minimum wage provision is by far the main reason for industrial conflict in Indonesia. In Indonesia, the objectives of minimum wage setting are as follows:

- a. To avoid and minimize unhealthy competition among workers under conditions of surplus labour, so that they accept wages below the decent level.
- b. To avoid and minimize exploitation of labour by employers who take advantage of market conditions to accumulate profits.
- c. As a safety net wage to prevent falling real wages.
- d. Minimize absolute poverty of workers, especially if the minimum wage is related to the basic needs of workers and their families.
- e. To encourage productivity increases through better nutrition and health of workers through increase in minimum wage.
- f. Increase the purchasing power of the public, which in turn could stimulate economic growth;
- g. To create stable and harmonious industrial relations (Simanjuntak, 1995).

In addition, the minimum wage policy is administratively simple to implement, does not have direct budgetary consequences to the government, increases the incentive to work and guarantees basic compensation for workers (Freeman, 1994).

However, there are also major concerns in implementing the current minimum wage policy. The minimum wage policy normally applies to the formal sector, whereas the majority of Indonesian workers are in the informal sector. In the aftermath of the 1998 economic crisis, the number of workers forced to join the informal sector appeared to increase significantly (McGee and Firman, 2000). Thus, the danger is that the minimum wage policy will most likely miss the intended target of helping disadvantaged workers who are not covered by the policy. In addition, Indonesia has an oversupply of labour and any attempt by the government to intervene in the labour market would have unfavourable employment consequences for these workers. Determining the appropriate minimum wage levels must also take into account the interests of both employers and workers. More importantly, the current minimum wage policy is being applied against

the backdrop of the economic crisis from which Indonesia has not fully recovered. Previous implementation of the policy, during the 1990s, might not have had detrimental consequences because economic growth during that time was considerable. However, it could be argued that it would be disastrous for Indonesia's development goals to apply the current minimum wage policy when the country is still recovering from the crisis.

Objective of the Thesis

The description of the role of the minimum wage policy and its potential implications clearly underscores the importance of the policy in the overall development strategy of the country, as well as its potential future impact on regional development. More importantly, the minimum wage policy has the potential to promote a more balanced economic development, i.e., maintaining the economic *status quo* of industrialization without neglecting the needs of workers. Thus, several crucial questions come to mind: What are the implications of decentralizing the minimum wage setting process to district and city level? Do the minimum wage policy and other labour regulations provide appropriate protection for workers from the negative effects of globalisation? Is it a beneficial long-term solution for the government to allow districts and city governments the authority to set and implement the minimum wage level, given the highly sensitive political dimension surrounding its implementation? Can the minimum wage policy create more harmonious and stable industrial relations?

The major aim of this dissertation is to assess the implication of decentralized minimum wage fixing on a variety of economic and social issues. The specific aims of this thesis are to: assess the impact of the minimum wage fixing process on employment; assess the impact of the decentralized minimum wage fixing on industrial relations, namely, workers' participation in the wage bargaining; and assess other factors that affect employment, such as employment legislation.

In addition, the thesis explores the process of minimum wage fixing since the decentralisation process began in 2000. To assess its impact on industrial relations, the thesis also explores the development of trade unions since 1998 and the viability of the minimum wage policy in the 'freedom to organize' era. Consequently, the thesis also aims to find out whether the minimum wage policy could promote *decent work* through

social dialogue and insulate workers from the negative effects of globalisation. The assessment accounted for the year 2001, 2002 and to a lesser extent, 2003 when the decentralisation of the minimum wage fixing had commenced. The analysis focuses on the manufacturing sector due to its importance in developing countries as the key to EOI development.

Overview of the Theoretical Framework and Literature

Minimum wages encompass economic and political, as well as developmental, aspects. The debate over the merits of the minimum wage has raged continuously since its implementation, but nowhere more so than in the economics literature. However, the political and developmental justifications are as strong, if not stronger. Recent events have shown that the minimum wage policy in developing countries is intertwined with democratization and decentralisation. The minimum wage debate is also prominent in the International Labour Organisations' concept on *decent work*. Therefore, to analyze its implications, one should start with the source of the debate - the economic dimension of minimum wages.

The Economic Dimension of Minimum Wages

Although economic theory presents several models of the economic impact of the minimum wage policy, most economists consider the neo-classical model as a realistic model to empirically test the theory. The theory posits that an increase in wages means a decrease in employment opportunities. Minimum wage policy could benefit low-wage workers at the expense of reduced job opportunities for others (Reynolds et al., 1998, p. 247). Neo-classical economists, starting with Stigler (1946) and supported by, among others, Neumark and Wascher (1992), Neumark (2001) and Partridge and Partridge (1999), abhor the use of the minimum wage policy on the premise that it would create distortion in the labour market and have a detrimental effect on employment. Nonetheless, particularly in the past two decades, other economists such as Card and Krueger (1995), Freeman (1994 and 1998) and Machin and Manning (1997), have challenged that view and argue that an increase in minimum wages need not have detrimental effects on employment. Their view has been supported by economists such as Reich (2000), Heyes and Grey (2001), Prasch (1996), Levin-Waldman (1998; 2000), Cordero (2000) and Waltman (2000) who argue for the need of a minimum wage policy

based on socio-political reasoning. While minimum wage studies in developing countries yielded mixed results (Freeman and Freeman, 1991; Maloney and Nunez, 2001; Jones, 1997; Livingstone, 1995; Bell, 1995; Saget, 2001), organizations like the World Bank (1995) stress that the labour market in developing countries tends to be highly competitive and follows the neo-classical model.

The debate over the minimum wage policy is similarly seen in the case of Indonesia where experts appear to be divided on the merit of the policy. Observers such as Rama (1996 and 2001), Islam and Nazara (2001) and Alatas and Cameron (2001) found insignificant results for the impact of minimum wage policy on employment. Others found adverse impact on the urban formal workers (Smeru, 2001; Suryahadi et al., 2003) and informal workers (Bird and Manning, 2003). However, while economists debate whether a statutory minimum wage has a negative employment effect and if so, what the actual impact is, public opinion often favours a statutory minimum wage for equity reasons (Deeks and Rasmussen, 2002, p. 165). Thus, the issue of minimum wages is much more complex than simply measuring its impact on employment and few researchers have performed a comprehensive study of the minimum wage, ranging from its impact on employment to its social impact on industrial relations. In addition, these studies mainly focused on national and provincial statutory minimum wages. With the ongoing decentralisation process, it can likewise be argued that the minimum wage policy is further complicated by the shift of authority, to fix minimum wage levels, from central to local government.

Minimum Wages and Development

The minimum wage policy is consistent with the notion of social justice embedded in the fifth *Pancasila* constitution: Social justice for all Indonesians⁴. Social justice includes providing a living wage that is sufficient for a worker's basic needs, such as food, clothing and shelter. One of the fundamental purposes of development is to provide an environment in which all people can expand their capabilities, and opportunities can be enlarged for both present and future generations (United Nations, 1994). Development has to be more concerned with enhancing the lives we lead and the

⁴ The *Pancasila* came from the Sanskrit word Panca, meaning five, and Sila which means constitution. The *Pancasila* consists of five fundamental principals: 1) belief in one God, 2) just and civilized humanity, 3) unity of Indonesia, 4) democracy guided by the inner wisdom in unanimity arising out of deliberations amongst representatives, and 5) social justice for all Indonesians.

freedoms we enjoy (United Nations, 1994). The minimum wage is consistent with the basic concept of development, i.e. improving the quality of life by providing the basic needs of the people so that they are able to concentrate on gainful employment and be less concerned with the question of survival. The current Proenas (Bappenas, 2004) development plan did not specifically mention the policy, but one vital aspect of this plan reiterates the need to increase employment as well as to increase workers' wages, welfare insurance, protection and freedom of association. Unfortunately, the country's overall development strategy, which calls for more integration into the global economy, also increases the exposure of workers to its detrimental ramifications, such as greater insecurity of jobs and low wages.

The minimum wage policy, through the current minimum wage fixing process, is also consistent with the logic of development participation. Participation is a means to further human capabilities and other goals of development (Todaro and Smith, 2003, p. 715). In the case of the minimum wage fixing process, the trio of minimum wage stakeholders, the government, employers and workers have an equal stake in the decision making process of determining the minimum wage level of a given area under their jurisdiction. While employers and workers negotiate on the appropriate level of minimum wage, based on their interests, the government has the task of balancing the needs of both based on the policy of the government. The participation of trade unions had been boosted by the recent democratization and decentralisation of the country.

The Politics of Minimum Wages: Democratisation and Decentralisation

The political transformation to a more democratic society in Indonesia has also resulted in the decentralisation process which provides local governments with much greater autonomy. Decentralisation is defined as a process whereby a central government relinquishes some of its management responsibilities or powers to a local government, local leader, or community institutions (UNDP, 2004, p. 90)⁵. Under Law Number 22, 1999 on decentralisation, many state functions have been delegated to local authorities, i.e. provincial and district or city administration, including fixing the level of minimum

⁵ In addition, the standard argument stated that local governments are closer to the citizens and to the consumer of services, and are thus better able to make choices that reflect the needs and priorities in their jurisdiction (Devas, 1997, p. 352). Decentralisation could also accommodate diversity, enabling participation and ensuring countervailing of power. The case of the minimum wage council certainly fits this framework.

wage. Previously, though provincial governments were allowed to recommend the level of minimum wage, the final decision rested on the central government, i.e., the Ministry of Manpower as the nominating authority. Moreover, the trade union that was supposed to take part in the process was controlled by the state. While the central government retained the right to legislate the minimum wage provision, including setting the criteria for calculating the minimum wage, under the new legislation provincial and district/city government deal with setting the level of minimum wages in their own region.

The changes have created a lot of uncertainty about the implications of decentralizing the minimum wage fixing process. Firstly, local governments are still in the early stages of the decentralisation process and may not have sufficient manpower to perform the task. Secondly, corruption has become a major problem in economic recovery and could pose problems in the implementation of the minimum wage provision. Thirdly, the abolition of state control of trade unions means that trade unions can more actively participate in the minimum wage fixing process and thus present more challenges to local government. Fourthly, significantly high increases in minimum wage level can undermine the local economy by potentially creating more unemployment. Lastly, several provincial governments, particularly West Java, have resorted to delegating the minimum wage fixing process to the district government. The focus of this thesis is to assess the implication of this type of decentralized minimum wage fixing. Thus, it is appropriate to inquire whether decentralisation of the minimum wage fixing is beneficial for regional development.

Even though the minimum wage policy applies more to the modern sector, i.e. large and foreign-owned firms, than to the traditional sector, its implication reverberates indirectly to other sectors such as the informal sector and eventually to overall economic development. Previously, several studies in Indonesia have shown a significant negative impact of minimum wage increases on employment (SMERU, 2001; Bird and Manning, 2002; Suryahadi et al.; 2003). Other studies have also shown that the impact was insignificant (Rama, 1996 and 2001; Islam and Nazara, 1999; Alatas and Cameron, 2002). Notwithstanding these conflicting results, the study of the impact of minimum wages is a challenging pursuit because it encompasses social and political dimensions, e.g. the public tend to favour the application of minimum wages, and failure to comply

with the minimum wage provision has been documented as causing strikes and workers' protests which eventually have the potential to destabilize the country.

Industrial Relations

Industrial relations are an important part of the development strategy in developing countries. In many parts of Asia, in particular, it is argued that congruence between the industrialization strategy and industrial relations policy is an important precondition for successful economic development (Kuruvilla, 1996, p. 653). The EOI development strategy is characterized by labour intensive manufacturing exports, in which the primary source of competition is the low costs of labour and production (Kuruvilla, 1996, p. 637). Unfortunately, this strategy also requires heavy government intervention in industrial relations which includes restricting trade union movement. Indonesia became one such country when it switched from import substitution industrialization to EOI in the 1980s and early 1990s.

The economic crisis of 1998 changed all that. In Indonesia, the fall of the Soeharto regime abolished restrictive state control over workers' freedom of choice. The successors of this previous regime initiated several measures to allow more freedom for workers. The first measure was the ratification of ILO Convention Number 87 on Freedom of Association. This made Indonesia the first country in Asia to ratify all core ILO Conventions (Islam, 2001). It opened the way for workers to form and join independent trade unions outside the state sponsored trade union. As a consequence, independent trade unions have flourished. Verily, the condition is ripe for Indonesia to shift towards a more participatory approach to labour market policy. The minimum wage policy could be the starting point in the move towards *social dialogue* and *decent work*.

In addition to being granted freedom of association, after the political transformation in 1998, the labour movement was also boosted by the legalization of two new employment acts: Law Number 13, 2003 on Employment and Law Number 2, 2004 on Industrial Relations Dispute Resolution. Even though these laws have only recently been approved, their impact has been felt since 1999, due to the fact that some of the clauses in the new laws were already applied through ministerial decrees implemented

shortly after the democratic transition of 1998. The new laws merely strengthened the level of legality in the provisions. Two important clauses in the new laws were the inclusion of the minimum wage provision and the setting up of independent trade unions. Another minor clause was the hotly contested Ministerial Decree 150/1999 on compensation. This decree was abolished and replaced by a clause in the new employment law.

The only novelty in the new legislation is Law Number 2, 2004 on Industrial Relations Dispute Resolution. The new law includes additional methods of settling disputes, as well as adding a new method to resolve industrial conflict via the establishment of a special employment court. This court would consist of a professional judge and two ad-hoc judges from the representatives of employers and workers. In addition, the method of dispute settlement also includes arbitration, as well as mediation and conciliation. The new employment laws appear to push for less central government intervention and focus more on the judicial dimension. The recent development of trade unions in Indonesia will ensure its political backing.

The growing strength of trade unions in Indonesia, particularly independent trade unions, will also ensure the growing political support of the minimum wage provision. The ratification of ILO Convention Number 87 on Freedom of Association means that workers have the freedom to join trade unions, independent or otherwise, or form their own trade unions. Moreover, trade unions are able to join forces with other unions, as well as other socio-political forces, and exert more political pressure on the government to provide better working conditions for workers. It also means that the minimum wage is as binding as ever because trade unions are fearful of reprisal for reporting minimum wage violations.

Lastly, it is important to note that decentralisation has also affected the way minimum wage levels are being determined, especially in the fieldwork area. Law Number 22, 1999 on regional autonomy has delegated many central government functions to local governments, i.e. provincial and district/city government, including regional minimum wage setting. Particularly for regions with a concentration of industries, such as West Java, minimum wage levels are set at provincial as well as district/city levels. A combination of greater freedom for workers and greater authority for local governments

should present a significant challenge to Indonesia's industrial relations. On that score a *social dialogue* which is part of the *decent work* approach to development envisaged by the ILO, is beneficial in developing national labour market policies.

Decent Work

Decent work, the International Labour Organization's development approach, to cope with the unavoidable trend of economic globalisation, is defined as work which is carried out in conditions of freedom, equity, security and human dignity (ILO, 1999). *Decent work* does not challenge economic globalization, but rather it is seen as a coping mechanism to prevent fall-out, such as low wages and the growing insecurity of work. Under decent work, global firms planning to invest in a country that values *decent work* must conform to the existing decent work standards. The four strategic objectives of *decent work* are: achieving universal respect for fundamental principles and rights at work; the creation of greater employment and income opportunities for women and men; extending social protection; and promoting *social dialogue* (ILO, 1999). *Social dialogue* itself is defined as any form of negotiation between labour, management and government around the world. *Social dialogue* is a participatory approach to development in which bipartite, as well as tripartite negotiations, could be used to improve industrial relations and settle industrial dispute more quickly. *Social dialogue*, through greater employee participation in the workplace, ensures stability and also helps the interests of both unionized and non-unionized workers. Indonesia is one of many countries targeted for improving industrial relations through social dialogue (ILO, 2004). Post-crisis Indonesia seems to have fallen behind other crisis-affected economies in East Asia that have made significant progress in using the instrument of *social dialogue* at the national level to deal with large-scale labour market adjustments (Campbell 1999, cited in Islam, 2001). Can the decentralized minimum wage setting process be used to create more harmonious, stable industrial relations and also promote *social dialogue*?

Overview of Methodology

The research employed both quantitative and qualitative methods to triangulate the impact of the minimum wage policy⁶. The quantitative research used several

⁶ Methodology is covered in greater detail in Chapter VI.

econometric analyses by using several models and multiple secondary data sources to assess the impact of the minimum wage on economic variables such as employment and wages. The econometric models employed ordinary least squares (OLS) and two-stage least squares (2SLS) with instrumental variables to estimate the employment impact of the minimum wage policy. Other methods, such as the birth and death of firms were additionally employed to estimate employment changes after the start of the decentralisation process. The analysis included the presence of trade unions as an explanatory variable. However, this type of analysis is not sufficient to explain other issues, such as the political environment and trade union activities.

Qualitative methods were used to explain the impact of the minimum wage setting process on these issues, as well as finding out additional information concerning the current minimum wage setting process. Qualitative methods involved elite interviewing, group interviews, and semi-structured interviews using pre-designed questionnaires. The research also focused on the foreign-owned and export-oriented sub-sectors in manufacturing (textiles, garments, footwear, electronics and automotive parts). It was limited to a few provinces for the study area and focused on the West Java province. Jakarta is used as a comparison due to its past influence as the capital city and its close proximity to West Java. More detailed explanations of the methods appear in Chapter VI of the thesis.

Background of the Study Area

The West Java area is an important part of the industrialization process in Indonesia. It borders the capital of Jakarta in the North and provides several satellite cities for many people who work in Jakarta. The so-called JABOTABEK area includes Jakarta plus several satellite cities in West Java; Bekasi, Bogor and Tangerang. Tangerang, which was once part of West Java, before the start of decentralisation, is now part of the newly formed province of Banten. However, the minimum wage fixing process in Banten followed the process conducted by West Java and even the industrial relations dispute resolution process is still conducted in West Java's capital of Bandung.

The Bandung region is an important part of West Java region, not just due to its role as the capital of West Java, but it is also the location of many labour intensive industries,

particularly the so-called TGF (textile, garment and footwear) firms⁷. Just recently, Bandung has also become the centre for factory outlets and imported garments. The Bekasi district is known for its bonded zones areas where many of the electronics and automotive parts industries, such as Sony and Toyota, are located. These firms are also important because they represent the white-collar workers that are supposed to benefit the most from the increase of the minimum wage level.

Industrial disputes tend to occur in manufacturing firms in West Java (See Chapter IV). The fieldwork focused on areas in which many strikes had occurred. The researcher conducted his fieldwork in the following districts in West Java/Banten; Tangerang, Bekasi, Bogor and Bandung. Many of the disputes ranged from reluctance of firms to pay minimum wages, to other working conditions such as working hours and menstruation leave for women. There were also reports of sexual harassment and other mistreatment of workers by employers (*Kompas*, 2001a).

Jakarta, the administrative capital of Indonesia (also classified as a special province), has been included in the analysis due to its close proximity to West Java and Banten. Jakarta also boasts many manufacturing firms located on its periphery. The minimum wage fixing process in Jakarta is sometimes used as a model for other regions and the minimum wage level is sometimes used as the basis for calculating other region's minimum wage levels, especially in the periphery districts such as Bogor, Bekasi and Tangerang. Nonetheless, unlike West Java, only the provincial wage council has the authority to set the minimum wage level in Jakarta, with the approval of the governor. There is a standard minimum wage setting process for the whole of Jakarta whereas authorities in the sub-cities of West, North, East, Central and South Jakarta do not have the task of setting the minimum wage levels in their respective areas. Consequently, district/city minimum wage fixing in Jakarta is being used as a model to be applied to other provinces. Thus, the success of the decentralized minimum wage fixing process will be crucial for the future minimum wage policy in Indonesia, and it is the main issue this thesis attempts to address.

⁷ Bandung region consists of the City of Bandung and the district of Bandung which consists of sub-districts and border towns on the periphery of the Bandung city. Many textile factories, as well as garment and footwear factories are located in this area. Examples are the shoe centre in Cibaduyut within the city of Bandung and Majalaya sub-district and the centre of garment production in Bandung District.

Thesis Summary

The thesis summary, consisting of ten chapters, is as follows:

Chapter II explains the challenges faced by workers in the globalised economy, as well as counter measures to cope with the unavoidable outcome of globalisation. Economic globalisation has created many benefits and obstacles to the labour market. Proponents of globalisation have emphasized that globalisation has created many jobs and increased income. Opponents to globalisation counter that it has created labour flexibilities where the quality of jobs has deteriorated and workers, especially vulnerable workers, have been increasingly marginalized. Either way, some have instituted ways of coping with globalisation. The ILO (1999) has introduced the *decent work* concept as one way to maximise the benefits of globalisation for workers' welfare. In addition, decentralisation is another way of meeting the challenges of globalisation. Minimum wage fixing is one of the processes decentralised to the local government. Nonetheless, others still debate the inclusion of minimum wages in the *decent work* concept due to its potential negative impact on employment.

Chapter III details the theoretical overview of the minimum wage impact. This chapter focuses on the minimum wage debate among economists in developed as well as developing countries. The debate shows that the impact of minimum wage can be both positive and negative, depending on the theoretical concept. The traditional economic view of the minimum wage is that in a competitive environment an increase in minimum wage has a negative impact on employment. However, the impact need not be detrimental if an increase in minimum wage is not too high. In fact, Card and Krueger (1995) and others have proven empirically that in developed countries the impact of minimum wage increases need not be detrimental to employment. Moreover, they show a positive relationship between minimum wage and employment in some sectors of the economy. Although their views are counter challenged by other economists such as Neumark (2001), they are supported by other studies which focus on the social and political dimension of the minimum wage impact. Studies of minimum wage impact in developing countries have mixed results but tend to lean towards the traditional view, due to the competitive nature of the labour market. However, Saget (2001) argues that the minimum wage had a positive impact on poverty and can promote *decent work*.

Chapter IV describes Indonesia's economic development, especially the industrialization phase, and its impact on workers. Industrialization in Indonesia actually dates from 1966 under President Soeharto's "New Order" Policy (Gall, 1998, p. 362). Industrialization, which started in the mid 1970s, focused mainly on import substitution funded by oil revenues. However, Indonesia did not enjoy high economic growth until the late 1980s and 1990s when the government adopted the strategy of export-oriented industrialization (EOI). High economic growth created many jobs, as well as increasing income, and created a substantial number of jobs for the working class. Nonetheless, industrialization was achieved through labour control, especially the freedom to choose and conduct strikes. Pressure from inside and outside the country forced the government to introduce the minimum wage policy to appease workers. However, lack of enforcement and maintaining strict control of trade union activity were deemed insufficient to stem workers' dissatisfaction. The crisis of 1998 exposed Indonesia's fundamental economic weakness and created spill over effects to the political and social dimension. The fall of Soeharto's government created mixed blessings for workers. The crisis created much unemployment, due mainly to firm closures, and decreased real wages significantly due to the high inflation rate. On the other hand, workers gained more freedom and were allowed to join independent unions. The minimum wage policy was also transformed by delegating the minimum wage fixing process to local level.

Chapter V introduces the minimum wage fixing process in Indonesia. The minimum wage policy was first introduced, albeit for symbolic purposes only, in the early 1970s. The government started to take the minimum wage seriously in 1989 when strong pressure emerged from inside and outside Indonesia to improve workers' conditions. The minimum wage increased substantially during the 1990s (Rama, 2001). However, enforcement was initially weak and strikes occurred because of employers' failure to pay the prescribed minimum wage. The importance of the minimum wage policy was at the forefront again after the 1998 crisis, due to the fall of real wages, and also due to the decentralisation process that delegated the authority to set minimum wage levels to provincial governments. Even though studies on the minimum wage policy had mixed results, some positive (Rama, 1996 and 2001; Islam and Nazara, 2001), others negative (Smeru 2002; Suryahadi et al., 2003; Bird and Manning, 2003), all agreed that the impact of a minimum wage policy benefited white collar workers more than blue collar

workers. Several provinces, that delegated the fixing of minimum wage to district and city level, further complicated the minimum wage policy.

Chapter VI describes the methods used in collecting the information needed in the analysis. It consisted of both qualitative and quantitative methods of data collection. The qualitative method involved semi-structured and open, single and group interviews of respondents involved in the minimum wage fixing process. The analysis included tabulations as well as interpretation from the interviews. Most of the interviews involved elite interviewing of officials and trade union members. The quantitative method, using OLS and 2SLS estimation methods, were used to measure the impact of increases in minimum wage level in 2001 and 2002 on employment. The analysis used multiple secondary data sources to achieve the results. Additional methods were also used to support the econometric models.

Chapter VII explores the post-decentralisation minimum wage setting process and assesses its impact, based on the fieldwork. The fieldwork found that employers were particularly concerned about the 2001 and 2002 increases of minimum wage level. However, the adverse impact on employment and business environment in the study area were mainly caused by decrease in product demand. The minimum wage merely accelerated the adverse impact because many firms, especially those in the TGF sectors, simply could not pay wages to their workers, let alone increase them. In any case, even without the increase in minimum wage, these firms decreased their number of workers. The significant increase of minimum wage level in 2001 and 2002 was designed to make up for the fall in real wages during the crisis. Nonetheless, the increase in minimum wage had little effect on white-collar workers, i.e. those working in the electronics and automotive sectors. Even though there were signs that the significant minimum wage increases in 2002 had made these firms apply some cost saving measures, such as increasing the number of flexible workers, it would be safe to say that the government did not drastically increase minimum wage levels once the minimum wage fixing process had commenced and was running smoothly. Raising the minimum wage slightly was found not to have an adverse impact on employment and also avoided costly industrial conflict with workers.

Chapter VIII measures the impact of minimum wage increases using econometric analysis. It applies OLS and 2SLS regression methods to estimate the employment

impact of minimum wage level increase. In addition, the BGDC methods, based on birth and death of firms, were used to support the regression results. The regression method found that increases in minimum wages in 2001 and 2002 did not provide significant results on the impact of minimum wages. The main reasons for the insignificant results stemmed from several factors such as weaknesses in the secondary data and implications of the minimum wage policy did not significantly affect employment during 2001 and 2002. The BGDC method, however, revealed significant employment changes from 2001 to 2004. Nonetheless, it was not conclusive that employment losses were mainly caused by the minimum wage increases, even though the fieldwork reveals that increase in minimum wages was beginning to bite in 2003.

Chapter IX investigates the links between the minimum wage policy and changing industrial relations in Indonesia. The chapter begins with the legal framework from which the minimum wage policy and other labour issues originate. It also focuses on the impact of minimum wage policy as a whole, as well as the minimum wage fixing process, on trade union activities. The decentralisation of the minimum wage fixing process had opened up new challenges which trade unions could exploit. Tripartite minimum wage fixing could improve workers' abilities to bargain on their own behalf and in the firm where they worked. This type of challenge is exactly what *social dialogue*, part of the *decent work* agenda, is aiming for in the development of grass root or firm level trade unions. Lastly, the chapter also investigates the macro environment, such as relocation and rent seeking, which can affect the way employers respond to minimum wage increases.

Chapter X summarises the results of the analyses of the impact of the minimum wage setting processes in West Java. It focuses on the overall impact of the minimum wage fixing process on employment, workers' participation and trade union development. The chapter also assesses the implication of the minimum wage policy on development, *decent work*, globalisation and decentralisation. Finally, it recommends policy implications and future studies of minimum wages.

Chapter II

Globalisation, *Decent work* and Decentralisation

Most countries and companies see that globalisation is creating enormous opportunities, but also new problems. For almost every country today, the primary struggle centers on globalization issues such as growth, poverty eradication, disease prevention, education, urbanization and the preservation of identity. Developing nations that once feared globalization are beginning to learn how to use it to their advantage. Some countries cleverly combine populist measures with pro-growth policies (Zakaria, 2004).

Introduction

Globalisation affected the world well before the concept became a common usage. Globalisation emphasizes the convergence between economic systems in various parts of the world (Lansbury, Yun and Jamieson, 1998, p. 223). Export-oriented industrialisation (EOI) has become a major globalisation process in many developing countries in Asia, including Indonesia. These were so successful that several Asian countries were referred to as 'tigers' for their successful export-oriented drive towards industrialisation. Unfortunately, there is also a darker side to globalisation. A major concern is that many trans-national firms (TNCs) spread globalisation through low wage production which results in the so-called 'race to the bottom'. To counter the negative effect of globalisation, the International Labour Organisation (ILO) devised a concept called *decent work*. This is defined as work which is carried out in conditions of freedom, equality, security and human dignity (1999, p. 3). Indonesia is a candidate for implementing this *decent work* approach mainly due to the recent democratisation process in which state control over workers has been eased. In addition, the minimum wage policy is not just retained but, as a result of the ongoing decentralisation process, its implementation had been delegated to local government.

The purpose of this chapter is to establish a research question based on the relationship between minimum wages, globalisation, *decent work* and decentralisation. It argues whether the minimum wage policy should be inclusive in the *decent work* concept and should *decent work* be promoted through the minimum wage fixing process at local

level. The chapter initially explains the impact of globalisation on labour. Secondly, it introduces *decent work* as a strategy to cope with the impact of globalisation. Thirdly, it explains the link between labour standards to *decent work*. Fourthly, it introduces decentralisation, both in government functions and collective bargaining, and argues about its link to globalisation. Lastly, it explains the current democratisation and decentralisation process in Indonesia.

Economic Globalisation

Specifically, economic globalisation is characterised by the increasing integration of input, factor and final product markets coupled with the increasing salience of multinational enterprises' cross-national value chain networks (Prakash and Hart, 2000, 2). The world as we know it is becoming one interdependent economic system.

Broad shows another face of what globalisation means:

... this globalisation, which is currently being referred to as something new, is actually capitalism in full bloom. What is being called "restructuring" is capitalism showing its true face. This is the so-called triumph of capitalism, which staved off historical struggles for civil, political, and social rights—by struggles for the welfare state. We have heard a lot in recent years about privatisation and deregulation, which really amounts to the re-emergence of a trend that has been part of capitalism from its beginning—"the commodification of everything" (1995, p. 3).

Globalisation means, amongst other things, global competition, global flow of capital, global manufacturing and global movement of labour. However, globalisation is more striking in the realm of money and finance than any other factors of production. Capital enjoys less restriction as it moves globally.

Others, like Navarro (1998), also contend that globalisation is not just about free movement of capital, but also economic regionalisation. Many economies are now interconnected together (Herod, 1999, p. 1782). As an example, the European Union has practically become one economic entity by using a common currency, the Euro. Other countries have participated in regional economic blocs, such as NAFTA in North America, APEC in the Asia Pacific and MERCOSUR in South America in order to boost regional economic cooperation. Nevertheless, Walker also stresses that even

though globalisation may have internationalised trade, local economic systems still pursue their own development paths (1999, p. 265).

One aspect of globalisation that has drawn attention is its effect on governments' development strategies. Economic strategies are argued to benefit the global economy rather than national economic development strategies (McMichael, 1995). While it has not necessarily caused the weakening of governments, globalisation could influence a government's intervention in the national economy to suit its dependence on the global market. Singapore is one of the most globalised countries in the world and government power has not been inhibited (Brown, 1998). In fact, some like Deyo (1987) argue that to some extent or another, governments in the newly industrialised countries (NICs) do have significant impact on their own economic development. Countries like Indonesia follow the neo-liberal economic policies by deregulation and privatisation in which state control of the economy was decreased (Liddle, 1996). However, state control over civil society, such as control over its workers tends to increase.

Impact of Globalisation on Labour

While globalisation has made capital more mobile than ever before, its impact on labour is certainly open for debate. President Clinton made a controversial remark to the ILO Conference (1999) and previously at the 1998 WTO Conference in Geneva (cited in Dionne Jr., 1998; United States Embassy 1999) in which he pointed out that that globalisation needs a human face. The reference to the term human face is a more responsible globalisation with respect to social and environmental protection. Others, like Korten (1995) and Martin and Schuman (1997), were especially critical of globalisation in which they argued that this globalised world had created fewer places for people. Without a doubt, although globalisation puts tremendous pressure on labour and the environment, it also creates some benefits to workers.

Proponents argue that globalisation has created many jobs in developing countries, as well as increasing labour mobility between countries. Rama concluded that globalisation, through trade liberalisation, might in the long run prove positive for wages (2003, p. 182). However, he did admit that globalisation might have negative effect in the short and medium term, especially to old and unskilled workers, due to a

decline in wages and increased unemployment. Arguably the best example of the impact of globalisation on employment is foreign direct investment (FDI) and export-oriented industrialisation (EOI). Chudnovsky and Lopez contend that, under certain conditions, FDI contributed to the host country's competitiveness and the fulfilment of sustainable human development objectives through innovative activities and technological spill over, employment creation, poverty alleviation and income distribution (2002, p. 45-46). Nonetheless, they also added that FDI might also create negative impact through diminishing competitiveness of local firms and exploiting natural resources, crowding-out local competitors or engaging in distorting practices (Chudnovsky and Lopez, 2002, p. 48).

Opponents identify three main contentions in which globalisation has a tremendous impact on labour. They argue that globalisation tends to create:

1. A 'race to the bottom' where global firms transfer industries from countries with high levels of wages, taxation and regulation to countries with lower levels (Prakash and Hart, 2000, p. 36).
2. Growing insecurity of work (Standing, 1999; Walker, 1999)
3. The weakening of trade union power in developed countries (Clarke et al., 1998).

In the so-called 'race to the bottom', corporations would seek out countries with low labour and environmental protections that would result in lower production costs (Korten, 1995). The industries transferred to the periphery are mostly the TGF (textile, garment and footwear) industries and assembly for electrical, automobile, or computer chip industries (McMichael, 1996, p. 96). Opponents have argued that globalisation tends to create the so-called 'race to the bottom' where global firms transfer industries from countries with high levels of wages, taxation and regulation to countries with lower levels (Prakash and Hart, 2000, p. 36). Globalisation has not only created low paid labour but also caused an enormous instability in the labour force and worsening living conditions for the majority of the population in third world countries (Navarro, 1998). The welfare of workers, especially vulnerable workers, has been declining in the integrating world economy (Mehmet, Mendes and Sinding, 1999). Globalisation, as the transformation of capitalist development, has produced or accelerated the degradation of labour, which includes casualisation, feminisation, marginalisation and peripheralisation

of labour (Pearson, 1994; p. 343; Broad, 1995, p. 3) or what others referred to as flexibilisation of labour (Standing, 1999; Oxfam International, 2002)¹. Flexible workers receive less job and income security than that accorded to regular workers. Instead of improvement, workers now suffer more insecurity and more widespread unemployment than ever before, in addition to greater income inequality (Walker, 1999, p. 263).

The strategy of export-led industrialisation (EOI), adopted in many developing countries in Asia, is a prime example of the ‘race to the bottom’ as well as the growing insecurity of work. Oxfam International reported that export growth, especially manufacturing, was limited to mostly East Asia. High-volume export products were of low quality, many high-technology exporters were entering world markets on the basis of low wage, low skill assembly work rather than through innovation and technological upgrading (2002, p. 71). Others, such as Deyo (1987), suggested that the development path of EOI requires the state to rule in favour of the capitalist class over the working class. The EOI strategy takes advantage of the abundant low cost labour supply. The state, in turn, provides the political institutional machinery to keep labour costs low and stifle workers through control of labour movements. According to Deyo, EOI has led to the political marginalisation and repression of labour via state control over labour unions and workers. In addition, as developing countries compete against each other, social protection such as the minimum wage policy has been relaxed (Oxfam International, 2001, p. 190). The condition is even worse for women workers, due to the fact that many do not receive even a meagre minimum wage: in effect minimum statutory wages have become the maximum wage. Yet the EOI strategy has been successful, in terms of economic growth, to countries such as Korea, Taiwan, Hong Kong and Singapore. The system has also been adopted to great effect by ASEAN countries, such as Indonesia, China and more recently, Vietnam.

TGF-based industrialisation, a key component in the EOI development, which indeed at first seemed like a development planner’s dream (with every new factory creating

¹ Flexibilisation not only refers to flexible jobs such as part time employment, but also includes flexible time at work where workers only work and are paid on demand. This means that workers do not have job and income security because their work is based on fluctuations in demand for the products being produced. This is not to be confused with a flexible labour market. Egger and Sengenberger (2001) define labour market flexibility as lower cost and higher speed of adjustment in the labour market to changing conditions in the economic cycle. Oxfam International (2002) define as ‘good’ flexible labour market as a condition where it would be easier for workers to move from one job to another, as opposed to a ‘bad’ flexible labour market where employers can easily fire workers to make way for new ones.

between two and seven thousand jobs, at very little cost to the government beyond provision of basic infrastructure), can become a development nightmare if countries such as Indonesia can only achieve it by falling over each other in the attempt to offer low wages in Asia (White, 1993, p. 137). Though this type of industrialisation created numerous jobs in the short run, workers would bear the long run cost as these types of TNCs tend to move on in search of other countries with lower wages. Moreover, the boom goes hand in hand with corruption, political repression, massive environmental destruction and, often, extreme exploitation of a labour force with (little or) no rights (Martin and Schumann, 1997, p. 145).

In developed countries, the obvious effects of globalisation are unemployment and under-employment as industries are transferred from developed countries to the developing countries. Walker also states that workers are engaging in extra jobs and inequality between skilled and unskilled workers increased (1999, p. 264). Manufacturing jobs have been lost from developed countries due to outsourcing to developing countries and also due to the shift from low to high productivity jobs (Doorman 1998; *Yahoo News*, 2004). By transferring to third world countries, industries are ensured of low cost production due to less labour and environmental protection. In addition, in the post-industrial society, trade unions have been weakened due to globalisation and neo-liberal economic regimes as employment declined in industries where trade unions were strongest.

Walker (1999) tended to blame this development on the weakening of labour generally, as well as the failures of global capitalism. Defeat of pro-union political parties in the US and Europe contributed significantly to the weakening of labour power (Barnet and Cavanagh, 2000, p. 311). During the neo-liberal regime that dominated US trade policy in the 1980s, capitalists were able to weaken the collective strength of trade unions by court actions, the inaction of trade unions themselves and de-regulation of labour market policies (Clawson and Clawson, 1999). In neo-liberal economic regimes the power of the state is significantly reduced by de-regulation and privatisation in many sectors, such as the financial sector and the labour market. Neo-liberalism's agenda, based on the neo-classical principals of economic liberalisation, free trade and open markets, has provided intellectual support for the integration of international markets in the interests of these trans-national corporations (Brohman, 1995, p. 134). This was

particularly evident during the Reagan and Thatcher years. Even in developing countries such as Indonesia, governments were enticed to deregulate their economies to make way for capitalism (Manning, 2000). There were also indications that as profit and re-investment increased for capitalist productivity the real wages of workers were not rising and were, in some cases, actually falling (Walker, 1999, p. 264).

Despite Clinton's controversial speech, can globalisation be more responsible, especially with regard to social protection, or is his speech just empty rhetoric designed to justify the continuous and seemingly unstoppable progress of economic globalisation itself? How do trade unions in developing countries expect to develop under globalisation when their counterparts in developed countries are experiencing a decline? How can workers' real wages be improved if globalisation compels countries to keep wages low to compete in the global economy? Answers to these questions depend on how countries cope with the inevitable march of globalisation.

Responses to Globalisation

In recent years however, responses to globalisation have emerged, especially in terms of environmental and labour protection. There are two kinds of social responses to globalisation concerning labour: a radical and a conservative response. McMichael (1995) presented several social responses to globalisation such as rejection through fundamentalism and coping strategies such as social protection and sustainable development. Fundamentalism is outside the context of this thesis. A coping strategy is still entrenched under the framework of the present globalisation but calls for more re-regulation rather than de-regulation of economic activities. Re-regulation in the form of social policies might be needed to avoid or counter the negative effects of globalisation.

One such social protection is the introduction of a social clause that calls for the harmonizing of core labour standards into world trade. One of the ongoing efforts of the global fair trade campaign has been to impose core labour standards on world trade. Ardon (2002) even suggested that a global minimum wage should be set to minimise mass migration. One of the consequences of globalisation is migration of people from developing countries to developed countries looking for better jobs, the guarantee of better social protection, and decent wages. At the World Economic Forum, interest groups discussed the concept at the World Trade Organisation (WTO) general meeting

in Dubai (ICFTU, 2001). The failure of interest groups to link core labour standards to international trade and investment has not diminished attempts by labour and non-government organizations to lobby for these standards (ICFTU, 2001). However, many scholars, proponents as well as opponents, were sceptical whether standardised social protection, such as applying core labour standards, could be applied on a global scale when many countries have different stages of development. From an economic perspective, labour standards constitute imperfections in the global market. Economists such as Bhagwati (1995) reject the very idea of labour protection because it distorts the natural function of the labour market. He also perceives linking labour standards to international trade as protectionism that could cause developing countries to lose their competitive advantage. Protectionism is deemed counterproductive because it is costly and saves few jobs, and is not beneficial to the world economy (de Wet, 1995, p. 3).

On the other hand, an imperfect market is exactly the nature of the market in many developing countries. Rent seeking is an important feature in many developing countries' economic development, whether it is corruption, participation of labour unions in collective bargaining or imposition of large increases in minimum wage levels. In economic terms, rent seeking basically means monopoly (Eatwell et al, 1987, p. 147). In a developing country such as Indonesia, corruption is probably the worst form of rent-seeking in terms of lost resources that can be used for other productive activities. Indonesia has recently been considered as the sixth most corrupt country in the world (*Kompas*, 2003a). It is a chronic problem which has persisted with the implementation of the decentralisation process. The pressure for regional governments to generate their own income with little assistance from the central government also aggravated the rent-seeking problem. Not only did the process cause an explosion of new taxes and levies as well as new regulations at local level, it also added more rent-seeking practices which commonly accompanied implementation.

Social protection for labour means introducing better labour rights and standards, such as better working conditions, rights of association and collective bargaining, and decent wages. Scholars such as Blowfield (1999) and Barrientos (2000) propose fair and ethical trade movements promoting social protection through the improvement of labour standards. ILO also proposes something similar called *decent work* in which labour standards should be respected. This involves private sector initiatives through sourcing

of products from firms guaranteeing core labour standards to their employees. While in some aspects fair and ethical trade may be a more humane and environmentally friendly way of conducting business and may be successful on a smaller scale, it is not guaranteed success in the global capitalist world where cut throat competition is a daunting challenge.

Revisionist economists, though they also reject the idea of social clause, insist that protection through labour standards is a good ingredient for economic and social development (Sengenberger, 1994, p. 20). This view is shared by others such as Stiglitz (2001). In his speech, during the International Labour Organisation's (ILO) *Labour in a Globalised World Conference*, he suggested that if development is broader based, then we must pay at least as much attention to workers and their security, as well as capital accumulation (1994, p.11). He added that equitable, sustainable, and democratic development requires basic labour rights, including freedom of association (1994, p. 16). Reich (1994 cited in Levine, 1997, p. 216) also concurs with this view and suggest that the imposition of labour standards should also consider the development stage of the country. Thus, it falls on national governments to apply the right combination of political will together with labour and macro-economic policies in order to pursue a higher road of development. Basic rights, including workers right to freedom of association, the right to organise, and the right to decent wage are part of the overall paradigm of *decent work* envisaged by the ILO.

The Concept of *Decent Work*

The official concept of *decent work* was first introduced during the 1999 keynote speech of the current ILO secretary general, Juan Somavia (ILO, 1999). He defined the concept of *decent work* as work which is carried out in conditions of freedom, equity, security and human dignity (ILO, 1999, p. 3). Since its inception, *decent work* has gained ground in the Southeast Asia and the Pacific regions, particularly in relation to the overall national agenda for reducing poverty and generating employment opportunities (*Scoop*, 2003). *Decent work* has now become ILO's goal for fair globalisation (ILO, 2004). The Philippines was the first country in Asia to promote the concept of *decent work* (*Dole News*, 2002). The *decent work* approach to development stems from the framework of right-based thinking. Sen describes it as a framework that extends from the pure

domain of legality to the broader arena of social ethics (2000, p. 123). *Decent work* involves providing more stable incomes and productive employment, allowing people to meet their basic needs and those of their families (Scoop, 2003). *Decent work* actually reflects ILO's conventions on labour rights and standards. It includes workers rights, such as freedom of association, the right to a living wage and abolition of child labour. In addition, *decent work* not only includes those who work, but also those who are looking for work.

Since it was introduced in 1999, the concept of *decent work* has been the main theme of ILO's drive for economic and social development. The concept of *decent work* is basically to provide new decent jobs for everyone in the world, as well as increasing the quality of existing jobs. In addition, *decent work* also strives to help alleviate poverty via the provision of quality jobs. Ghai (2003, p. 113) enumerates the four components of *decent work*:

1. Employment
2. Social Protection
3. Workers' rights
4. *Social dialogue*

Decent work appears to complement economic globalisation rather than be against it. Fields (2003) agrees that economic growth is needed to provide more jobs and could eventually increase the earnings of workers. However, *decent work* was designed to remedy the negative impact of globalisation by providing some sort of protection to all workers, including women and children. This is reflected in the last three components: social protection, workers' rights and *social dialogue* which are all designed to provide security to workers from the exploitative nature of globalisation.

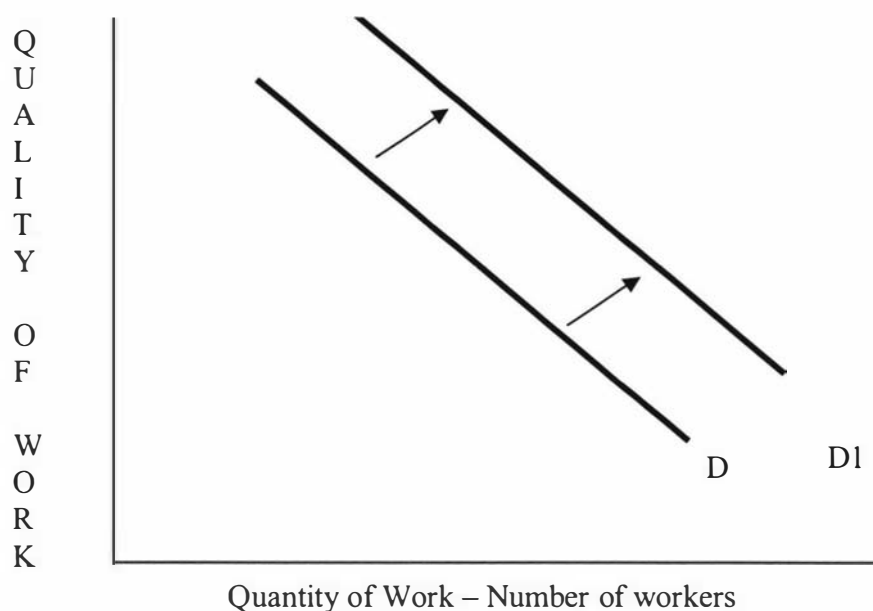
This means that *decent work* applies to all workers, whether they are in the formal or organised sector, those who reside in the informal sector and even those who are actively looking for work. The initial drive was to promote core international labour standards, i.e. freedom of association and the right to collective bargaining in addition to elimination of forced and compulsory labour, child labour and discrimination in employment or occupation. In terms of a development goal, *decent work* could promote the maximisation of both the quantity and quality of work (Fields, 2003, p. 249). With

respect to this thesis the discourse is limited to *social dialogue* due to its relation to the minimum wage policy.

Decent Work Frontier

According to Fields (2003), *decent work* incorporates both the quantity and quality of work in which core labour standards are respected. Figure 2.1 shows the trade-off between employment and earnings in the *decent work* frontier. The idea is that public policy must be geared at increasing both earnings and employment as depicted by the shift of demand for labour from D to D1. The shift means that an increase in the number of jobs or employment is followed by an increase in the quality of work, such as higher wage, better working conditions and so on. It would be tantamount to the so-called 'high road to development' in which higher technology ensures higher pay and better welfare for workers. The quality of work, depicted in Figure 2.1, includes not just an increase in wages but also better working conditions, job security and a willingness to negotiate for better conditions.

Figure 2.1 *Decent work* Frontier Model of Increasing Earnings and Employment



Source: Fields (2003, p. 245)

According to Reich (2002), the challenge for government of *decent work* can be short term and long term. In the short term, he proposes expansionary and monetary policies to create an abundance of decent jobs. He adds that *decent work* should be an important condition for achieving a political consensus in favour of opening national borders (Reich, 2002, p. 120). This could mean that governments should allow only those TNCs that tend to provide jobs that conform to the *decent work* requirements, such as freedom of association and minimum wages. In the long term this would mean adequate education and training, better labour market flexibility and the positive aspects of global economic integration would continue by providing better jobs for everyone. Nevertheless, with regards to labour standards such as (minimum) wages and working conditions, Reich admitted that such standards could not be applied uniformly across countries because different countries might not be able to afford such uniform standards.

This summation was also correct from the point of view of the employers. They also surmised that *decent work* should first take into account the creation of employment opportunities and it would be conditional upon the adequate level of sustainable economic development and capacity (IOE, 2002). While acknowledging that the *decent work* paradigm is a worthwhile objective, national capacities must be taken into account and the result in the balance of economic and social development needs to be achieved through a competitive national economy (IOE, 2002, p. 8). *Decent work also*, in the first instance, requires the creation of employment opportunities (IOE, 2002, p. 1). Other *decent work* objectives, such as applying core labour standards, would depend on the affordability of each country to implement them. Thus, a national government plays a crucial role in creating an environment conducive to the creation of quality employment, as envisaged by the *decent work* concept. It is a challenge that national governments must undertake to make *decent work* a realistic development objective in the face of increasing and inevitable global competition.

Decent Work as a New Paradigm

Decent work does not appear to constitute a paradigm shift for development, but rather compounds several ingredients of approaches to development. It does not reject globalisation, but rather provides safety mechanisms to prevent and remedy any danger

ensuing from globalisation. Basically, it is a rights-based approach to development (Egger and Sengenberger, 2001, p. 9). However, it also mixes previous development approaches such as economic growth, basic needs and albeit, empowerment². *Decent work* is also consistent with the core values of development. According to Todaro (2000, p. 16) the core values of development are:

1. Sustenance- the ability to meet basic needs
2. Self esteem
3. Freedom

Basic needs have been used to justify the imposition of the minimum wage. Increasing a worker's capability to meet basic needs requirements could improve a worker's self esteem and may improve productivity. Freedom of association ensures workers a collective voice to negotiate for better conditions and even avoids costly confrontation. Recognising the ILO Convention on workers' rights would be the first step in this direction.

The self-esteem and freedom concept are consistent with the notion of freedom of association and collective bargaining where the minimum wage is inclusive. The ratification of the ILO Convention on freedom of association guarantees freedom of choice for workers to join any labour unions, independent or otherwise. Cognizant of this, Law Number 21, 2000 in Indonesia even stipulates that workers could set up their own labour union with a minimum of ten members. During the New Order regime workers were allowed to join a union; that right was only limited to a one allowable state-controlled union, the SPSI. At present, workers not only have these rights, they have also been allowed to negotiate minimum wage levels at local level via their representatives in the labour unions. What the workers lack now is their ability to bargain collectively for better working conditions.

Another author argues that the *decent work* approach also has a positive effect on the overall human development of a country. Ahmed (2003) entertained the possibility that

² The researcher surmised that decent work takes into account countries that already allow independent trade unions to flourish. As we can see later on in the chapter, South Korea and several European countries provide some examples of social dialogue, an important component of decent work in action. Empowerment here, according to the researcher, meant the ILO has implemented programs that assist trade unions to properly use their new found rights to improve welfare.

the *decent work* policy can contribute to human development, as measured by the HDI (Human Development Index). Indeed, increasing both the number of jobs and the quality of those jobs in terms of increased earnings, *vis a vis* the minimum wage, and improving working conditions are important ingredients for a good life. It is especially important to Indonesia because human development in Indonesia has recently declined. Human development, which is based on the calculations of HDI, measures the average quality of life of a person in a given country. UNDP in 2003 reported that Indonesia's HDI ranking had slipped slightly from 110 to 112, out of 175 countries (*Kompas*, 2003b). Kwik Kian Gie, the minister of development planning for Indonesia under Megawati presidency, cited the reason for the low quality of Indonesians was the fact that past development strategies focused solely on economic growth without concern for improving the quality of life (*Kompas*, 2003b).

Social Dialogue in Decent Work

The *decent work* approach to development appears to originate from attempts of *social dialogue* by a number of European countries. *Social dialogue* is defined by the ILO as all types of negotiations, consultations, or simply exchange of information between the representatives of governments, employers and workers on issues of common interest relating to economic and social policy (Islam, 2001, p. 314). Under *social dialogue*, employee participation was to increase through some form of institutional arrangement enabling employees and their representatives to participate in the decision-making process within the workplace (Bridgford & Stirling, 1994, p. 135). There are three stages to employee participation:

1. Access to information
2. Consultation, and
3. Co-determination or joint decision-making (Bridgford & Stirling, 1994, p. 135).

Based on the experience of a number of European countries, such as Germany and Sweden, the concept of *social dialogue* demands the establishment of a so-called 'works council' in which all workers are represented. The 'works council' is formed through state legislation (Bridgford and Stirling, 1994). In light of the continuing process of economic restructuring through flexibility of labour, the 'works council' is crucial

because it includes not just the unionised sector but also representation from non-unionised or non-regular workers. Thus, the interests of all workers can be represented in the 'works council'. The name itself is not standard as South Korea adopted a different name, labour-management council (Park and Park, 2000). In developing countries in the Asia Pacific region such as Indonesia and the Philippines, *decent work* has only recently been introduced (*Dole News*, 2002; *Scoop*, 2003).

With regards to the United Nations Millennium Development goals (MDG), *decent work* is part of the goal number 8 on developing a global partnership for development, and target 16 which is to develop and implement strategies for decent and productive work for youth (United Nations, 2005). However, the focus of the goal is mainly to provide decent employment opportunities for young people and does not appear to extend to minimum wages or trade unions. The target is also likely to be of less priority compared to the other goals and targets of MDG, as evident by the recent UNDP report on its progress.

Labour Standards

The implementation of core labour standards is the key start-up component of the *decent work* approach to development. Without these key components, the *decent work* agenda might not be an achievable objective. Labour standards or rights based on the ILO's conventions cover five broad areas:

1. The right of association
2. The right to organise and to bargain collectively
3. The prohibition of forced labour
4. Effective abolition of child labour
5. Acceptable conditions of work with respect to minimum wages, hours of work, and occupational health and safety³.

The prohibition of forced labour and minimum age for the employment of children will not be discussed in this thesis. The right of association and the right to organise and to bargain collectively are related to the establishment and development of trade unions.

³ Levine (1997) breaks down labour standards into two parts. The first is labour rights which include the right to organize, the right of association, collective bargaining, female labour, child labour, forced labour and termination rights. The second concerns labour standards which are interconnected with labour rights, but it also includes working conditions such as minimum wage, maximum hours of work, fringe benefits and occupational safety and hazard.

Minimum wage may be indirectly related to the establishment of trade unions because trade unions can also act as enforcement agents for the implementation of labour policies. These issues formed the core of the analysis due to its increasing importance in Indonesia as it enters the realm of increased regional autonomy. Indonesia appears to be the only country in the Southeast Asia region that fully ratified all core ILO conventions in 1999 (Islam, 2001, p. 313). As explained in the latter part of the thesis, increased regional autonomy has also given local government, especially at district level, considerably more authority to handle labour issues. More freedom given to labour unions has also changed the way in which regional government deals with labour unions on labour issues, such as increases in minimum wage.

There are two contrasting views on the merit of labour standards: one view states that labour standards create distortions in the labour market by increasing costs, and another view is where labour standards are considered necessary for sustainable and balance development. Neo-classical economists have been the strongest critics of the imposition of labour standards on labour policies. They argue that labour standards, such as minimum wage and collective bargaining, misallocate labour, waste resources through rent-seeking, impair adjustments to economic shocks and deter investment, thereby reducing growth (Freeman, 1993b, p. 119). Labour standards create distortions in the labour market because employers are not able to maximise profit due to increased costs. Eventually, employers need to shed labour or devise other cost saving means to keep cost down or to re-locate elsewhere where labour cost is lower.

On the other hand, proponents argue that labour standards are considered as a pre-requisite for sustainable and balanced economic development. Sengenberger (1994) contends that development, as the ultimate goal of restructuring, should be balanced and sustainable. Balanced (social and economic) development means that the goal is to coordinate activities and develops resources cooperatively, to the mutual benefit of all units, and with a view to equalising the chances of long-term development in order to promote social cohesion. Labour market regulations, particularly the setting of an effective minimum wage and working conditions throughout the economy, are an essential requirement for a balanced development (Sengenberger, 1994, p. 35). Sustainable development means that development should produce desired outcomes not merely in the present period of time, but in subsequent periods as well. With regard to

workers, labour standards can be used to keep them content so that production can be carried on continuously.

Labour standards are highly valued by social economic revisionists who favour state interventions in the labour market. They argued that a modest increase in minimum wage has little effect on employment (Card and Krueger, 1995, p. 9). Freeman (1993a) stresses that there is no significant evidence that interventions in the labour market, such as minimum wage and other labour standards are major impediments to resource allocation, structural adjustment, or stabilisation programs even though, in some cases, they do incur significant costs. Labour standards could enhance mass purchasing power and political stability, thus promoting development (Levine, 1997, p. 213). Political stability is a formulae badly needed by the current administration in Indonesia in order to pursue economic and social development. Other writers such as Navarro (1998) provide evidence that regulated labour markets are successful in producing jobs and lowering unemployment.

Attempts have been made to integrate the core labour standards into the world economic system. The recent WTO meeting in Doha in 2001 has proven that the pressure to include core labour standards, such as freedom of association in the global economic system is so great that developed countries have reconsidered their position with regards to labour (ICFTU online, 2001). Even though the lobbying failed to include labour standards in their policies, there is an increasing pressure to address labour rights at national level. However, economists such as Bhagwati (1995) disagree that a social clause of core labour standards should be included in the WTO policies, arguing that there would be a campaign of protectionism from proponents in developed countries. He emphasizes that labour standards create distortion in the labour market and makes developing countries lose their competitive edge in the world market. Sapir (1995) concluded in his study that the ethical and economic issue of labour standards, especially in developing countries where labour standards are low, are development issues that should be addressed by development policies instead of standardising labour standards in world trade.

Freedom of Association and Collective Bargaining

Freedom of association and collective bargaining, which are enshrined in the ILO's Convention Number 87, are important prerequisites for a strong labour movement and participation in the *decent work* approach to development. A trade union, whether it is independent or federated, as the product of these conventions, is crucial in the analysis of minimum wage impact because it is an important player in industrial relations. It is an institution that negotiates for better wages and could effectively enforce the implementation of minimum wage policy. Trade unions routinely support minimum wage legislation and unionised workers normally have wages higher than the mandated minimum wages for non-unionised workers (Pencavel, 2002, p. 20). However, the right to join unions are perceived by neo-classical economists as rent seeking, thereby distorting the natural function of the labour market. In addition, unions are said to prevent the unemployed competing for unionised jobs (Mehmet et al, 1999). Nevertheless, others also argue that independent trade unions can make the economy more dynamic. For instance, trade unions can be seen as the best mechanism for enforcing other labour standards such as minimum wage. Another reason is that unionised workers are often more productive than non-unionised workers (Mehmet et al, 1999, p. 95).

Due to their influence in collective bargaining, labour unions can affect wages in various ways. Pencavel (2002) explains that trade unions tend to push wages above the level that would be obtained in their absence, including wages of non-unionised workers. A wage gap is created because of wage differentials created by union bargaining. However, wages in non-unionised firms may also increase as a result of the union wage push. This is called the 'threat effect' of unions, where firms increase the wages of workers as incentives not to organise themselves. In the case of minimum wage fixing, unions can influence the level of increases in regional and even sectoral minimum wages.

The main issues of labour standards dominating developing countries, and in some cases developed countries, are the establishment of independent trade unions and minimum wage legislation. This standard is listed under Convention Number 98 that guarantees the right to organise and bargain collectively, and Convention Number 87 that gives workers the right of association. In the case of developed countries, labour

unions are showing signs of life after being under pressure from neo-liberalism and now globalisation. In the United States, for example, unionised workers declined from 35 percent of the American workforce to less than 10 percent in the 1990s (Reich, 2002, p. 117). While the share of unionised labour in the workforce has been declining in many industrial countries, at least partly as a consequence of the increasing share of services in total employment, it has been rising in developing countries because of greater industrialisation and democratisation (Devarajan, Ghanem and Thierfelder, 1997, p. 145). Several other reasons for the decline in developed countries include intensified employer opposition and erosion of traditional strongholds (Reynolds, Masters and Moser, 1998, p. 379). In addition, there are also other causes such as the rise in flexibility of work, non-standard employment and work restructuring (Standing, 1999). The decline may also be attributed to the transfer of capital from developed countries to developing countries in search of lower costs. Even though studies show that unions did not drive firms to bankruptcy (Freeman and Kleiner, 1998), membership of unions has been decreasing for some time in the US. However, there are now signs that trade unions are active again due to community organisation and alliances with other social organization (Clawson and Clawson, 1999).

In developing countries there have been, until recently, limited or non-existent rights to organize and the right of association. In South Korea, for instance, the government has only recently become more tolerant of independent trade unions. Organised labour has now become a critical factor in South Korean society (Lansbury, Yun and Jamieson, 1998, p. 223). There was exploitation of workers prior to 1997 that affected not just women and children but also other workers as well. Thus, contrary to the declining importance of trade unions in western society, independent labour unions in some developing countries are just beginning to develop.

In Indonesia the development of trade unions has become an important part of the country's stabilisation effort. Labour movements are no longer restricted to a single state-controlled union as in the past. Thus, instead of liberalising labour regulations, the government has tried to achieve industrial peace by increasing mandated benefits, especially minimum wages (Devarajan et al, 1997, p. 164). In addition, the government often uses the police and the military to intervene in industrial disputes. This strategy may have succeeded at first, but it only increased the frustration of workers and

consequently made conflict more costly. The massive strikes of 1994 bear witness to this argument. But as long as Indonesia's leaders continue to promote industrialisation, the working class is likely to expand and become harder to contain through coercion alone (Liddle, 1999, p. 6). Presumably, it would be more appropriate to combine limited state intervention with assisting the development of trade unions to be independently capable of collective bargaining.

Brint proposes several variables which are good ingredients for promoting stabilisation by organisational development and collective bargaining for trade unions. These variables are:

1. Stabilisation of the labour movement
2. Stabilisation of leadership
3. Acceptance of unions by the management
4. A political party that supports the labour movement
5. State intervention and the setting up of dispute resolution policies (1998, p. 169).

After the fall of the New Order regime in Indonesia, the government moved away from the total control of the labour movement and embarked on a more egalitarian approach to industrial relations, by including all five approaches, in order to minimise strikes. The researcher argues that even with an egalitarian approach the government should continue to hold the reins and monitor the development of labour relations. A free rein might jeopardise the sustainability of the minimum wage policies and procedures. A vigorous pursuit of the minimum wage policy would be unlikely to be sustainable in the long run. As Bird and Manning commented, "...a more realistic balance between labour protection and employment growth is essential for sustained creation of better jobs in a developing economy" (2002, p. 15). This balance is crucial for the implementation of a *decent work* framework. It could include the proper implementation of the minimum wage policy and the organisational development of labour unions and collective bargaining without sacrificing the need of other workers, such as those in the informal sector and new entrants to the labour force.

The development concept propounded by the ILO is also implicitly similar to Indonesia's current development goal of increasing employment opportunities, as well as increasing wages and allowing freedom to organise (Bappenas, 2004). Under the current development goals, the government must combine capitalist development policies with popular policies. It is important to note that, with the recent ratification of the ILO Convention Number 87 on the Right of Association, the government has now honoured the existence of independent labour unions and is paving the way for their development. It is safe to say, that in terms of achieving the goal of *decent work*, the government's development path would be a high road to economic and social development. It is the government's fundamental obligation to increase the demand for quality of employment. The minimum wage policy could be used as a symbol of quality employment by promoting the safety net wage as a standard for poverty alleviation.

Re-regulation of Labour Policies

Decent work is a workable objective if a country's labour policies support workers' rights to protection and equitable employment. The re-regulation of labour policies means that governance from the top might be required to cope with the negative effects of globalisation, i.e. prevent 'race to the bottom' (Spar and Yoffie, 2000). In the past, governments altered labour policies on the side of capitalists through labour control. Labour control has been an important pre-requisite for a development strategy that centres on manufacturing for world markets (Deyo, 1987, p. 191). In the NICs of Korea, Taiwan, Singapore and Hongkong, labour control has been obtained to a certain degree, from labour repressions or a more benign corporatist labour policy. In Indonesia, the New Order Government under Soeharto was able to overcome significant structural, social and political structural obstacles to development by a deliberate strategy of combining pro-market policies with a powerful and stable political base (Liddle, 1999, p. 236). While there is no question that this choice of policies achieved stunning success in terms of economic growth and income distribution, it came at the expense of workers' welfare. The development policy also incorporated restrictive labour policies in order to open the way for global capitalism. The political power of the unions was disrupted through restrictions on unions' rights to strike and disallowing independent unions (Levine, 1997, p. 212). The minimum wage policy was at first more of a symbol

rather than it being implemented adequately for workers. Eventually, though, political pressures forced the government to belatedly apply it to some measures.

Pressures from below can also force governments to re-regulate labour policies towards workers' interests. In South Korea, for instance, government intervention has been more prominent in the industrialisation process, during the early stages of the export-oriented industrialisation. Governments can reverse that role by concentrating on economic and political stability rather than economic growth. This is what occurred in Korea where the government switched from the main development goal of economic growth to stability. Despite the political marginalisation and outright repression of East Asian workers, the chosen export-oriented development strategy has fostered efforts to maintain low labour costs, but its structural consequences have been precisely the opposite: it has brought economically marginalised families into the developmental mainstream (Deyo, 1987, p. 243). This development strategy led to the increasing number and influence of the industrial working class. However, the strategy came at a price. South Korea's trade unions were forced to affiliate with the single worker's Federation of Korean Trade Unions (FKTU) (Deyo, 1987, p. 185). By amalgamating into this form of government-controlled union, for all practical purposes, the union's political clout has been greatly diminished. However, their collective voice has been strengthened by informal means, such as through NGOs.

Even though labour repression was compensated by increased worker's benefits, it was likely that this repressive measure was partly responsible for labour unrest and the strengthening of the collective power of the South Korean industrial working class. The explosion of labour unrest in 1987 stood as evidence that wage and employment gains were not enough to satisfy the needs and aspirations of South Korea's expanding industrial workforce (Lindauer, 1997, p. 7). These strikes and demonstrations made the government re-think their position on labour policy. Since 1987, unions have become a powerful institution in South Korea's labour-management relations, and collective bargaining became an important institution for improving the working conditions of both union members and general workers (Park & Park, 2000, p. 81). Furthermore, the government has also been paying more attention to labour conditions and freedom.

In many ways, the labour situation in Indonesia mirrored that of South Korea. It had the same result as in South Korea, bringing marginal families into the development mainstream. It also created a capitalist class of conglomerates and an urban industrial working class, although the latter were still small compared to the total labour force. During the Soeharto regime, Indonesia eventually mimicked the NICs development path by embarking on the neo-liberal economic regime of export-led orientation, followed by de-regulation in the financial sector. It also used repressive labour control to provide the economic engine with low cost labour. As in Korea, labour unions were also forced to amalgamate under the umbrella of the All Indonesia Labour Union (SPSI). Independent unions not affiliated with this one were considered illegal. Strikes were banned because it was against the *Pancasila* principle of industrial relations⁴.

However, this policy of industrial peace did not last long. Workers' strikes had worried the government so that an amendment designed to cut back on workers' rights was put on hold (Far Eastern Economic Review, 2002). The government altered the policy of maintaining industrial peace by invoking the once symbolic minimum wage policy and providing workers with social security benefit and at the same time still restricting labour freedom. Union participation was restricted to a single state-controlled union and the minimum wage was initially set up as a mere symbol. Nonetheless, White argues that it was lack of enforcement as well as management labour strategies which created the conditions of labour unrest which then made potential investors look for other poor countries in which to place their factories (1993, p. 136). The situation changed somewhat during the 1990s, when the government pursued the minimum wage policy with more urgency and, though still considered illegal, allowed several independent unions to operate on a limited basis.

The fall of this regime also opened the door to more labour freedom. In Korea, democratisation took place in 1987 and dismantled the authoritarian regime, characterised by the state's interventionist labour policy and this led to explosive growth in labour movements in the late 1980s (Lee, 2004, p. 83). Indonesia was experiencing the same profound changes to its industrial relations in 1998, after the fall

⁴ The *Pancasila* industrial relation posits that industrial disputes should be settled by consensus, not by strikes (Simanjuntak, 1993). Capitalists were supposed to act as father figures and the workers as children. Thus, strikes were deemed illegal and strike leaders were considered communist sympathisers by the authorities and usually intimidated and/or arrested.

of Soeharto. Even though in general they were still weak, unions had the capacity to create social disruption. Through labour standards, such as freedom of association, basic needs provision, and even the inclusion of unions to participate in formulating national labour policies, development started building from the bottom-up in line with the discourse of grass root development. Consequently, consistent with the *decent work* discourse, the government took an active role because the *decent work* approach to development calls for increasing the demand of better quality jobs. In addition to increasing and maintaining job quality in the formal sector the government must also provide as much attention to the marginalised section of society, the informal sector, child workers and other poor workers.

In addition to repressive labour policies, governments in developing countries are also accused of rampant corruption and complicated bureaucracies. The international NGO Oxfam has gone so far as labelling corruption and bureaucracies as a highly regressive tax on development that falls most heavily on the poor (Oxfam International, 2002, p. 244). Funds that could be channelled for improving workers' welfare might have been lost to these so-called gatekeepers. In addition, Oxfam also reiterates development tax as a barrier to good investment. It creates significantly higher transaction costs caused by firms paying extra to avoid delays in their production. Economists refer to this tax as 'economic rent'. This so-called development tax has implications in the way firms manage their production costs. Firms who are forced to pay these transaction costs must therefore restructure other costs to cope with the high transaction costs. Thus, labour cost is deemed as a part of the production cost that firms can minimise. Therefore, having higher minimum wage or collective bargaining may not bode well for firms who want to stay afloat because these two factors tend to raise wage costs.

Linking Minimum Wages with Decent Work

Thus, how does the minimum wage policy fit into the model of *decent work* and human development? Fields (2003) argues that it is economic growth that contributes to increased workers' earnings, not minimum wage setting. In the context of the *decent work* discourse, higher labour earnings are not going to be achieved through international labour standards - nor should they be (Fields, 2003, p. 244). Nevertheless others, such as Saget (2001), argue that the minimum wage policy does promote *decent*

work and may even partly help in poverty alleviation. Egger and Sengenberger (2001) also argue that inclusive labour market policies, as one of the six policy clusters of *decent work*, must be made compatible with a level of remuneration that is above the national poverty line and with the domestic incomes policy and equality objectives. This underscores the importance of an active minimum wage policy ensuring that work sustains a decent livelihood (Sengenberger, 2001, p. 11). The minimum wage policy, while not acceptable as a core international labour standard, could be applied at national or regional level. Moreover, the minimum wage policy is about the trade-off between earning for labour and employment. While minimum wage increase does not mean an increase in the quality of jobs, through an increase in productivity, it has the potential to encourage employers to seek more efficient and productive labour.

Minimum wage or living wage is arguably consistent with the basic need approach. Improvement in the quality of life is strongly related to access to basic needs such as work, education and food (*Kompas*, 2000a). The levels of minimum wage are partly determined by minimum physical or subsistence needs which incorporate the goods needed for minimum subsistence needs. The ultimate concern would be how the impact of increasing workers' earnings via increasing minimum wage affects employment. Certainly, if the implementation of minimum wage policy does not significantly affect employment, it may improve the quality of life of workers because minimum wage levels can be set above the poverty level. Increasing the quality of life may induce workers to be more productive and thus promote positive human development.

A crucial concern, in the context of the *decent work* paradigm, is the problem of low wages. Egger and Sengenberger argue that low wages could be raised through higher rates of labour demand, collective bargaining and minimum wage fixing (2001, p. 16). Furthermore, they argue that collective bargaining and minimum wage fixing can appropriately raise wage floors to levels where a more productive use of labour is stimulated through better management, work organisation, investment in training, safety and health, and in social protection. Therefore, they contend that raising the quality of labour will raise productivity, thereby increasing the rate of growth thus leading to higher investment rates, higher consumption and a more stable business cycle. Increasing the minimum wage may improve motivation and eventually induce workers to work more productively and reduce absenteeism. It is a challenge that a transitional

democracy such as Indonesia can undertake, especially when both collective bargaining and minimum wage fixing are part of the de-centralisation process. Centralised minimum wage fixing may not be appropriate because it lacks knowledge of the local conditions and does not allow participation of local stakeholders. Likewise, de-centralisation of collective bargaining may be more efficient than centralised bargaining because it is likely to be bipartite and with less intervention from the government.

Decentralisation: A New Hope?

Decentralisation has been a recent occurrence which follows democratisation in developing countries. However, the extent of decentralisation appears to be different in each country. In developing countries, decentralisation first started in Latin American countries, followed by countries in Africa and Asia. The Philippines has perhaps one of the most advanced and successful forms of decentralisation in developing countries since the ousting of former president Marcos (Guess, 2005). Thailand and Indonesia are the most recent cases of the de-centralisation process in this region. In many cases, these decentralisation processes resulted from a combination of pressures from local government and popular organizations and from international agencies (Todaro and Smith, 2003, p. 714). In extreme cases, de-centralization was a desperate attempt to keep the country united (Smith, 1985, p. 160).

By definition, decentralisation means the transfer of significant degrees of authority and responsibility for governmental expenditures and revenues from the central government to lower levels of government (Alm et al, 2001, p. 84; Oxhorn, 2004, p. 7). Smith (1985, pp. 155-157) identified four broad dimensions of decentralisation:

1. Geographical - dividing a territory of a state into smaller areas and assigning jurisdictional powers among them
2. Functional - distributing state's authority and responsibility among different functional entities of government
3. Political and administrative - shifting decision-making to lower levels of government
4. Fiscal - transferring expenditure and revenue responsibilities from the central to sub-national governments

Smith also defined degrees of de-centralisation based on the extent of the autonomy of local governments. They are: de-concentration, shifts of administrative workload from central to local staff; delegation, authority delegated to local government but still accountable to central government and devolution, the highest degree of autonomy where local government can recruit their own staff and generate own income (1995, p. 158).

It is argued that decentralisation produces many benefits to the society. Decentralisation can promote good governance by making local government function more efficiently and effectively because local officials know the situation in their area and can better conduct decision-making, compared to the faceless bureaucrats in the capital (Doorman, 1998, p. 145). Decentralisation is said to bring the government closer to the people by helping to balance central government oversight and regulation with local input and empowerment (UNDP, 2005). Decentralisation also opens an environment for public participation in government decision making, resulting in more flexible and effective administration, political stability and national unity (Smith, 1985, p. 160). Decentralisation also allows local governments to have more control over rural development and put them in a better position to tackle the problems facing development program implementation at grass-root level, such as poverty alleviation and employment.

Decentralisation entails costs if not implemented properly. Smith (1985) explains that the costs of decentralisation could create co-ordination problems and jeopardise the civil and social rights of certain minorities. Local government from poorer regions will also have less subsidies from the central government and must generate their own revenues to keep afloat (*The economic times*, 2002). Hadiz (2004) also points out that decentralisation could worsen the problem of corruption which could also be 'decentralised' to local government. This concern is justified because one of the problems facing governments in developing countries is corruption at all levels of government even though others argued that decentralisation, if conducted properly, has the potential to reduce corruption (Gurgur and Shah, 2005).

Decentralisation: A Panacea for Development?

There has been a great deal of debate on the link between de-centralisation and globalisation, or whether they are indeed connected at all. Opponents of globalisation, like Doorman, argue that de-centralisation is the solution to development in the midst of globalisation because it strengthens economic and political power at the local level (1998, p. 197). It brings back decision-making to sub-national and local levels (UNDP, 1998). Decentralisation, if done properly, could improve governments' functions in addressing the needs of the public. With decentralisation the government can better implement development policies, such as poverty alleviation and community participation. It also helps the local government to be better able to cope with the effects of globalisation through capacity building.

On the other hand, there are those who argued that decentralisation, especially in developing countries, emerged as a result of the globalisation process. Proponents of globalisation actually insist that decentralisation, mainly in the form of fiscal decentralisation and divestment, actually supports globalisation by minimising trade barriers which hamper globalisation. International institutions such as the World Bank have been promoting decentralisation since the 1990s (Doorman, 1998). It appears that their brand of decentralisation, fiscal decentralisation and divestment, is likely to support globalisation. Divestment, in the form of de-regulation and privatisation, is a key ingredient of the neo-liberal regime which supports trade liberalisation, and hence globalisation⁵. Decentralisation, at grass-root level, can empower those who had long been supplicants before statism and can spread the benefits of globalisation to the grass-root level (*The Economic Times*, 2002).

Others also argue whether there is a globalisation-decentralisation nexus. Garrett and Rodden (2001) conclude that the relationship between globalisation and de-centralisation is still not clear. Although they based their conclusions on limited information, Garrett and Rodden contend that globalisation may strengthen the credibility of regional autonomy movements and put pressure on central governments to cede policy controls to local officials but it may also encourage regions, that choose to

⁵ The so-called Washington Consensus (See Beeson and Islam, 2005, p. 202) contains deregulation and privatization packages as one of the seven foci of programs. Recently, the newly formed augmented Washington consensus includes flexible labour markets as well as social safety nets and democratic participation.

stay within countries, to push for fiscal arrangements to better mitigate market risk for citizens within their borders (2001, p. 31). Tsukamoto and Vogel (2004) also argue that, based on their study of 20 world cities, globalisation has little relevance to political de-centralisation of governments. They add that globalisation encourages greater centralisation of authority. Indeed, Indonesia resisted de-centralisation to a greater degree (Devas, 1997), even during the high economic growth of the 1990s, and had to accelerate de-centralisation, due to democratisation and the threat of secession from a number of provinces. Perhaps a clearer example of a stronger link is between globalisation and decentralisation of collective bargaining.

Decentralisation of Collective Bargaining

De-centralisation of collective bargaining is distinctly complicated and it only concerns decentralising collective bargaining, the process and methods of obtaining collective agreements from national or industry level trade unions to firm level trade unions. Globalisation has had a negative effect on trade union power and influence (Clark et al., 1998), and brought about the emergence of de-centralised collective bargaining. Since the mid-1980s, there has been a trend towards less-centralised forms of collective bargaining in most developed countries (Bamber and Lansbury, 1998, p. 12). There is currently a shift away from centralised multi-employer and union bargaining, which most trade unions prefer, to firm-level or individual contracts. Wherever collective bargaining has been established, there has been a widespread tendency among employers to call for de-centralisation, implying a shift from multi- to single employer or even individual bargaining (Traxler 1998, p. 207). Katz (1993) argues that, although there is strong evidence of mutual gain for labour and employer through decentralisation, there is also a power shift from trade unions to employers as well as diversification of corporate and worker interests. This trend coincides with the decline in trade union power in developed countries and the rise of neo-liberalism, in which there is a push for restoration of managerial prerogatives and more flexibility in the labour market, especially where unions and legal provisions for employment protection are weak (Bamber and Lansbury, 1998, pp. 19-20).

The same outcome could also be occurring in developing countries such as Indonesia, where workers appear to have established more democratic industrial relations.

Minimum wage setting, in which multi-stakeholder bargaining is required for agreement, is already delegated to local government level and there are calls to develop collective bargaining at firm level under the pretext of strengthening grass-root trade unions. There is a danger that this combination of factors has the potential to weaken the collective voice of trade unions. Moreover, de-centralised collective bargaining could also be at loggerheads with *social dialogue*, where negotiations at both centre and periphery are required to achieve quality employment.

Democratisation and Decentralisation in Indonesia

The recent fall of the New Order regime has renewed hopes of better human rights conditions in Indonesia, including the rights of workers. In the aftermath, Indonesia faced four monumental tasks to get development back on track. Deuster called these challenges, “the four horsemen”: economic restructuring and recovery, political transition to democracy, decentralisation of government functions, and redefining national identity (2002, p. 6). With respect to labour policies, all four tasks could significantly affect the way in which the central and local governments deal with labour. At present, political transformation and de-centralisation of government functions may be more crucial in the implementation of labour policies. Current macro-economic policies, in which EOI is still the main development trajectory, have to be adjusted to account for the political transformation of the country. One of the adjustments must be a shift in labour policy from a tendency to control labour to a more open and socially responsible labour policy. Allowing independent trade unions to flourish is a start in the right direction. However, de-centralising the minimum wage fixing mechanism, in the early stages of decentralisation, could prove a more daunting challenge, particularly when regional government officers still lack the expertise in implementing the minimum wage provision.

Decentralisation of Government Functions

The de-centralisation process, which has been comparatively slow under the Soeharto regime, has now been fast tracked due to the crisis. Under the new de-centralisation Law No. 22,1999 on Regional Government, the central government has devolved many

of their previous authorities to local governments, mainly district or city level⁶. Tambunan stated that the main goals of decentralisation in Indonesia are:

1. To make decentralised sub-districts become economically self-sufficient
2. To provide conditions to establish workable plans for improving the welfare of the majority of each region's population
3. To make it easier for sub-districts to promote participation in governance and political democracy, which are essential for harmonizing the diversity of ethnic populations, with whom the sub-district level of government deals most directly (1999, p. 54).

The devolution of power does not include authority on financial, security and order, law and foreign policies which the central government still retains. Local governments are now given many wide-ranging powers at their disposal including labour policy implementation, raising their own staff and levying new taxes and redistribution of these taxes in their region for the purpose of generating their own income. In terms of local responsibility, with regards to labour issues, the task of implementing manpower policies now falls to local governments. This includes setting the minimum wage level, 'socialisation' and enforcement⁷.

Furthermore, the de-centralisation law also includes de-concentration of some central government offices at local level (Alm et al, 2001, p. 85). Regional offices, which were previously under the jurisdiction of the central government, such as the manpower office, now fall under the jurisdiction of provincial and district government. In addition, local governments have been given the authority to set the minimum wage level in their respective regions. The local manpower office, where local minimum wage has been negotiated between employers and labour unions through an institution called the wage council, is now completely autonomous and does not answer to the central government, i.e. the Ministry of Manpower and Transmigration. Moreover, in several provinces, the

⁶ Law Number 22/1999 stipulates that all authorities previously held by the central government, except monetary, foreign, peace and security and law making are now the responsibilities of regional government, particularly district and city governments. This includes the minimum wage setting machinery. The responsibility fell on the provincial government, except in West Java, where the governor delegated the authority to district heads and mayors.

⁷ Socialisation refers to disseminating information on the new minimum wage level to stakeholders, such as trade unions, workers and employers.

district and city authorities have complete autonomy concerning the minimum wage fixing process. The central government now concerns itself with lawmaking and the monitoring and implementation of these laws. This includes setting the criteria for determining minimum wage levels. Conversely, this change in authority means the challenge to balance and accommodate the increasing strength and participation of labour, capability building of local governments, as well as coping with globalisation which the government still depends on for economic development.

Promoting Independent Trade Unions

In addition to the challenge of de-centralisation, the democratisation process also provides workers with a chance to build on their collective power. In Indonesia the ILO's Convention Number 87 on the right of association was ratified in 1998, while Convention Number 98 was ratified much earlier in 1957. Under the repressive authoritarian government of Soeharto, workers in the formal sector were allowed to join trade unions as a consequence of ratifying Convention 98 on the Right to Organise, but that right to join a union was restricted to the state controlled union of the SPSI (Levine, 1997). All unions were forced to amalgamate under the banner of SPSI during that time. Even though workers were consequently able to set up company unions, they were still not allowed to join other national unions such as SBSI or SBM, the government citing that these unions were illegal.

With the political transformation to the ratification of Convention 87, workers are now allowed to set up their own union or join any independent national union or union federation they wish. As a result, there are now more than 65 national trade unions or trade union federations that exist in Indonesia competing for new members. These unions also have regional branches and some have even amalgamated into two distinct confederations. The move was obviously designed to increase the collective power of the unions at national level. Unfortunately, Hadiz (2001) suspects that many of the unions are led by people closely linked to the political elites. It is hard to form an effective united front for workers if the leadership does not emerge from the workers themselves. If its leadership is not co-opted, urban industrial labour could become fertile ground for mobilisation by future aspirants to national power (Liddle, 1999, p. 69). One of the reasons for forming a union is for collective action, i.e. collective

bargaining. One of the most important tasks that an effective union can undertake is to negotiate for better wages as well as better working conditions. With regards to the de-centralisation of minimum wage setting, unions must also be effective at local level to negotiate for better wages.

Allowing the development of independent unions would insure the active participation of workers in fighting for their rights. Devarajan et al. argue that, assuming that Indonesia substantially liberalises its market, allowing unions greater freedom is superior to the current minimum wage policy (1997, p. 168). The reason is that unions can still be more flexible in wage mark-up especially in the face of adverse demand shocks, whereas the minimum wage policy creates wage rigidities within the economy. With the economy in recovery and central government functions de-centralised, greater union participation in the economy is a tempting prospect. Moreover, trade unions could also contribute significantly to their country's social and political development (World Bank, 1995, p. 79). Thus, abolishing the minimum wage policy could have serious political implication. Unions and workers normally support the minimum wage provision and any attempt to extinguish it would have to have the approval of these stakeholders.

The challenge for all stakeholders would be to make the combination of minimum wage policy and more active union participation, an ingredient for a *decent work* approach to development, work at local level. The Indonesian government has committed itself to the project. It is clear that the present government's main goal is political and economic stability. The *decent work* approach could have positive results in terms of political and even economic stability. In any case, decisions regarding the minimum wage fixing machinery, and to some extent the development of labour unions, tend to be more political rather than economic. Therefore, abolishing the minimum wage policy would not be politically correct during the present conditions. However, the minimum wage policy could be applied in tandem with greater union participation through collective bargaining at national and local level. Thus, the development goal for labour has, for the moment, shifted slightly away from employment creation and more towards employment welfare. Labour unions must also de-centralise their power to local level so that local labour union, i.e. at firm level, can participate in collective bargaining. The de-centralised minimum wage setting regime may be an opportunity for labour to use

their newfound power to participate for mutual gain and move away from costly labour militancy. On the other hand, it would also be beneficial, in the long run, for employers to accept labour unions as partners in production and negotiate accordingly. The ILO is currently making significant efforts to educate workers, via labour unions, to negotiate effectively and only resort to strikes as a last option. The ILO is also keen to implement one of the keys to the *decent work* concept, that of the *social dialogue*.

The danger caused by improper negotiations of minimum wage levels can be disastrous for both labour and employers, especially when the economy has not been improving significantly since the crisis of 1998. Hendarmin (2001) reports that one of the reasons for the breakdown of minimum wage negotiations at district level was that employers felt it tended to favour workers' welfare too much and concentrated less on the condition of businesses. Employers who feel that minimum wage increase is too high could respond by employing more and more non-permanent workers, such as outsourced or fixed-term contract workers or employers could change their production processes from labour intensive to capital-intensive industries, thus decreasing employment. Worst yet, if minimum wage increase is too high, thereby increasing production cost to an unsustainable level, employers can pack up and re-locate their businesses elsewhere. If a minimum wage increase has negative implication on the formal sector by creating unemployment, it would also create more informal workers. Indonesia's lack of unemployment benefit would ensure that those workers laid-off in the formal sector were forced into working in the informal sector. Furthermore, the crowding of the informal sector could put pressure on wages in the informal sector and could decrease real wages there. Nonetheless, it is important to note that low wages are not the only, not even the main criterion for many investors deciding to place their TGF operations in Indonesia. More important ultimately are the prospects of obtaining a quality product, delivered on time and to specifications, in an environment not plagued with chronic labour unrest (White, 1993, pp. 137-138).

The Research Question

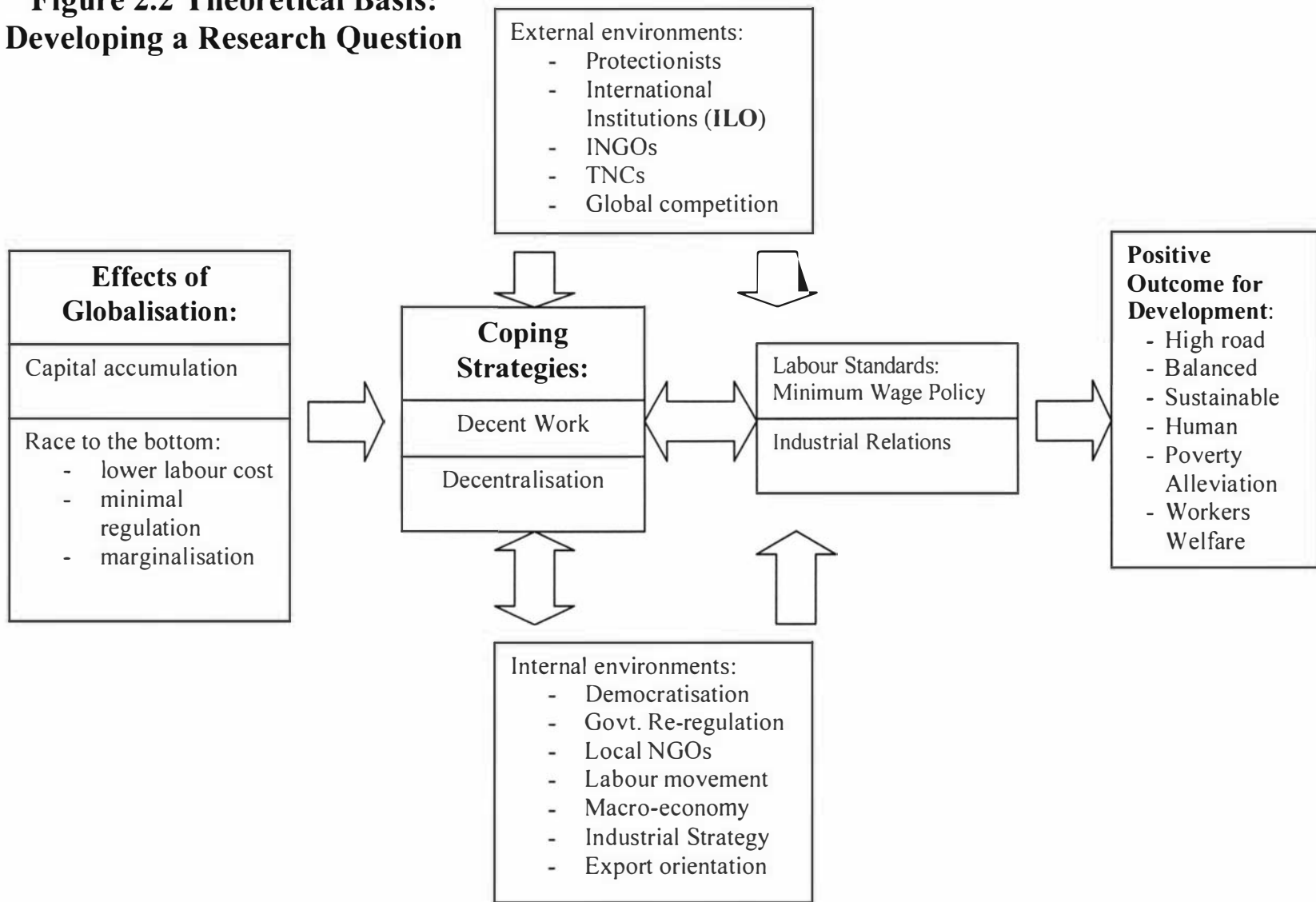
The *decent work* concept and de-centralisation have been touted as two of the approaches in coping with the inevitable effect of globalisation. Figure 2.2 illustrates this quite clearly. The *decent work* approach to industrial relations, via *social dialogue*,

could be a promising tool in ensuring more effective negotiations in determining the minimum wage level. In addition, the minimum wage fixing process could promote *social dialogue* among the stakeholders. To make *social dialogue* work, the role of government institutions in charge of labour must be strengthened and on a par with the other strategically key ministries. The role of local governments, whether it is the provincial or district government, must be inclusive in the *social dialogue* framework. Otherwise, *social dialogue* can not work at local level. Thus, de-centralisation, arguably another strategy of coping with globalisation, can make local government more efficient and effective in implementing policies of the central government. Local governments know the situation in their locality much better than the bureaucrats in central government. The wage council could be used as a model for *social dialogue* because it involves all the key figures, including officials representing local and central government⁸.

The researcher argues that the current minimum wage process in Indonesia should be incorporated within the *decent work* paradigm and local government autonomy. Questions still remain on the effectiveness of the minimum wage policy. However, the minimum wage process itself, coupled with the increasing political clout of independent unions, could be used to promote *decent work*. In addition to the continuation of the minimum wage policy, the current political climate in Indonesia also adds a new player to the list of stakeholders of the minimum wage policy which is the local government. Thus, successful implementation of the minimum wage policy and consequently *decent work* would depend on the successful co-operative ventures of all the key players. Therefore, this thesis conducts a holistic approach to the minimum wage policy, specifically the de-centralised minimum wage fixing process at local level.

⁸ For example, one of the members of the wage council at provincial level is an official from the local statistics office. The office is a regional office of the Statistics Indonesia, which is essentially part of the central government based in Jakarta.

**Figure 2.2 Theoretical Basis:
Developing a Research Question**



Therefore what are the implications of decentralising the minimum wage setting to district and city level? Is the minimum wage policy relevant and will it insulate workers against the negative effects of globalisation? Is it a beneficial long-term solution for the government to allow districts and city governments the authority to set-up and implement their own minimum wages, given the highly sensitive political dimension surrounding its implementation? Can the minimum wage policy create more harmonious and stable industrial relations?

The main analysis of this thesis is to assess the early impact of the de-centralised minimum wage fixing process on several issues, namely:

1. Economic - employment and wage differentials
2. Socio-political- trade union responses and regional stability.

The analysis is divided into three parts: Chapter VII discusses the result of the fieldwork on the impact of the decentralised minimum wage fixing process, Chapter VIII analysis the employment impact of the de-centralised minimum wage fixing, using quantitative methods, and Chapter IX presents the changes in industrial relations as a result of changes in the legislative environment, including the minimum wage policy, as well as other factors that could potentially affect industrial relations.

However, it is crucial to first discuss the theoretical and historical debate surrounding the minimum wage policy in order to shed a better light and understanding of this controversial policy. The argument over the inclusion of minimum wages to the *decent work* concept is based on the traditional economic view that minimum wages cause a trade-off between wages and employment. This trade-off does not appear to comply with the *decent work* frontier which calls for increasing both employment and wages. However, there are other reasons why the minimum wage policy may be imposed. Chapter III discusses the theoretical aspects of the minimum wage policy from the point of view of the opponents as well as proponents of the policy as well as empirical studies that support their corresponding views.

Chapter III

The Minimum Wage Debate: Theoretical Framework and Literature Review

Introduction

The purpose of this chapter is to introduce the theoretical background of the minimum wage policy and to present empirical and other studies that challenge the merit of the minimum wage policy as well as those studies that advocate the importance of the policy. Minimum wages represent the lowest level of remuneration permitted in law or fact whatever the method of remuneration or the qualification of the worker (ILO, 1992, p. 10). In addition, minimum wages are based on the fair wage concept in order to ensure that workers receive a basic minimum wage that will enable them to meet their basic needs. Negotiations on minimum wage fixing, at local government level, can be used to initiate social dialogue at other levels, such as firm-level and even national level. The opportunity is greatly enhanced by the ratification of ILO Convention Number 87 on Freedom of Association, where independent trade unions now flourish with minimum government intervention. In the case of Indonesia, the minimum wage policy has been effectively applied since the early 1990s. The government has been under pressure to improve workers' conditions and has opted to implement the policy, while still limiting trade union freedom (Levine, 1997). Its implementation is again under the spotlight since the start of the decentralisation process whereby the authority of minimum wage fixing has been transferred to local governments.

The Minimum Wage Policy

The history of minimum wages is discussed by Starr (1981). He notes that the practical use of minimum wage regulation was first developed in New Zealand and Australia at the turn of the 19th century. In New Zealand, under the New Zealand Industrial Conciliation and Arbitration Act of 1894, the minimum wage was introduced to settle industrial disputes and make minimum wage fixing binding to areas where the industrial dispute took place. In Victoria, Australia, an experiment on minimum wage regulation was in place to eliminate low wage 'sweat-shop' employment in 1898. Afterwards, other developed countries followed and provided protection to workers with excessively

low wages. Nonetheless, since its introduction, particularly in the US via the Fair Labor Standards Act of 1938, social scientists, particularly economists have debated the merits or otherwise of the minimum wage policy.

According to Starr (1981), the basic objectives of minimum wages are:

1. To provide protection for only a small number of low-paid workers who are considered to have particularly vulnerable positions in the labour market.
2. To ensure the payment of what may be termed 'fair' wages.
3. To provide a basic floor for the wage structure. This concept views minimum wage fixing as an instrument for making a modest contribution to the reduction of poverty by providing all, or almost all workers, with 'safety' net protection against unduly low wages.
4. To be used as an instrument of macro-economic policy for achieving such broad national objectives as national stability and growth and also to ensure major improvements in the distribution of income.

There are two types of minimum wages. The first is the minimum wage set by national or local governments called statutory minimum wage. The second is set through collective labour agreements between employers and labour unions (ILO, 1992, p. 15). The former is the minimum wage linked to the minimum wage policy and the one addressed in this thesis. The latter is strongly linked to the establishment of trade unions. The statutory minimum wage could be the same as the minimum wage obtained through collective bargaining, if there is a strong enforcement by the government, as well as input from trade unions. As explained later in the chapter, many workers in developing countries earn less than the statutory minimum wage. For example, during their studies on the impact of minimum wage in Puerto Rico, Freeman and Freeman (1991) found that 44 percent of workers earned below the statutory minimum wage¹.

¹ Henceforth, the term minimum wages refer to the statutory minimum wage.

Administration of the Minimum Wage Policy

Minimum wage policy is also a popular policy because it is administratively simple to implement (Freeman, 1994, p. 9). In addition, minimum wages do not have direct budgetary consequences on the government, they increase the incentive to work and guarantee base compensation for workers. Theoretically, it is easier to determine compliance because workers, who receive less than the minimum wage, can report the violations. Thus, governments may find minimum wages to be more attractive, even though this chapter shows that many economists have proven that the effects of minimum wages are often not beneficial.

In addition to being administratively simple, the minimum wage policy is also popular politically. In the U.S. the minimum wage policy found support among voters after the Reagan administration had stepped down (Levin-Waldman, 1998). Minimum wages stayed frozen during the Reagan years, in which the neo-liberal economic regime was dominant, but popular support grew towards the end of this period and it found plenty of support during the George Bush Sr. and Bill Clinton presidencies (Levin-Waldman, 1998). Nominal and real minimum wages were increased several times during this period. In other countries, like Australia, empirical evidence conducted by Austen (1997) concluded that there was a strong public support for minimum wage policy. Thus, to study the impact of minimum wage, one has to look beyond economics and also include the political, social and developmental aspects. In the context of the *decent work* paradigm, the main goal is to find an effective minimum wage policy that does not create a detrimental impact on the main objective of the *decent work* discourse, which is to increase quality employment.

The problem of the minimum wage policy is one of implementation and enforcement. Due to the competing forces of stakeholders within the minimum wage fixing process, it would be difficult to even finalise the exact level of minimum wage in a given period of time. Each stakeholder has their own reasons for presenting and defending its preferred minimum wage rate. Even government representatives, who must act as mediators between the interests of workers and employers, must choose sides accordingly, based on the development strategy of their government. Moreover, the government lacks the means of enforcing the policy, although it could use indirect means such as obtaining the assistance of trade unions to monitor compliance.

The Economic Dimension of Minimum Wages

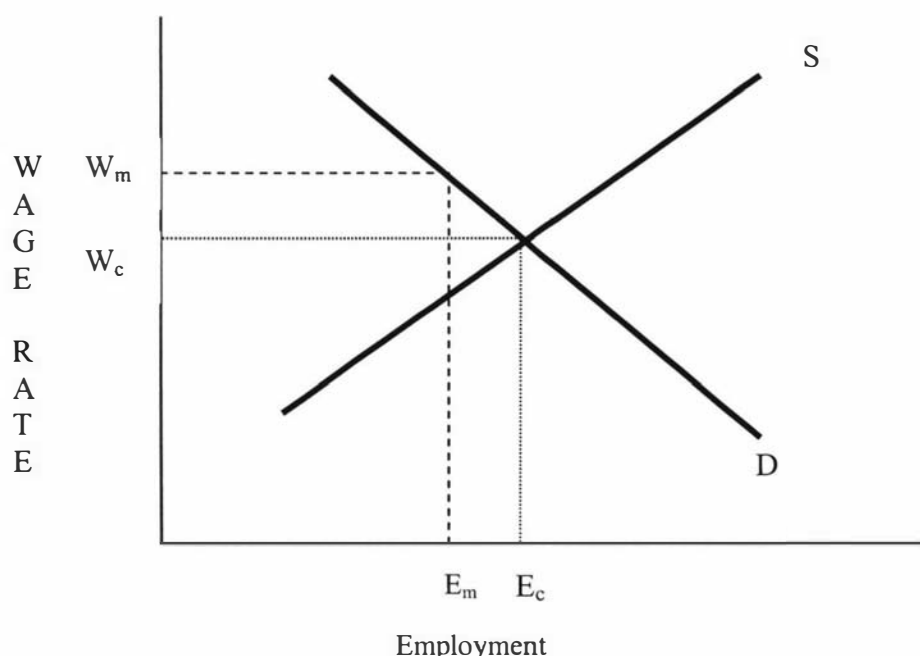
The minimum wage policy has been a controversial issue in academic policy debate since its first inception. However, nowhere has the debate been so hotly contested than in the economics profession (Champlin, 2001). The main contention in economics is the effect of minimum wage changes on employment. The most critical opponents are neo-classical economists who reject the notion of minimum wage on the grounds that it distorts the labour market by setting wages above the market-clearing rate, beginning with Stigler (1946 cited in Hammermesh, 1993, p. 182) who argues that minimum wages are an impediment to employment growth. In addition, neo-classical economists claimed that such labour market interventions misallocate labour, waste resources through rent-seeking, impair adjustments to economic shocks and deter investments, thereby reducing rates of growth (Freeman, 1993b, p. 119). Card and Krueger maintain that minimum wage provides a clear test of the standard neo-classical economic model (1995, p. 11). It gives economists a chance to empirically test the theory of the negative impact of a minimum wage hike on employment. However, as described later on in this chapter, empirical testing on this subject can produce different results. Firms would operate with less profit than if wages were set at market prices. Under perfect competition, wages in firms are set by the equilibrium of demand and supply of labour. By fixing a wage floor at a higher level than the wage set by the market, this would cause firms to hire fewer workers than they would have otherwise under the market-clearing wage. Nonetheless, Card and Krueger's assertions, and subsequent studies by others, were tested in developed countries, such as the United States and several European countries. The World Bank has implied, in their 1995 yearly report, that an increase in minimum wage, under certain conditions, could have an insignificant impact on the number of workers in developed countries. However, the same could not be the conclusion for developing countries with a large informal sector.

The neo-classical model

Most economists also argue that the application of minimum wage can hurt the very workers it is trying to protect. By setting the minimum wage above market clearing rates, firms can respond by hiring less workers and thereby creating less employment opportunities (Reynolds, Masters and Moser, 1998, p. 144). Figure 3.1 illustrates the

effect of wage changes on employment in a one-sector model. All things being equal, the intersection of labour supply and demand is where a perfectly competitive labour market works. An increase of wage from W_c to W_m causes employment to shift from E_c to E_m . This means that demand for employment decreases as wage increase. The magnitude of the loss depends on the elasticity of the demand. However, in general, minimum wages produce little loss of employment if they are kept low (Hammermesh, 1993, p. 191). Seltzer (1997) concurs with this observation and adds that minimum wages also incur low administrative costs for a government. Firms can also decrease other non-wage benefit to offset the decrease in wages. High labour costs, attributed to a minimum wage hike, can also lead firms to substitute labour to capital, leading to more unemployment (Mehmet, Mendez and Sinding, 1999, p. 94).

Figure 3.1 Neo-classical Economic Model of Employment Effect of Minimum Wage Legislation



Source: Reynolds, Masters and Moser (1998)

Minimum wages in developing countries: a two-sector model

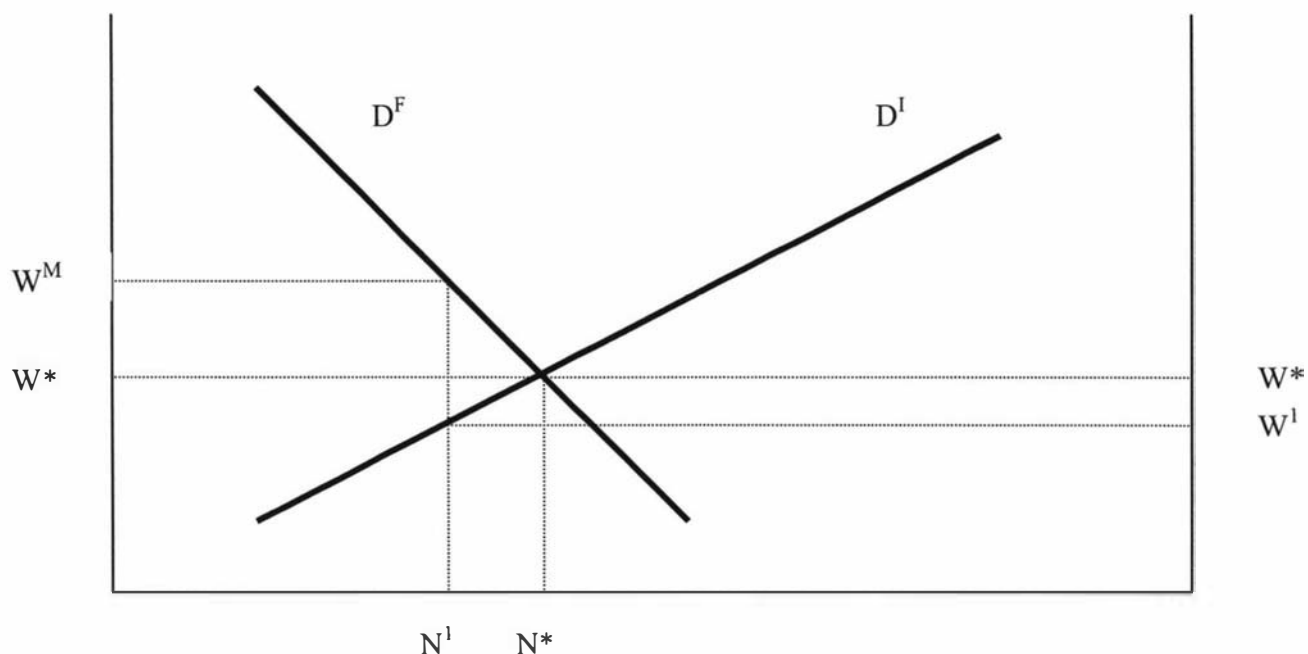
Increase in minimum wage, especially one that applies to the modern urban industrial sector, also has secondary implications to the uncovered sector². Scholars argue that an

² The uncovered sector in Hammermesh (1993) refers to the informal rural sector. However, with regards to this thesis, the uncovered sector could also include the growing urban informal sector, as well as child workers in Indonesia.

increased minimum wage can have a positive effect on the number of workers in the uncovered sector and a negative effect on wages of these workers (Hammermesh, 1993, p. 378). This means that increasing the minimum wage can increase the number of workers in the informal sector and, at the same time, depress wages of workers in that sector. Welch (1976 cited in Hammermesh, 1993, p. 182) proposes a two-sector model of the minimum wage effect. Firstly, the covered sector where the minimum wage applies and secondly, the uncovered sector in which workers displaced by a higher minimum wage could find jobs. This model is more suited to developing countries, due to the presence of a large informal sector. In many developing countries, the size of the informal sector is often much larger than the formal sector, in terms of the number of workers.

Developing countries, such as Indonesia, provide a clear example of the two-sector model where the informal sector is as important as the formal sector in economic development. Figure 3.2 shows a two-sector labour demand model consisting of demand for the formal sector, D^f , and demand for the informal sector, D^l . The market is assumed to be cleared if wages are set at equilibrium $W^*W^*N^*$. The formal sector is able to absorb N^* workers and the rest, N^*N , are absorbed by the informal sector. However, if there is a distortion in the form of the minimum wage, demand for formal workers would decrease from N^* to N^l . The informal sector would then have to absorb the excess labour of N^*N^l . Thus, after the imposition of the minimum wage policy, workers laid off as a result of minimum wage increase must find employment in the informal sector because there is usually little or no unemployment benefit for them to receive. This in turn can depress wages in the informal sector from W^* to W^l .

Figure 3.2 Neo-Classical Economic Model of Employment Effects of Minimum Wages in the Formal and Informal Sector



Source: Suryahadi et al. (2003, p. 40), and Hammermesh (1993)

In addition to a two-sector model, developing economies are also characterised by the types of informal sector including the rural informal sector and the urban informal sector. Indonesia is also home to a large informal sector, especially in Jakarta and its surrounding districts and cities³. Any distortion in the labour market would theoretically affect both the urban and rural informal sector, depending on the elasticity of the labour demand in the modern sector. This was particularly true during the aftermath of the 1998 economic crisis in Indonesia where many workers, who lost their formal sector jobs, had to contend with working in the urban informal sector, as well as returning home to their rural villages.

A study by Basu (2000) also raises an intriguing prospect that minimum wage policy can exacerbate the problem of child labour. He hypothesises that an increase in minimum wage might lay-off workers, which in turn, could affect their household income. Therefore, the family might be forced to send their children to work for a certain amount of time to earn the lost income (Basu, 2000, p. 59). This would also

³ See Chapters IV for the proportion of informal sector jobs.

exacerbate the problem because these children would most likely be entering the informal sector.

In addition to the effects of minimum wage on employment, an increase in minimum wage may affect other non-wage benefits. Card and Krueger hypothesise that firms may be compelled to reduce fringe benefits, such as training (1995, p. 154). Firms may also opt for less permanent workers and more flexible workers such as part-time workers or piece-rate workers (Standing, 1999). Firms could also outsource their production to smaller home-based firms to reduce employment costs or switch to capital based production. These types of workers are easily disposed of when firms no longer need their services. There will also be less human resource development, as these so-called 'flexible' workers are often unskilled and firms do not need to spend money on their training. Such are the ways that firms can bring more misery on their workers. Indeed, contrary to the concept of *decent work*, the minimum wage policy is hypothesised to create a trade-off between increasing the quality of employment through higher wages and creating more unemployment.

On the other hand, economists such as Card and Krueger (1995) argue that the minimum wage policy need not have a detrimental impact on employment. They also argue that the basic model assumes a homogeneous worker, perfect competition and the perfect flow of information that does not exist in the real world and they theorise that, under certain conditions, the minimum wage might not have detrimental effects on wages and employment (Card and Krueger, 1995). Reich suggests that a more useful approach to minimum wage is for all countries to strive for a minimum wage between 40 and 50 per cent of the national median average (2002, p. 121). He adds that such a standard would not only respect each country's capacity to pay, but also acknowledge that the world community has an interest in the development of a strong middle class to which the poor in every country can aspire.

Competing economic models

Economists have also presented other economic models in which wage increases are not detrimental to employment. They show that under the monopsony and the efficiency wage models, wages can be increased above the market-clearing rate (Reynold, Masters and Moser 1998, p. 50). Under monopsony, where only a single employer exists, the

employer can increase wages to entice more workers to work for him/her. Thus, under this model, minimum wage has a positive relationship with employment. An increase of minimum wage could also increase the number of workers joining the employer. However, a monopsony model might not apply to the Indonesian case where many employers are present. Only in the outlying provinces, where manufacturing firms are few, could this concept be applied.

In the efficiency wage model, increases in wages are correlated with workers' effort or productivity. This theory is part of the New Keynesian economics that explains real wage rigidity (Snowdon, Vine and Wynarczyk, 1994). An employer can increase wages to provide the basic needs of the workers and prevent shirking in order to increase the productivity of his/her workers⁴. The efficiency wage takes into account the social goals that the neo-classical model lacks, such as the notion of fairness. Thus, firms set an increasing wage profile to minimise shirking costs (Jellal and Faria 2001, p. 10; Wikipedia, 2005). In addition, it is assumed that workers' effort increases with real wages and worker's effort is also positively related to overall job satisfaction, which is strongly and positively correlated to the rate of wage growth. In other words, it pays for firms to increase the wages of workers in order to increase their productivity.

Another reason for the application of efficiency wages is based on the fairness model (Akerloff and Yellen, 1990 cited in Snowdon et al., 1994, p. 315). This model could aptly be applied to developing countries, where many workers are paid below the basic needs in which minimum wage calculation is based. In these circumstances, an efficiency wage may improve their health and hence, their inherent physical productivity (Stiglitz 1987 cited in Hammermesh 1993, p. 374; Wikipedia, 2005). However, it is not clear whether the abstract illustrations of the efficiency wage model, where it takes into account the level of skills, can be applied to the Indonesian condition with its oversupply of unskilled labour and duality of the labour market, i.e. the formal and informal sectors. Manning (1998) suggests that the efficiency wage concept appears to apply to capital-intensive firms in Indonesia, in which highly skilled workers are needed to run the production processes. It is also important to note that market

⁴ Shirking means that workers do less work than agreed. By paying workers efficiency wage employers also avoid giving workers an incentive to shirk (Snowdon et al., 1994, p. 309; Wikipedia, 2005)

imperfections such as rent-seeking are also largely present. For this reason, it would be appropriate to seek other approaches to the minimum wage policy.

The impact of trade unions

Another economic reason, by which firms prefer paying the minimum without significant consequences, is the 'union threat effect' explained by Pencavel (2002). In this model, firms prefer to comply with the official minimum wage level, or even increase wages paid to workers, for the main reason of maintaining industrial peace and minimising union interference. Firms, instead of unions, can readily influence the minimum wage levels so that any increase will not put too much strain on the firm's profitability. This might be a challenging prospect in Indonesia, where decentralisation of authority has exposed the weaknesses of trade union power. The collective power of trade unions in Indonesia has not been challenged and is largely untested at local level, while independent labour unions are still developing at national level. In addition, workers have only recently become aware of their rights and are still learning to bargain collectively. Workers can also be enticed with higher pay and encouraged not to join unions. Firms can also set up workers' associations under management control and encourage the rejection of outside unions. A firm's strategy may be to keep trade unions at a safe distance to avoid costly negotiations at firm level and avoid potential grievances that could lead to costly work stoppages.

With the growing strength of trade unions in Indonesia, the minimum wage legislation could still be a useful labour policy. Experiences in some developing countries has led Watanabe to argue that the minimum wage policy can be an effective tool for restraining wage increases in the better-paid organised sector (1976, p. 357). Like the minimum wage policy, unionism is associated with higher wages and benefits for workers and lower profits for firms (Freeman and Kleiner, 1998). As unions are increasingly influential in the minimum wage fixing process, they can use that influence to demand wage increases which are not sustainable for firms to maintain. The Indonesian government or local government could play a leading role in preventing excessive wage increases by trade unions that might cause negative impacts on businesses. Modest increases in minimum wage level are still possible without putting

too much strain on employment, as well as preventing real wages to fall⁵. The government's central role in the wage council, whether it is at national or local level, could ensure the effectiveness of the minimum wage policy as a type of tool.

The Social Dimension of Minimum Wages

The minimum wage policy, as part of the basic needs and *decent work* approach, also has socio-economic justice dimensions. Under the neo-classical model, it is assumed that people pursue only their own self-interest and do not care about 'social' goals (Wikipedia, 2005). The defenders of the minimum wage policy would point out the social dimension, i.e. justice and ethical aspects, to justify the maintenance of minimum wage policy. Social economists such as Levin-Waldman (1998), Cordero (2000) and Prasch (1996), defend the minimum wage policy by pointing out this ethical, justice and political aspects of minimum wage policy. Minimum wage is not created solely as a labour market policy, but also as a social policy to narrow the gap between the rich and the poor, and between male and female wage differentials. The idea of minimum wage is also consistent with socio-economic justice (Levin-Waldman, 1998; Prasch and Sheth, 1999). Korten (1995) explains that the principle of economic justice is that healthy societies provide all their members-present and future-with those things that are essential to a healthy, secure, productive, and fulfilling life. There is nothing wrong with additional rewards for those who contribute more-but only so long as everyone's basic needs are met, the options of future generations are not impaired, and the distribution of economic power does not become destabilizing (Korten, 1995, p. 272).

Minimum wages are also consistent with the Universal Declaration of Human Rights, Article 23 Number three, advocated by the United Nations (1946) and the 'basic needs' approach introduced by the ILO and the World Bank. The U.N. stresses implicitly the rights for human beings to have *decent work* and pay. The 'basic need' approach is defined as the minimum requirement of a community for a decent standard of life (Welsh and Butorin 1990, p. 98). The concept of minimum wages is consistent with the notion of basic needs because, in Indonesia in particular, the minimum wage level is partly determined by society's minimum basic needs. During the early implementation

⁵ Opponents and proponents of minimum wage policy (Hammermesh, 1993; Palley, 1998; Card and Krueger, 1995) agree that small increases in minimum wages need not have a negative impact on employment.

of the minimum wage, the government based the minimum wage on the minimum physical needs. Later, when workers became increasingly aware of their rights, the government improved the standard of the minimum wage by basing it on the minimum daily need or subsistence need. Nevertheless, the minimum wage has seldom been on level par with the two types of minimum requirement. Only in 2000 did the Indonesian government make unprecedented efforts to alleviate the minimum wage requirement by increasing the minimum wage level twice in one year.

In the context of minimum wage in Indonesia, the term 'basic needs' is maybe understood to mean the Minimum Physical Need (KFM-*Kebutuhan fisik minimum*) and the Minimum Subsistence Need (KHM-*Kebutuhan Hidup Minimum*). The KFM, which was the basis for calculating minimum wage levels before 1997, is equivalent to an average intake of 2600 calories per day in Indonesia. The KHM has a slightly better condition than the KFM (about 15 percent higher). After 1997, the KFM was deemed insufficient for the calculation of minimum wage level and thus the government replaced it with the KHM. Unfortunately, even today, the minimum wage level seldom exceeds the basic requirement of KFM and KHM. This is most likely to be the root of the problem which persisted during the 2002 and 2003 with minimum wage setting in several districts and cities in Indonesia.

Minimum wages are also in line with the notion of 'social justice' in raising the wages of the working poor to a level that enables them to provide for themselves, without the assistance of others. With more than one-fifth of the world's population living in poverty, there is a need for the basic necessities of life, such as employment opportunities, which permit the very poor to earn at least a certain minimum level of income (Torres 1993, p. 101). Minimum wages enable people to earn a living, which is consistent with an elementary component of human dignity and social justice (Prasch 1996, p. 1). Even Marx (cited in Cordero 2000, p. 207) stated succinctly that minimal wages are sufficient for a good life. In the case of Indonesia, minimum wages provide workers with their basic needs without having to generate other means of income.

Proponents of the minimum wage policy argue that it is beneficial as a tool to redistribute income. Scholars such as Addison and Blackburn (1999) argue that minimum wage policy can reduce poverty. Their studies in the US, during the 1990s,

show that, under certain conditions, increases in minimum wage could reduce poverty among young workers. Others, such as Boadway and Cuff (2001), contend that theoretically minimum wage legislation can be used as a tool for the redistribution of income and the reduction of unemployment, through the application of optimal proportional and non-linear income tax schemes. Moreover, minimum wage, like other labour standards, may bring about a redistribution of income from the rentier to the wage-earning class, thus raising aggregate demand, which is good for the expansion of production and employment (Mehmet et al., 1999, p. 92).

Setting a minimum wage level would theoretically ensure that workers could also benefit from development, especially women and young workers, where minimum wage can close the wage gap between men and women (OECD, 1998; Shannon, 1996, p. 1567). Women workers, especially in manufacturing, have been presumed to have wages below those of men and these were set around the minimum wage or even lower. The minimum wage policy may reduce these gaps and ensure more equal pay between men and women (Rubery, 2003, p. 26).

The Political Dimension of Minimum Wages

It would be insufficient to limit the understanding of minimum wage policy purely at economic and social dimensions. Minimum wages are a political good, instituted by the body of politics, not by economists (Freeman, 1994). One must also examine the impact of minimum wage policy under the wider framework of political economy, particularly in a developing country such as Indonesia⁶. Liddle (1996) believes that development policies include the calculations of politicians as much as officials. He argues two research foci occupying the central place in development literature: the calculations of politicians and officials when they make policy decisions; and, reversing the causal arrow from politics → economics to economics → politics, the implications for the politics of policy-making of certain economic variables and policies (Liddle, 1996, p. 227). A major element of such a framework is the ideological system which determines

⁶ Political economy is a social science that deals with political science and economics as a unified subject; the study of the interrelationships between political and economics processes. Political economy seeks to examine the alternative policy actions that policy makers within a particular country may take, to move from the previous system of economic governance to the presumably more efficient system (Rosen, 1996, p. 175).

how policy makers, intellectuals and influential groups within the society operate (Rosen, 1987, p. 175).

Based on Liddle's interpretation of Indonesia's political landscape during the New Order, Soeharto used free trade policies to maintain his hold on power to great effect. In the area of economic development, he was able to combine economic liberalisation with political patrimonialism, to overcome Indonesia's diverse cultural barriers and launch the country into one of the most vibrant economies in the Asia, something his predecessor Sukarno could not do. In addition, according to Liddle, economists dominated Indonesia's development even more during the 1980s and 1990s when the oil boom had run its course. Of course, the price of maintaining this type of policy came at the expense of many social groups. To maintain this type of development and keep his powers intact, Soeharto had to resort to coercion to keep the masses at bay. One such measure was to limit the political freedom of various social groups such as trade unions and NGOs. Even though the minimum wage policy had been in place in the 1970s, it was initially not a major part of the New Order development strategy, but was largely symbolic (Manning, 1993, p. 72). Not until the events of the increasing labour unrests and political pressures in 1990s was the government pushed into a serious recalibration of the policy (Levine, 1997).

However, this type of authoritarian leadership may not hold sway in today's Indonesia where democratisation and decentralisation have strengthened the position of social groups such as trade unions. Trade unions are the die-hard supporters of minimum wage policy and their increased collective strength could greatly influence its level and implementation. It is even more crucial in the context of decentralisation of power to regional or local government. Rosen notes the experience in Latin America where there are splits between economic control and/or political control, and the distribution of gains of development take on regional dimensions within a country. This may lend support to the political break-up within a country (1996, p. 273). One of the major reasons for the decentralisation in Indonesia is to prevent such break ups by appeasing the provinces with more wide-ranging power and authority.

It is highly likely that this sort of experience has prompted the Indonesian government to pursue and maintain a vigorous minimum wage policy for political stability since 1995. In wage determination, politics certainly play a major role where classes manoeuvre and struggle through administrative, legal, and even violent means, most of which are mediated by the state (Walker, 1999, p. 275). The minimum wage fixing machinery in Indonesia is certainly no exception, where the government tries to balance the need for capital deepening with the need for increased welfare. The current political landscape has brought local government into the political battle of minimum wage determination. As part of the overall decentralisation process, the government has also decentralised minimum wage fixing to local level. Local government unsupportive of the minimum wage policy could anger labour and destabilise local government, and eventually cause major political problems for the central government. Militant labour action, reminiscent of the 1994 strikes, may destabilise local governments and rekindle a secessionist movement. It is in this setting that this thesis addresses the impact of the minimum wage policy.

In the first instance, the minimum wage policy can be seen as largely symbolic and, in symbolic politics, ideology naturally becomes the driving force (Waltman and Pittman 2002, p. 54). Politically, the state must balance the need for political stability and the desire to continue economic development through increased investment. It is a political trade-off that a country, such as Indonesia, must choose because of its political transition from an authoritarian state to a more democratic and decentralised state. Levin-Waldman (1998, p. 774) argue that the ambiguity of empirical results for minimum wage models makes the choice of models political, with regards to implications, and it is more likely that minimum wage increases will occur when there is strong political support for them. To understand the political implication of decentralising the minimum wage policy, one must relate it to its effect on the empowerment of trade unions. Previously called the 'class struggle of labour through trade unions', it is now called 'the social contract' or 'the labour regime' (Walker, 1999, p. 264). In this struggle, capitalists manoeuvre to strengthen their hand in bargaining and to weaken labour, whereas workers organize to increase their collective strength.

In a welfare state, the system of industrial relations would show employers and labour unions engaged in collective bargaining. It is argued that the policy stance between

unions and employers is assumed to be fixed: unions would promote universal welfare states, and employers would oppose each and every step leading to an expansion of social rights (Ebbinghaus and Manow, 2001, p. 13). Moreover, in a welfare state, weak governmental structures are less capable of establishing and administering complex policies (Weir et al., 1988 cited in Waltman and Pittman, 2002, p. 53). Industrial relations, under a welfare state concept, might be difficult to apply in Indonesia. Under a welfare state, trade unions and employers continually engage in a struggle to advance their respective interests. Moreover, the nature of Indonesian culture with its paternalism and patronage characteristics may not be compatible with the notion of conflict (Devas, 1997, p. 365).

The minimum wage policy administration, at local level in Indonesia, certainly bears a resemblance of policy implementation in a welfare state. However, trade unions in Indonesia are still learning the so-called 'game theory' of collective bargaining tactics that early reports of minimum wage bargaining demonstrated with the break down of negotiations and increased tension. In some cities in Indonesia, the governor had to intervene and recalculate the minimum wage level unilaterally which angered businesses and labour alike. This type of intervention defeats the purpose of collective bargaining and allows the political elite undue influence in deciding such an important matter. Also such problems may spill over to other contentious labour issues, such as working conditions and bonuses.

Labour issues were under international scrutiny when the New Order regime of Indonesia started the so-called long-term development plan. The EOI development strategy, which had been successful in the Asian NIC's, was adopted by the government. It was argued that the strategy for implementing the EOI development strategy was to open the doors of the country to capitalism on the one hand, and labour control on the other (Manning, 1993). Nonetheless, the main reason for labour controls has been political rather than economic; a fear – particularly on the part of the military – of the potential political strength of organised labour, especially against the backdrop of the latter's considerable influence in the political arena in the pre-1965 period (Manning, 1993, p. 87). At the same time, labour protection was expanded by providing workers with social security and the minimum wage legislation.

Initially, EOI development had been successful in Indonesia, as indicated by economic growth exceeding seven percent per annum during the early 1990s. The second stage of economic liberalisation was initiated by the so-called 'deregulation of the financial sector'. During this stage, the number of banks mushroomed and foreign investment significantly poured into Indonesia. At the time, there was still a considerable amount of labour control. However, in the middle of the 1990s, there were signs that this control had been somewhat relaxed. One important decision was to increase the minimum wage level significantly. It was argued that the move had nothing to do with macro-economic policies, but rather it occurred because of various international pressures to improve labour conditions in the country (Levine, 1997). One of the pressures was the threat, by the US government, of removing GSP preferential treatment. This threat was triggered by the costly labour riots of 1994. Towards the end of the New Order regime, an explosion of wildcat strikes and illegal organisations, wanting to improve wages and conditions and to protest lay-offs, were labelled communists and met with repression (Liddle, 1999, p. 69). Following the aftermath of the 1998 crisis, in which labour had been hurt even further, Indonesia now faces another difficult challenge which is the possibility of deindustrialisation which is partly blamed on the changing labour conditions, including the increase of minimum wage levels and also the increase of the collective power of trade unions.

In the new era of democratisation in Indonesia, the increasing power of labour unions could run counterproductive to the current EOI development strategy. There is a belief that, to maintain rapid growth, the government must continue to pursue an export-led strategy. The social forces in favour of such strategy are much less powerful than those in opposition (Liddle, 1996, p. 251). However, many still believe that it still requires an authoritarian government to achieve this goal. With the fall of the New Order regime, the supposition that EOI development requires authoritarian control could be in jeopardy, particularly when the so-called 'oppositional social forces' are growing in strength. Policies that would favour workers would depend on which political party controls the government. In the United States, for example, the Democratic Party is known to be more accommodating to workers than the Republican Party (Waltman and Pittman, 2002). Even without a favourable political party, the current political transition has made the labour movement a more potent force than just a thorn in the side of the government.

Labour movement had been curtailed for much of the New Order period and the minimum wage policy at that time was more symbolic than a tool for social protection. Thus, it was no surprise that the leading cause of strikes in Indonesia, prior to 1995, had been the failure of employers to observe the labour regulations, particularly those regarding minimum wages (Levine, 1997, p. 183). After the fall of the New Order regime, there were renewed hopes for an effective labour movement and effective minimum wage policy. However, Hadiz (2001) posits that in a labour surplus country such as Indonesia, it is difficult to develop effective labour movements. In addition, Indonesian labour can be easily influenced by the political elite to do their bidding in the name of nationalist sentiment. However, there are reports that a labour union has set its own political party to challenge the election. Even though the political move is relatively small, but given other political backing it could create instability if the Indonesian government's policies do not go their way. It is noteworthy that political strategy plays an important part in the application of the minimum wage strategy. It would be appropriate to argue that political reasoning is a significant force behind the decentralisation of minimum wage fixing in Indonesia.

It is also worthwhile to find out how labour movement responds to changes in the process of minimum wage determination. One important development in the industrial relations movement is the government's willingness to discuss the recent employment bill, processed and approved by the House of Representatives. Nevertheless, it has been reported that minor labour unions were opposed to the imposition of the new labour law (*The Jakarta Post*, 2003a). About 40 small unions were reported to have banded together to oppose the law (*The Jakarta post*, 2003a). In point of fact, only three large trade unions were invited to participate in the formulation of the Bill. However, the government stressed that the law was too general and detailed government rules and regulations will be formulated to implement the law. What this development indicates is that public dialogue on the formulation of labour laws has been unprecedented and from a political point of view, this occurrence significantly demonstrates a tilting in the balance of power in favour of workers.

However, it is unclear whether local independent unions will enjoy this same privilege. Unions may be a voice at national level in the participation of lawmaking decisions, but

the challenge now will be to show that same collective bargaining strength at grass-roots level, particularly when negotiating minimum wage levels at district level. Levinson (2001) charges that the World Bank, through its 1995 World Development Report, recommends that developing countries should decentralise bargaining in order to minimise union negotiating leverage. The Indonesian culture of patron-client relations, explained earlier in the chapter, may need a strong central leadership to maintain unity at national level and allow the participation of local leaders. The current minimum wage fixing in Indonesia involves negotiations between unions and employers and this is mediated by local government. The decentralisation of minimum wage fixing could, in the long run, polarise the strength of labour unions if they do not adapt quickly to the changes. Local unions would be less independent if officials from national level often intervened in disputes with firms.

The Minimum Wage Debate

Since its implementation, the cost and benefit of the minimum wage policy has been debated in both developed and developing countries. There are numerous studies on the impact of minimum wage policy, but most of these mainly occurred in the United States and Europe. During the 1980s, when the neo-liberal economic regime had become prominent, the validity of the minimum wage policy was again being questioned. One of the ideas was to improve the operation of the labour market by making it more flexible and by increasing the quantity and quality of the labour supplied. However, it was argued that minimum wage was a key impediment to the flexibility of the labour market and the bringing down of unemployment (Bazen, 1994, p. 63). During that time, economists and policy-makers were convinced that lower minimum wages could induce businesses to hire and provide experience to more unskilled workers (Prasch, 1996, p. 392). However, during 1996/97 the US government increased the minimum wage (Sunley and Martin, 2000, p. 1740). Britain also followed suit by re-regulating the minimum wage in the late 1990s.

The reascendancy of minimum wage policy debate was, in no small part, triggered by the so-called new economics of minimum wage proposed by Card and Krueger (1995). They started to reassess the economists' position regarding the textbook view of minimum wage. Through empirical evidence, via natural experiment of fast food

restaurants in several states in the United States, they found that increases in minimum wage did not have any significant impact on employment, including youth employment. In fact, they found that the minimum wage could have had even slightly positive relationships in the state of New Jersey. Even the World Bank has admitted that the minimum wage may be useful, under certain circumstances in industrialized countries, although they found no justification to applying it to developing countries (1995, p. 78). High unemployment in the US and Britain have caused their governments to reassess their position regarding the minimum wage policy. The timely success of Tony Blair's Labour governments in Britain also helped put the minimum wage policy back on their agenda (Heyes and Gray, 2001, p. 84). In the U.S. the then Clinton government enacted a law which allowed a two-stage increase in minimum wages by which the then secretary of labour Robert Rice referred to the Card and Krueger's studies to justify the increase (Dawkins, 1997, 187-188). Moreover, in the U.S., some states have their own minimum wage on top of the federal minimum wage.

Economists such as Freeman (1993) argue that there are conditions in which minimum wage fixing can be applied, without creating too much distortion in the labour market. He hypothesises that, in many cases, countries follow a strategy of 'optimal selective enforcement' of minimum wage (and other) regulations; that is, they effectively implement these laws to protect workers when the cost is modest in terms of lost jobs (demand is high in the labour market; employers have low elasticity of demand for labour), but they enforce the laws weakly when the cost of employment is sizable (demand is low; elasticity is high) (1993b, p. 128). Thus, many countries frequently increase minimum wage when their economic growth is high, but decline an increase in minimum wage when the economy is in a downturn. Indonesia applied the minimum wage policy during the 1990s when economic growth was high and the employment effect appeared to be mild (Rama, 2001). However, it is hard to see how they could effectively impose such a policy now when the economy is still recovering from a crisis.

Nevertheless, it is this type of argument, along with the fact that the minimum wage policy does not present any budgetary constraints, that governments might find it attractive to implement a minimum wage policy. One way to proceed with the minimum wage policy is to keep minimum wage increases to a minimum so as to avoid substantial job losses. Preventing the real minimum wage from falling could also be an

effective strategy for avoiding costly industrial conflict. It would certainly help Indonesia's development, as it requires political stability to stimulate economic growth.

Evidence from Developed Countries

Most studies in developed countries, mainly from the economics profession, are opposed to the application of the minimum wage policy on the grounds that it causes negative employment effects, especially on young workers. Many of these studies base their conclusions on theoretical as well as empirical analysis. Earlier and subsequent studies on minimum wage support the standards competitive model of minimum wage. Most economic studies opposed the perceived benefits of minimum wage policy (Neumark, 2001; Neumark and Wascher, 1992; Neumark and Wascher, 2004; Williams, 1993; Basu, 2000, Partridge and Partridge, 1999; Hsing, 2000; Wimmer, 2000; Hout, 1997; Williams and Mills, 1996; and Soetanto and Kleiner, 2001). For example, a study by Partridge and Partridge (1999) was conducted during the 1980s in the U.S. when many states increased their minimum wage rates. They found evidence that, during that time, increase in minimum wage coverage increased the long-term unemployment rate. Another study by Hsing (2000), using 1998 data in the U.S., found evidence of the substitution effect in which an increase in relative wage will have a negative impact on the ratio of part-time/full-time employment. A rise in minimum wage hurts job opportunities for the poor or those for whom the law is intended to assist (Hsing, 2000, p. 227). It is surmised that an increase in minimum wage might cause students to drop out of school or not attend college for work.

Perhaps the staunchest critics of the minimum wage policy are Neumark and Wascher (1992). Their studies, that focus on the impact of minimum wage policy, are consistent with the traditional economic views of minimum wage impact. Using time series and panel data analysis, they show that increases in minimum wage levels caused disemployment effects on workers, especially teenagers and young adults. Their recent study on the employment effect of the minimum wage legislation in 17 OECD countries, including New Zealand, also tends to conclude with similar results (Neumark and Wascher, 2004). In fact, their findings also conclude that countries with restrictive labour standards and higher union coverage strengthened the disemployment effect of minimum wages (Neumark and Wascher, 2004). Moreover, they also surmise that the

minimum wage only redistributes income from poor families to other poor families, instead of from rich to poor families (Neumark and Wascher, 2002). They have also been openly critical of the results shown by Card and Krueger. Their reevaluation of the Card and Krueger's study, on the employment effect of minimum wages in Pennsylvania and New Jersey using payroll data, yielded a disemployment effect in Pennsylvania, relative to New Jersey, and pointed to a measurement error in the Card and Krueger findings (Neumark and Wascher, 2000, p. 1390).

In New Zealand, studies on the impact of minimum wages also show similar results. A study by Chapple (1997) concludes that, based on time series and panel data evidence, there was a slight negative impact of increasing the minimum wage on employment. Nonetheless, as with many other studies, the results of the regression showed non-robust results. He cautions about using the results for policy decisions, because auto-correlation and omitted variable problems has rendered the models suspect (p. 47). In addition, the result is consistent with the textbook result, in that the minimum wage increase has little impact on employment.

Many other economic studies on the impact of minimum wages, reviewed by Dowrick and Quiggin (2003), yield ambiguous results. Freeman (1994) also supports this view by arguing that the majority of these studies yield a small negative impact of the minimum wage on employment. Such dubious economic results prompted Card and Krueger (1995) to comment that the problem with minimum wage might lie with the textbook static model of minimum wage, rather than the empirical evidence. Perhaps it is due to conclusions such as these that challenges to the traditional views seemed destined to emerge.

Evidence of Support for the Minimum Wage Policy in Developed Countries

Support for the provision of the minimum wage comes mostly from those outside the economics profession, although Card and Krueger (1995) reestablished the debate of the standard textbook model of minimum wage within the economics profession. They found insignificant evidence on the negative impact of minimum wages on employment in the state of New Jersey and California. Some of their findings even conclude that

increase in minimum wages actually increases employment. In addition, the Card and Krueger study (1995) also refutes other findings that show negative impacts of the minimum wage policy by pointing out weaknesses and limitations of these methods and conclusions.

Their conclusions on the findings in the United States are also echoed by findings in Britain and Europe. Recent studies by Shannon (1996) and Heyes and Gray (2001) support the view introduced by Card and Krueger. They argue that, in some cases, increases in minimum wages yield ambiguous results ranging from insignificant negative effect to no effect, and even positive effect on employment. Card and Krueger's studies in the U.S. are also echoed by others such as Boadway and Cuff (2000) and Addison and Blackburn (1999). Addison and Blackburn found some indications of a poverty reducing effect of minimum wage among teenagers and older junior high school dropouts. They measured the relationship between minimum wage changes and the family income position of low-wage workers, using state-level panel data. Boadway and Cuff also show that the minimum wage policy could be welfare-improving and employment-enhancing if combined with the institutional features of a typical welfare system.

Studies by Heyes and Grey (2001), Dickens, Machin and Manning (1994) and Machin and Manning (1997) conducted in Europe found that the national minimum wage has had a beneficial impact in raising textile and clothing workers' pay without significant negative effect on employment. Heyes and Grey argue that employer's reluctance to decrease employment was due to their desire to motivate their employees. They also add that higher wages might benefit economic development by encouraging innovation and modernization. They also propose to use wage regulation in the future, properly designed to stimulate economic dynamism. Dickens, Machin and Manning (1994) conclude that small increases of minimum wages did not have negative impact on employment in the United Kingdom (UK). Using the UK's earnings data for several years, they revealed that a small increase in minimum wage level could even have a positive impact on overall employment. Elsewhere in Europe, Machin and Manning (1997) also conclude that minimum wage increases did not threaten jobs and they also found some evidence of an equalising impact on the distribution of income among families with someone at work.

Other supporters of the minimum wage policy mainly focus on the socio-economic justice and political dimensions. Social economists, such as Levin-Waldman (1998) and Cordero (2000), focus on the notion of social justice as the reason for the application of the minimum wage. They emphasise that workers have the right to have wages that give them a good life. Cordero (2000) even echoes Marx's view that workers work according to their abilities and get paid according to their needs. However, even in the United States, the federal minimum wage may not be sufficient for a good life. Cordero contends that morally the goal is to get the minimum wage as close as possible to the good life minimum. This is much worse in developing countries, such as Indonesia, where the early minimum wage was set below the minimum physical need. Other social scientists, such as Hout (1997), express the need to increase minimum wage to decrease inequality for low-wage workers. The need to increase minimum wages is because real minimum wages will decrease over time and cause wage inequality.

There are also other studies that refute the textbook case. A study was conducted by Levin-Waldman (2000), based on the Levy Institute Survey of Small Business in the United States, during winter of 1998. The study concludes that a recent minimum wage hike did not have the expected theoretical disemployment effect on those small businesses. The minimum wage increase did not even affect the demand for labour. There were no significant lay-offs expected from the result of the minimum wage increase. In fact, the study concluded that existing workers were not at all affected by the increase. The study did conclude, however, that the increase in minimum wage did affect the future hiring of workers by small firms (Levin-Waldman, 2000, p. 725).

Levin-Waldman (1998) and Waltman (2000) also argue that the minimum wage is, above all else, a political issue. Waltman believes that the debate on the minimum wage stems from the lack of understanding of the minimum wage as a political issue. He argues that the general public support the minimum wage, which puts pressure on the legislative body to vote in favour of its imposition. This view is reinforced by a study, conducted by Levin-Waldman, on the voting patterns in the House of Representatives in the U.S. Even though Democrats traditionally favour a minimum wage, representatives from states with union density tend to favour increases in minimum wages, regardless of their political affiliation (Levin-Waldman, 1998, p. 774). As explained earlier, trade

unions are staunch supporters of the minimum wage. The same could also apply to developing countries such as Indonesia where democratic transformation can boost public support for the minimum wage policy.

In the end, the impact of minimum wage policy can depend on the methods used to assess the effects, which dimension is used to explain it and which institution assesses its impact. The International Labour Organisation and the World Bank appear to justify this notion as each positions itself at each end of the spectrum when it comes to the impact of minimum wages. However, while the former supports the imposition of the policy, the World Bank's (1995) view is unclear when it comes to developed countries, but it clearly rejects the merit of the policy in regards to developing countries. Nevertheless, the minimum wage debate has also extended to developing countries.

Minimum Wages in Developing Countries

Although most debates on the impact of minimum wage legislation occur in developed countries, there is also a body of research and debate related to developing countries. It appears that, with regards to developing countries, most studies relate the minimum wage policy to poverty alleviation as well as the employment impact. The results favour both proponents and opponents of minimum wage policy. However, the World Bank's World Development Report (1995, p. 75) argues that in developing countries the minimum wage policy clearly does not help to protect poverty-stricken workers. It argues that a more positive impact of the minimum wage policy is mostly found in developed countries and less in developing countries (World Bank, 1995, p. 74). The argument is based on the premise that labour demand in developing countries tends to resemble the neo-classical economic model, due to their oversupply of unskilled labour. This conclusion may hold true, due to the fact that the minimum wage policy only affects workers in the formal sector. The most vulnerable workers are usually employed in the informal sector and Indonesia is no exception. Even though the minimum wage policy was supposedly applied to all workers, it is unlikely that some workers in medium and small businesses, as well as the informal sector, receive the minimum wage. Studies published by the World Bank, on the impact on minimum wages in Indonesia, often point to the negative effects rather than the positive effects. The studies propose more democratic industrial relations by focusing on collective bargaining. In

this way, flexible wages can still be achieved instead of the minimum wage regime, where wages become rigid. Nonetheless, this argument does not take into account the social and political factors affecting the application of the minimum wage policy in developing countries.

Application of Minimum Wages in Developing Countries

The minimum wage policy has also been applied to many developing countries. Starr (1981) explains that the development of minimum wage policy had different beginnings in different parts of the developing world. In Latin America, the minimum wage policy was pioneered by Mexico and adopted throughout that country during the mid-1930s and especially 1940s (Starr, 1981, p. 7). In Africa, effective minimum wage laws were implemented in 1940s and 1950s in many former British Colonies. The development of minimum wage policy in Asian countries was not as extensive as elsewhere (Starr, 1981, p. 11). It was also in the former British colonies that the early minimum wage policy was imposed⁷. In South Korea, the minimum wage policy was implemented in 1988. In Indonesia the minimum wage law was actually introduced in 1969 (Simandjuntak, 1993). However, it was a mere symbol until the 1990s, when domestic and international pressures to improve working conditions, forced the government to vigorously pursue a more binding minimum wage policy (See Chapter V for more detailed explanation). Strangely enough, studies on the impact of the minimum wage policy in developing countries have not been as numerous as those in developed countries. However, interests on the impact of minimum wages in developing countries appeared to start anew after the Card and Krueger's debate.

The minimum wage in developing countries is intended for the protection of vulnerable group of workers but its application varies among countries and industries. The application of minimum wages is not confined to manufacturing, but has been used in various industry sectors in developing countries. Most frequently, the application of minimum wages is to eliminate the so-called 'sweating' or exploitation of workers (Starr, 1981, p. 17), mainly in the clothing industry. Even though there were exceptions, such as in Sri Lanka when the government implemented minimum wages to immigrant

⁷ According to Starr (1981, p. 12), the first Asian countries to adopt the minimum wage laws were Sri Lanka (1941), India (1948), Malaysia (1946), and Fiji (1957). Non British colonies like the Philippines introduced the minimum wage laws in 1951.

Indian workers, who were employed in tea plantations, (Starr, 1981, p. 30) and in Malawi where minimum wages were applied to plantations (Livingstone, 1995, p. 730). In India, the minimum wage is focused on the informal and unorganised sector, although its application in the agricultural sector is not enforced (Saget, 2001). In Indonesia, the minimum wage is focused on the manufacturing sector, although the provision applies generally to all industries employing at least 25 workers⁸. In addition to district/city minimum wage, there are also provincial minimum wage and a sectoral or industrial minimum wage, particularly in rubber and palm oil plantations in Sumatra and Kalimantan provinces. The district/city minimum wage level is usually higher than the provincial minimum wage level.

With regards to multinational firms (MNCs), the general norm is that MNCs pay workers less than the minimum wage. Complaints of lack of minimum wage compliance in MNCs appear directed at labour intensive industries such as textile, garments and footwear (TGF) firms in developing countries. In some cases, several MNCs such as Nike were under the spotlight for the mistreatment of workers, including complaints over minimum wage compliance. MNCs in general pay workers higher than local companies. Foreign ownership and export-oriented companies/firms are also associated with higher compliance with minimum wages (Harrison and Scorse, 2003). In Indonesia, for example, average wages in MNCs were higher than those of locally-owned firms (Lipsey and Sjöholm, 2001). Complaints about MNCs generally focus on other lack of labour standards, such as benefits other than minimum wages which workers are supposed to receive, and the use of child labour. However, Harrison and Scorse (2003) also argue that an increase in compliance is also associated with an increase of human rights activism and international pressure, such as those related to the GSP (Generalized System of Preferences) in the Indonesian case.

Minimum Wage Studies in Developing Countries

Some studies in developing countries took place in Latin America and Africa, with fewer studies in East and Southeast Asia. Unlike the controversies in the West, the general conclusion is that minimum wage increases in developing countries have had

⁸ Indonesia's OEI development in 1980s and 1990s was centred on TGF manufacturing which depended on low wages. The focus of the minimum wage policy was improving conditions for workers in these sectors (See Chapters IV and V for details).

detrimental effects on employment and wages. Results of these studies confirm and strengthen the detrimental effects of minimum wage increases. A study by Freeman and Freeman (1991) in Puerto Rico shows that applying a U.S. minimum wage in Puerto Rico resulted in substantial losses in employment and altered the allocation of labour across industries. The reason for this highly significant effect was that a high proportion of workers in Puerto Rico earn less than the minimum wage.

Bell (1995) conducted a comparative study on the impact of minimum wage in Mexico and Columbia. Based on a cross-section and time series evidence of manufacturing firms in both countries, she found contrasting results. In Mexico, minimum wages had a negligible impact on employment and wages, whereas in Columbia the impact was significantly negative. In Mexico, she contends that the minimum wage policy is not effective because there is considerable non-compliance, especially for part-time and female workers in the informal sector. Many workers, especially in the informal sector, were paid wages below the minimum wage. In Colombia, on the other hand, the minimum wage has a much stronger impact on wages, even though the majority of the sample for the panel data analysis were in large cities, where firms were relatively large and more stable (Bell, 1995, p. 14).

Another study by Maloney and Nunez (2001), on the impact of minimum wage in Colombia, concurs with Bell's findings and suggests a more severe distortionary effect of minimum wage on wage distribution and employment. They found that in Latin American countries, in which they use Colombia as an example, a trade-off between poverty and reduced flexibility of the labour market is likely to be more severe in Latin America than in The United States. A rise in minimum wages had a highly significant impact on employment. In addition, they also argue that there is likely to be an adverse impact of the minimum wage on the informal sector.

A study by Livingstone (1995), on minimum wage policy in Malawi, concludes that minimum wage policy is not the answer to increasing the wage of workers. He argues that the minimum wage policy creates a widening wage gap between the wages in large-scale and small-scale enterprises. The reason is that large enterprises tend to pay workers minimum wages, whereas smaller enterprises generally did not. He suggests instead that a more effective way was to raise the supply price of labour by improving

the farm and non-farm incomes of the rural households, through agricultural intensification and other measures (Livingstone, p. 751). Another study on the minimum wage effect in Africa by Jones (1997) also concludes that there is a detrimental effect of minimum wage increases on formal sector employees in Ghanaian manufacturing. She adds that there was also some evidence that displaced workers from the formal sector ended up working in the informal sector.

Warr (2004) entertains the prospect of raising the minimum wages as a poverty reduction strategy in Thailand. Like Indonesia, Thailand has been undergoing a decentralisation process and one of these aims is poverty reduction. Although he did not perform any empirical analysis, he concludes that increasing minimum wages would have two effects on the incomes of workers who receive minimum wages. Firstly, the incomes of those who retain their jobs and actually receive the minimum wages will increase. Secondly, the incomes of those who lose their jobs, because their labour becomes more costly to employers, will decrease. Since the recipients of minimum wages tend to be non-poor, he concludes that the minimum wage policy in Thailand is not a good instrument for poverty reduction.

Table 3.1 Selected Empirical Studies on the Employment Impact of the Minimum Wage Policy in Developing Countries

STUDIES BY	Country	Method Used	Results
Freeman and Freeman (1991)	Puerto Rico	Time series and cross industry analysis	Significant loss of employment due to application of United States minimum wages in Puerto Rico.
Livingstone (1995)	Malawi	Descriptive Statistics	Minimum wage creates a widening wage gap between the formal sector and an equilibrium wage rate.
Bell (1996)	Mexico and Colombia	Panel Data Analysis	Insignificant employment impact of minimum wage increases in Mexico, but significant disemployment impact in Colombia.
Lustig and McLeod (1996)	Developing countries (Latin America, Asia and Africa)	Cross country analysis	Minimum wage increase associated with short term poverty reduction, but this causes unemployment.
Jones (1997)	Ghana	Time series and cross-sectional analysis	Increase in minimum wages causes reduction in formal sector jobs and increases in informal sector jobs. There was evidence of displaced workers joining the informal sector.
Maloney and Nunez (2001)	Latin American Countries – Colombia	Panel data Analysis	Adverse impact of minimum wage increases on formal sector employment and the informal sector. Negative impact from increases in minimum wages is higher than those in industrialized countries.
Saget (2001)	Developing countries (Asia, Latin America and Africa)	Cross country analysis	The effect of minimum wage levels on employment appears to be insignificant and decent minimum wages might help poverty.
Warr (2004)	Thailand	None	Minimum wage increases are not a good policy for poverty reduction because recipients are usually non-poor.

An albeit more positive outcome of the minimum wage policy came from studies which combined data from developing countries in Latin America, Asia and Africa. A study by Lustig and McLeod (1996) reveals that increasing minimum wages is associated with poverty reduction. However, the study also concludes that increases in minimum wages also causes unemployment and cautions on the use of the minimum wage policy as an instrument for poverty reduction. On the other hand, a study by Saget (2001), using similar cross-country analysis of comparable developing countries, supports the application of minimum wage policy for poverty reduction and a guarantee of decent work. She concludes that higher minimum wage is associated with lower levels of poverty in developing countries and provides unskilled workers with a decent living.

Summary

The minimum wage debate clearly shows that the minimum wage policy can be beneficial and also detrimental to employment, depending on the conditions and empirical evidence. The traditional economic theory suggests that, under perfect competition, an increase in minimum wage can create disemployment in the formal sector and increase employment and depress wages in the informal sector. A counter argument, pioneered by the studies of Card and Krueger, suggests that the minimum wage need not have a detrimental impact on employment. Nonetheless, results of minimum wage studies from developing countries appear to lean towards a negative effect.

In addition, there are other reasons why the minimum wage policy should be imposed. Firstly, the minimum wage is consistent with the notion of human rights where a person has the right to work and receive fair wages. The minimum wage provides fair wages to workers. By setting the minimum wage level at the basic cost of living, the minimum wage ensures basic necessities to workers. Secondly, the minimum wage does not have direct budgetary consequences to a government. Thus, development funds can be diverted to other uses. Above all, minimum wages are not just a symbol but also represent a genuine effort on the part of the government to pay more attention to workers.

More importantly, the minimum wage policy is a political commodity. It was political pressure that allowed the minimum wage to be vigorously pursued by the Indonesian government in the 1990s. This government would not want a repeat of the labour riots in the past, which had the potential to destabilise the economy, particularly when it is still recovering from this crisis. It has also been suggested that politics were involved in recent high minimum wage increases in 2001 and 2002. The imposition of the minimum wage policy and the levels set are likely to be dependent on political as well as economic factors. Therefore, the continuous debate on minimum wage policy, and other non-economic factors that affect the setting of minimum wages justify the holistic approach taken by this thesis.

The ambiguity of empirical studies, on the effect of the minimum wage policy, also justifies the need to apply a holistic approach. The main contention of the debate is that empirical studies, in developed and developing countries, often contradict each other. Studies in developed countries generally agree with the neo-classical view of the negative employment impact of minimum wage policy. However, recent studies challenge that perception and some even argue that, under certain conditions, minimum wage increases need not have a detrimental impact on employment. With regards to developing countries, there are also studies that exonerate the negative perception of the minimum wage policy. However, most argue that the minimum wage policy is ineffective in addressing the problem of poverty because most of the poor work in the informal sector and are therefore not covered by the policy.

Despite its shortcomings, especially in relation to its impact on employment, the minimum wage policy, i.e. its overall process under the local government authority, could encourage and promote social dialogue. If one only considers the economic view of the minimum wage effect, then perhaps the minimum wage policy should not have been installed in the first place. Nonetheless, the ambiguity of much empirical evidence provides an impetus to at least argue on the merit of minimum wages. Even if the minimum wage policy does have a small negative impact on employment, its benefits in terms of improving industrial relations far outweighs its perceived negative impact on employment.

In any case, the advent of the newly found political strength of trade unions, make it difficult to abolish the minimum wage policy. Any such attempt could politically destabilise a country which is still trying to recover from its last crisis. As explained earlier in the chapter, trade unions are supporters of the minimum wage policy and can act as enforcement agents for its implementation. In addition, the minimum wage fixing process in Indonesia has now been transferred to local governments, who know the economic and labour market conditions of their respective regions. Thus, the development of independent trade unions and localisation of the minimum wage fixing are key ingredients to meet the challenges of decent work. The minimum wage fixing process could be used, as Watanabe (1976) argues, as a tool for restraining possible excessive wage increases by trade unions.

Chapter IV

Profile of Indonesian Economic Development and the Labour Market

Introduction

The Indonesian economy has been experiencing a transformation from an agrarian state to an industrial economy. The economy has experienced different phases since independence, from economic stagnation in the 1960s, to import substitution, financed by the oil boom in the 1980s, to accelerated growth in 1990s through export-oriented industrialisation. The process was interrupted by the economic crisis of 1998 and the economy has been recovering ever since. Recently, the economy was transformed again by a political decentralisation process that started in 2000. Regional governments have greater autonomy in their own regions to implement economic reform to generate their own income. Those regions with a concentration of industries would surely focus their attention on expanding these industries by attracting investment from outside the region. Thus, solving their labour problems would be crucial in attracting these investments to the regions. This chapter discusses the state of the economic development and the labour market that affected workers' conditions in Indonesia, as well as the employment dilemma facing the country. It addresses the problem of unemployment and under employment, as well as industrial conflicts due to the violations of labour standards, especially the lack of minimum wage compliance. It also explains the major reasons for choosing the fieldwork area as well as the relevance of studying the minimum wage policy within the context of Indonesia's development agenda.

Overview of Indonesian Economic Development

The Indonesian medium and long-term development trajectory followed the so-called "Development Trilogy": an equitable distribution of development and its outputs to create social justice, achieving significant economic growth, and ensuring a healthy and dynamic national stability (cited in ILO Jakarta, 1999). Prior to the economic crisis, Indonesia's economic development in the last quarter century had been considered a success (Liddle, 1996, p. 236). A large part of that success was the modernisation drive from an agrarian state to a predominantly industrial state. One of the stated objectives of

the current long term development plan that runs from 1994 to 2019 is improving the welfare of workers through "*Pancasila Industrial Relations*" such as improvements in working conditions and labour protection, including the situation of women workers by eliminating gender discrimination, and better protection will be provided to women as well as to overseas workers and working children (cited in ILO, 1999, p. 2).

Indonesia's Development Path

This type of development path started when the New Order government under the leadership of President Soeharto came to power in the late 1960s. Under Indonesia's first president Soekarno, economic policy was under hostage from his guided democracy principle (Liddle, 1996, p. 112). Soeharto shifted foreign policy away from the neutrality (and, some would say, pro-communism) of the latter years of Soekarno rule and emphasized economic rehabilitation and development along Western lines (Todaro and Smith, 2003, p. 663). The New Order government translated that path into the so-called long-term development plan (PJP), consisting of 25 years long-term development plan divided into five five-year development plans dubbed REPELITA. The PJP was mandated through the State Policy Guidelines called GBHN (*Garis-garis Besar Haluan Negara*), but the REPELITA during the *New Order* was enacted through Presidential Decrees. The first long term development plan, dubbed PJP I which ran from 1969 to 1993, was focused on economic growth (Bappenas, 1994). Other development goals, including employment, were calibrated to the success of economic growth. The drive towards industrialisation mainly focused on manufacturing growth. Since then, the government adopted market oriented macro-economic policies that had encouraged domestic and foreign private investment (Liddle, 1996, p. 237).

The industrialisation drives during the PJP I consisted of two stages, import substitution (ISI) and export-orientation industrialisation (EOI). During the 1970s the government opened the country to the outside world and embarked on an industrialisation strategy until the country was ready to achieve the take off stage at the end of the 20th century. Initially, the early stage of economic development involved import substitution and was funded by the so-called petro-dollars obtained from the oil boom of the 1970s and early 1980s. In the next stage, the decline of oil prices in the 1980s encouraged the

government to adopt export-oriented industrialisation (Akita and Hermawan, 2000, p. 271). The government also deregulated obstacles that impeded economic activity and shifted to a non-oil export-oriented industrialisation strategy, focusing on labour intensive light industries, such as garment, footwear and electronics assembling. By 1990, balance between agriculture and manufacturing was achieved, shown in Table 4.1 where manufacturing GDP exceeded agriculture.

The second long-term development plan (PJP II), which was supposed to run from 1994 to 2019, was to build on the success of the PJP I before it was disrupted by the crisis. The development strategy was to take into account the global era of competition by increasing the competitiveness of the economy. The industrial strategy was focused on increasing the competitiveness of industrial products based on higher technology, higher quality products, and more productive employment. It included development of small and medium firms in which linkages with larger firms are established to increase productivity. While the focus of PJP I was on textile, PJP II focused on agro-industry and higher value added products such as electronics and chemical products. In REPELITA VI, the first five-year plan of PJP II enacted through Presidential Decree Number 17 1994, manufacturing growth was planned to absorb more than 25 percent of all new labour force entrants (Bappenas, 1994). The success is reflected in Table 4.1 where the real GDP of manufacturing in 1997, by far, exceeded any other economic sectors. However, as we shall see in the later part of the chapter, the economic development was insufficient in addressing the employment issue.

The economic crisis of 1998, which disrupted the PJP II, has not diverted the purpose of long-term development, but the focus of the post-crisis government was to revitalise the economic, political and social fabric of Indonesia. The national development programs of 2000-2004 (PROPENAS) mandated through Law Number 25 2000, were designed for economic reform and revitalisation (Bappenas, 1999). This is the transitional phase as the PJP II was re-aligned to 2005-2025 periods. The PROPENAS appears to be pro-labour as one of the economic development programs was in the area of labour market policies. The democratic transition and decentralisation had forced the government to put more emphasis on workers' rights and welfare. In addition to increasing

employment opportunity, workers' wages were to be increased, minimum wage fixing shifted to local governments and trade unions were given more freedom to participate. The product of these developments culminated in two new labour legislations, namely Law Number 13 2003 on employment and Law Number 2 2004 on Industrial Relations Dispute Resolution, which were approved by the House of Representatives (see Chapter IX for more details). Economic development prior to the approval of these laws certainly reflected an emphasis on economic growth rather than social justice.

Table 4.1 Real GDP (1993 prices) of Indonesia 1990-2000 by Industrial Sectors (Billion Rupiahs)

Sectors	Year										
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999*)	2000**)
Agriculture	53,056.2	54,583.0	58,002.1	58,963.4	59,291.2	61,885.2	63,827.8	64,468.0	64,029.3	65,361.4	66,088.3
Mining and Quarrying	26,627.8	29,968.8	30,460.8	31,497.3	33,261.6	35,502.2	37,739.4	38,538.2	37,473.0	36,831.5	38,730.2
Manufacturing	54,210.5	59,940.8	66,042.0	73,556.4	82,649.0	91,637.1	102,259.7	107,629.7	95,320.6	97,786.3	105,102.5
Electricity, Gas and Water	2,507.6	2,719.5	2,960.8	3,290.3	3,702.7	4,291.9	4,876.8	5,479.9	5,623.2	6,084.8	6,649.5
Construction	15,225.6	17,486.5	19,663.5	22,512.9	25,857.5	29,197.8	32,923.7	35,346.4	22,460.4	22,093.8	23,246.9
Trade, Hotel and Restaurant	41,724.9	46,668.8	50,343.8	55,297.6	59,504.1	64,230.8	69,475.0	73,523.8	60,257.2	59,997.9	63,448.8
Transport and Communication	18,474.0	20,040.4	21,618.0	23,248.9	25,188.6	27,328.6	29,701.1	31,782.5	26,975.1	26,782.1	29,284.0
Financing, Insurance, Real Estate and Business Services	21,479.3	24,308.5	26,163.5	28,047.8	30,901.0	34,313.0	36,384.2	38,543.0	28,278.7	25,996.5	27,382.7
Social Services	29,956.0	31,049.1	32,219.6	33,361.4	34,285.1	35,405.8	36,610.2	37,934.5	36,475.1	37,117.1	38,001.5
Total GDP	263,261.9	286,765.3	307,474.2	329,775.8	354,640.8	383,792.3	413,797.9	433,245.9	376,892.5	378,051.4	397,934.3
Total GDP Without Oil and Gas	232,713.3	253,570.4	274,667.1	296,861.2	320,652.4	350,290.0	378,871.2	398,675.9	342,510.2	344,239.8	363,676.1

Source: Statistics Indonesia, Economic Indicators various years

Notes: *) Temporary **) Very temporary

Pre and Post Crisis Economic Development

Indonesia during the late 1980s and early 1990s was arguably on the way to becoming a newly industrialised economy following in the footsteps of the Asian Tiger economies of South Korea, Taiwan, Singapore and Hongkong. As the share of agricultural employment has fallen, manufacturing, construction, trade, transport and services have all absorbed substantial amounts of labour (Manning, 1993, p. 68). The country had successfully shifted from a totally agrarian state to light industry manufacturing. Table 4.1 shows that since 1990 the manufacturing sector gross domestic product (GDP) had exceeded agriculture. The service sector had also been growing significantly during the same period. The shift from import substitution to export orientation had ensured Indonesia's entry into the global market. The expansion of exports was also a key factor in output growth in addition to the rise in export-oriented investment (Akita and Hermawan, 2000; Thee, 2000). Deregulation and the so-called structural adjustment program packages during the 1980s and 1990s were proof that Indonesia's development trajectory followed those prescribed by the neo-liberal regimes of the West. Everything went according to plan until the financial crisis of 1997. Prior to the crisis the real GDP growth had exceeded seven percent per annum during the 1990s. The manufacturing sector, which accounted for approximately 25 percent of the total GDP, was the main export earner. An important source of growth was the non-oil manufacturing sector, especially in export-oriented industries such as garments and electronics. These sectors were also important in terms of labour absorption.

Lack of skills and education of workers mean that Indonesia chose the 'low road' to development in which industrialization depended on labour intensive sectors, such as textiles, garments and footwear (TGF). The 'low road' to development was primarily characterised by its high labour surplus and relatively low educated workforce, which attract multinational firms, but could backfire with decreased competitiveness. This type of development path also calls for control instead of labour freedom. Although workers were allowed to form firm-level unions, they were only allowed to join the state controlled All Indonesia Workers Union or SPSI. It was alleged that SPSI was created as an instrument of control by the government, instead of representing workers' interests. It was often alleged that the SPSI leadership was often appointed

by the government and included military officers to fill leadership roles. The issue of labour rights and standards only started to emerge during the early 1990s with the formation of rival trade unions and the murder of a female labour activist, and culminated in a violent demonstration in North Sumatera in 1994. Since then, political pressures from within the country and abroad to improve working conditions became so strong that the government had to yield to their demands. One of those pressures was the threat of taking away Indonesia's GSP (Generalised System of Preferences) rights by the United States government, which threatened to derail the country's export oriented development path. Consequently, one of the government's responses was to pursue the minimum wage policy vigorously. Unfortunately, labour control was still in place until the economic crisis of 1998.

The financial crisis and the subsequent global economic downturn significantly deflated Indonesia's perceived economic miracle. It was by far the worst affected economy in East Asia (Hill, 2000, p.117). The crisis was partly triggered by the Thai Baht's crash in June 1997, exposing Asian countries' weaknesses in unsustainable trade exchange, large external debt and a shaky financial system. The deregulation packages during the 1980s which had been the chief catalyst of export-oriented development also turned out to be its Achilles heel as bad debt partly contributed to the collapse of the whole economic system. Indonesia's deregulated banking sector was the first to fall, followed by the whole economy in 1998. This was aggravated by the fact that the political and social system was unable to cope with the crisis (Hill, 2000, p.135). As shown in Table 4.1, real GDP shrank by 13 percent in 1998, almost twice as much as the next affected economy, and the value of the Rupiah, the national currency, fell by more than 70 percent. The manufacturing sector also contracted by a similar margin as the decline in the GDP. There had been a rebound in some respects, but by 2000 real GDP had not reached the pre-crisis level of 1997. Hill (2000) also stressed that the crisis encompassed social, economic, and political dimensions.

The crisis affected Indonesia politically, culminating in the fall of Soeharto's New Order regime in 1998. Other significant changes included decentralization, in which local governments were given much greater autonomy to govern their own regions.

The main reason for decentralisation was that the central government could not effectively provide for and finance all public services in a country so physically large and ethnically diverse (Smoke and Lewis, 1996, p.1284). Perhaps an even more important reason, at least politically, was to prevent rebellious provinces seceding. Natural resource rich provinces such as Aceh and Papua had been attempting to seek self-rule from the central government for some time. By transferring significant authority from central control, local governments were being empowered through revenue sharing with the central government (Tambunan, 2000, p. 52). Local governments, especially those lacking natural resources, must eventually be able to generate their own revenues with little assistance from the central government. Thus, Indonesia has had to face not just the challenges of global economic integration but also decentralisation of power to the second tier local governments, which are district and city level. Indonesia's membership of international economic organisations such as the WTO and APEC, have ensured that it also has no choice but to join the global market (Tambunan, 2000, p. 51).

The Role of the Manufacturing Sector

Indonesia's manufacturing sector has been the engine of economic growth and employment creation since the late 1980s and early 1990s. The important role of the manufacturing sector came to the fore after the New Order government was installed in the late 1960s. However, accelerated manufacturing growth had only been achieved during the 1980s via import substitution and funded by the oil boom. During the 1990s, the most important developments were the marked slowdown in employment growth in agriculture and the acceleration in the rate of growth in job creation in manufacturing, construction, transport and communications (Manning, 1997, p. 4). Job creation in manufacturing was due to export-oriented industrialization which was spearheaded by labour intensive light industries, such as garments and footwear in the 1990s. By 1995, nine-tenths of manufacturing output comprised of a diverse range of manufacturing products, including those mostly oriented for domestic markets such as motor vehicles, and those mainly for export such as wood products, garments, footwear and electronics (Booth, 1999, p. 115).

The economic crisis of 1998 changed all that dramatically. However, although the crisis slowed down growth of 10-12 percent per annum from 1990 to 1996, to -12 percent in 1998, the manufacturing sector is still significantly important. In the year 2000 the manufacturing sector still contributed 26 percent of the total GDP and 18 percent of labour absorption, the third highest after agriculture and trade (see Table 4.2). However, since the recovery period (1999-2000), the number of workers in the manufacturing sector has been steadily increasing. The sector is important in absorbing the increasing number of labour force entrants in the future because the government is still relying on the export-oriented development strategy.

The sector is still recovering from the onslaught of the crisis and the new challenges that must be faced. The future looks more and more uncertain, especially for industries that rely on low wages. In fact, some Indonesian scholars have suggested that due to the rigid labour policies, such as the minimum wage policy, increasing global competition and a high cost economy due to a high degree of rent seeking, Indonesia's non-oil manufacturing sector is experiencing a de-industrialization process, especially pertaining to labour intensive industries (*Kompas*, 2004). The issue of minimum wage legislation would certainly be part of that concern, especially now that local governments as well as trade unions have greater influence in minimum wage setting. Moreover, the fact that the government is still relying on EOI to spur economic growth could alter the way the government, especially local government, implements the minimum wage policy.

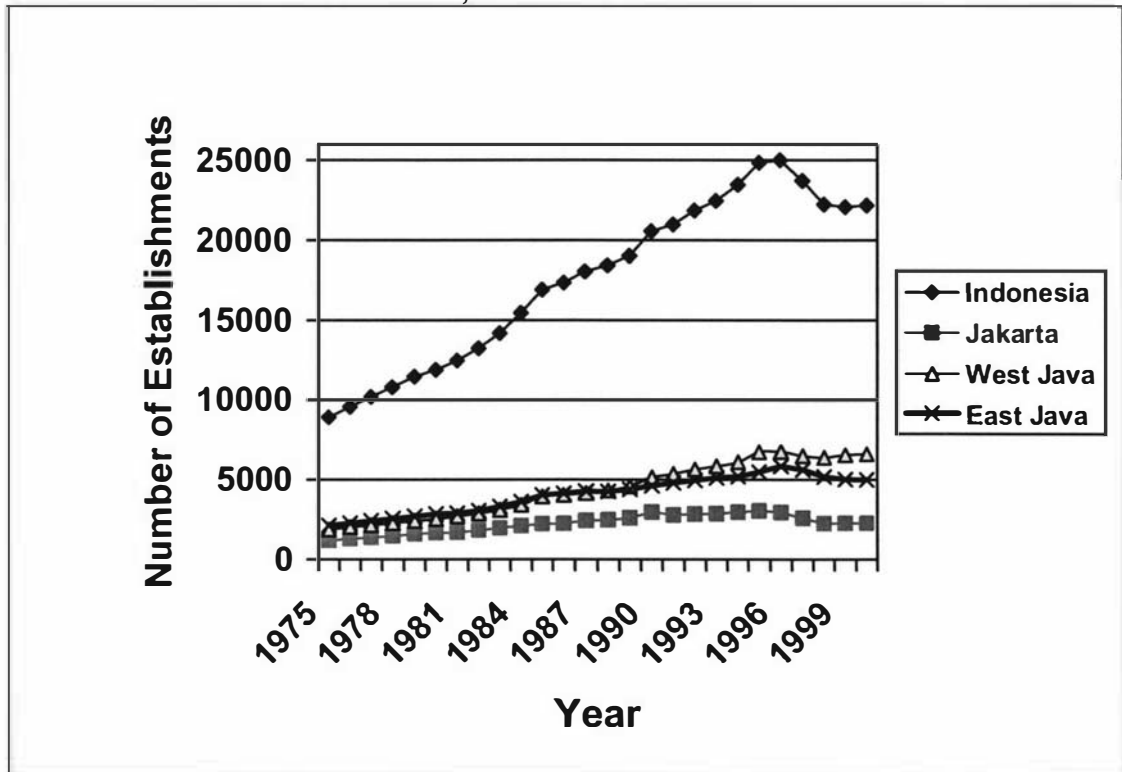
Large and Medium Manufacturing

Much of the growth in manufacturing has been contributed by the large and medium manufacturing sectors that account for more than 75 percent of manufacturing sector GDP. This was despite the fact that in terms of employment it only accounted for about one third of all manufacturing workers. The remaining two-thirds are employed in small and cottage industries. Figure 4.1 shows that the number of establishments doubled from under 9000 in 1975, to 18, 069 in 1990, and reached its peak of 25, 002 establishments in 1996. However, due to the crisis the number began to decrease significantly from 1997 onwards and has not recovered to the pre-crisis level of 1996, even though the number stabilized slightly in 1999 and 2000. This condition had

prompted some observers to suggest that the country is experiencing symptoms of de-industrialization (*Kompas*, 2004).

Large and medium manufacturing establishments are found in all Indonesian provinces, but the majority are concentrated on the island of Java, and several provinces in Sumatera, Kalimantan and South Sulawesi. Most of the factories that produce textiles, garments and footwear are located in the industrial urban centers of West Java, Jakarta, East Java and, to a lesser extent, Batam (a special free trade zone in Riau Province, Sumatera). Similarly, the metal products sector, which includes electronics are also concentrated in West Java and Batam. Other industries, such as wood and wood products (for examples rattan and plywood) are mostly concentrated in Kalimantan provinces, whereas agro-based industries such as rubber and palm oil industries are mainly concentrated in Sumatra.

Figure 4.1 Number of Large and Medium Manufacturing Establishments in Indonesia and Selected Provinces, 1975-2000



Source: Statistics Indonesia, Large and Medium Manufacturing Establishments Publications, Various Years (1975-1999) based on the Backcasting data and 2000 based on the annual data.

The large and medium manufacturing sectors are mainly concentrated in several provinces in Indonesia. The medium establishments, which by definition have between 20 to 99 persons engaged, make up more than 60 percent of the total large and medium establishments¹. Over fifty percent of large and medium manufacturing firms are concentrated in the island of Java, notably Jakarta, West Java and East Java². The rest are scattered in other provinces, such as North Sumatera and Riau, Central and East Kalimantan, and South Sulawesi. Provinces in Kalimantan Island have specialized in the wood industries, which are plywood and rattan. Several provinces in the Sumatera island, notably North Sumatera and Riau, are specializing in the rubber and palm oil industries. The island of Batam, part of the province of

¹ Establishments refers to the location of the production process, be it a factory or simply a workshop. Establishment is only synonymous with firm if the production site is only one firm. Most of the large and medium establishments are firms. However, there are also firms that could have more than one establishment, meaning that the firm has several production sites but with the same bookkeeping.

² The majority of large and medium manufacturing firms are concentrated in these four provinces.

Riau, is a special case due to its close proximity to Singapore. It is a special free trade industrial area for electronics, computer parts and, to a lesser extent, garments.

In Java, large and medium manufacturing establishments are concentrated in three provinces: West Java (Jawa Barat), East Java (Jawa Timur), Jakarta (the capital city and province). The three provinces make up more than 50 percent of the total number of large and medium manufacturing and almost 70 percent of large establishments. Central Java and Jogjakarta provinces, the other provinces in Java, are known more for medium establishments than large establishments³. Figure 4.1 shows that West Java was the province with the largest number of establishments (since 1988). The establishments range from food processing, textiles and garments, and electronics and automotive parts. Most of these establishments are located in the Jakarta, Bogor, Tangerang and Bekasi (Jabotabek) industrial belt, plus the greater Bandung area with its textiles, garments and footwear industries. As with the other provinces, West Java also suffered significantly from the crisis. Figure 4.1 shows that in 1997 the number of establishments decreased significantly. However, relative to other provinces, manufacturing firms in West Java recovered in 1998. In fact, while the total number of establishments in Indonesia remained somewhat steady after the crisis, the number of establishments in West Java actually increased from 1998 to 2000. This condition is of significant importance when one considers the implications of the recent labour policy changes of the minimum wage provision. It is one of the reasons West Java was chosen as the fieldwork area, particularly the Jabotabek and Bandung areas.

Manufacturing Sector in West Java

The manufacturing sector in West Java has been an engine of growth within the province. This sector was the largest contributor of economic growth in the last two decades. More than any other sector, over 40 percent of the Gross Domestic Regional Product of West Java during the 1990s came from the manufacturing sector. The growth of large and medium manufacturing, in particular, could be considered phenomenal compared to other provinces. Figure 4.1 shows that, prior to the crisis, the number of large and medium establishments grew from 1872 in 1975, below that

³ The newly promoted Banten Province officially became a province in 2001. However, it was part of West Java prior to 2001 and, for the purpose of this thesis, was mainly regarded as part of West Java partly because some government functions were still conducted in West Java.

of East Java at the same period, to 4305 in 1988 (exceeding East Java), and reached a peak of 6747 in 1996. However, as with other major provinces that number also started to decline in 1997 and has not recovered up to that level.

Figure 4.2 Map of West Java, Java Island, Indonesia

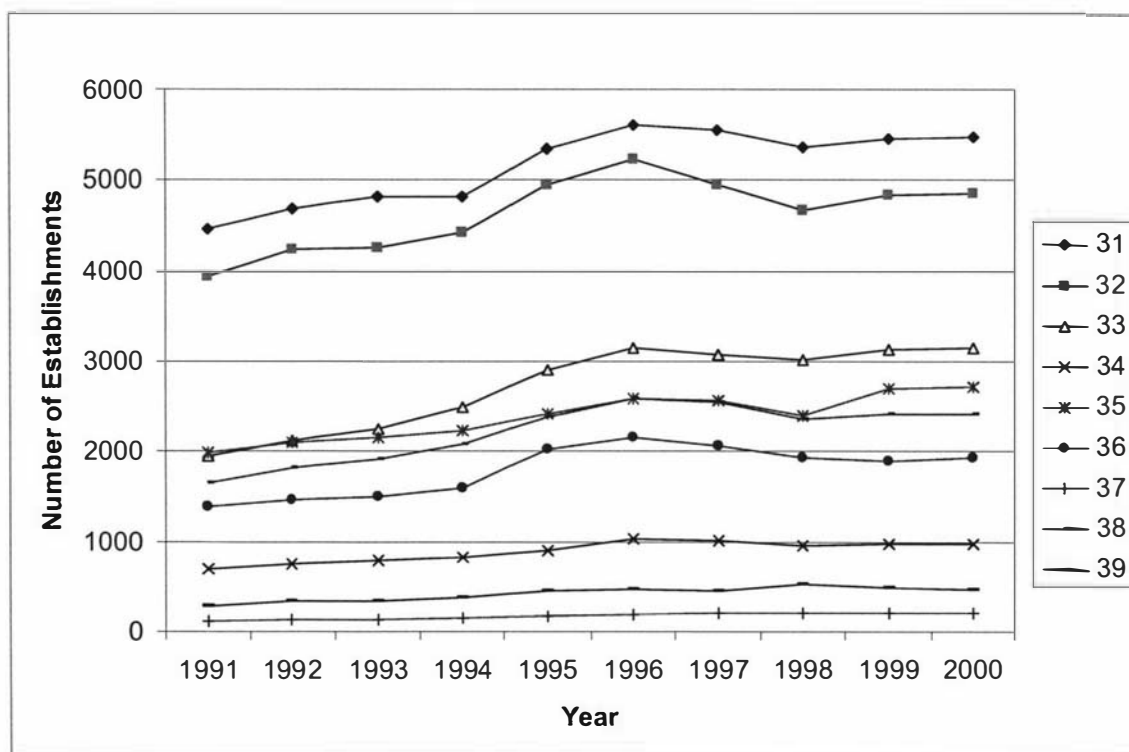


Source: 2005 Microsoft Mappoint

A major contribution to the growth of manufacturing in West Java came from the textiles, garments, footwear and leather sub-sector (sub-sector 32) and the metal products, machinery, transport equipment and electronic components sub-sector (sub-sector 38). Textiles, garments and footwear industries (TGF) are concentrated around Bandung city and district. Electronics, machinery and transport equipments are concentrated within the Botabek (Bogor, Tangerang and Bekasi) regions. Along with Jakarta, West Java has contributed the largest share of total GDP, as well as total GDP, for sub-sectors 32 and 38. The importance of these sub-sectors will be even more crucial as the province enters a new era of decentralisation. As provinces are relying more on their own income generation and less from central government contributions, the manufacturing sector will be a ripe target for the province's income generating activities, such as local taxes and levies.

West Java is also an area where export-oriented sectors are concentrated. Many industrial estates and bonded zones, such as MM2000 and the EJIP (East Jakarta Industrial Park) in Bekasi, are located in this province. In addition, the Bandung area is also known for its textile factories, garments centres and small-scale shoe manufacturers. Recently, the writer noticed during the fieldwork that Bandung had become a haven for second hand textile goods. Figure 4.3 shows that most of these establishments belong to subsector 31 (food, beverages and tobacco). However, most of these industries are not export-oriented and do not boast much investment from abroad compared with the next largest sub-sector in terms of the number of firms. The second most numerous is subsector 32 (textiles, garments, footwear and leather). Most of the establishments contain labour intensive and export-oriented establishments, especially garments and footwear. Sub-sector 38, which covers electronics, automotive assembling, and metal products were mostly capital intensive firms that tend to provide better remuneration for workers than other sub-sectors. In addition, the majority of establishments in sector 38 tend to have overseas capital (Lipsev and Sjöholm, 2001). The majority of establishments in sub-sector 38 are also concentrated in the Jabotabek areas. For this reason, sub-sector 38, as well as 32 would be included in the fieldwork as they are part of the network of economic globalization.

Figure 4.3 Number of Large and Medium Manufacturing Establishments by Two-digit ISIC in Indonesia, 1991-2000



Source: Statistics Indonesia, Large and Medium Manufacturing Industry publication, various years⁴

The Indonesian Labour Market

Indonesia has undergone profound changes in employment structure since the 1970s. There was a shift of employment from the agricultural sector to the modern sectors such as manufacturing and service (McGee and Firman, 2000). The proportion of the labour force employed in the agricultural sector has decreased, while the proportion working in the manufacturing sector and the service sector has increased (Simanjuntak, 1993, p. 60). Female employment during this period increased significantly, although most of the increase occurred in labour intensive manufacturing where wages were below that of their male counterparts and, in many cases, far below the minimum wage. With the exception of young women, who

⁴ Sectors 31 to 39 are ISIC codes version 2 dividing the manufacturing sector into 9 sub-sectors. Sector 31 covers the food, beverages and tobacco industries. Sector 32 covers the TGF sectors. Sector 33 covers the wood and wood product industries. Sector 34 covers paper products and printing. Sector 35 covers chemical and chemical industries. Sector 36 covers cement and clay industries. Sector 37 covers basic metal industries. Sector 38 covers electronics, metal products and automotive industries. And sector 39 covers other industries not belonging to 31 to 38.

dominate the work force in modern and foreign owned factories, women workers were stuck in stagnating sectors, while men managed to enter the booming sectors (Grijns and van Velzen, 1993, p. 227). Even so, women that worked in the modern sector tended to have lower wages and conditions than their male counterpart (Grijns and van Velzen, 1993, p. 227).

Table 4.2 Number of workers in Indonesia by Type of Main Industry 1996-2001

Main Industry Sector	Year					
	1996	1997	1998	1999	2000*)	2001
Agriculture, Forestry, Hunting and Fishery	36,500,310	34,789,927	39,414,765	38,378,133	40,676,713	39,743,908
Mining and Quarrying	752,954	875,280	674,597	725,739	-	-
Manufacturing Industry	10,570,415	11,008,951	9,933,622	11,515,955	11,641,756	12,086,122
Electricity, Gas, and Water	164,142	233,237	147,849	188,321	-	-
Construction	3,779,055	4,184,970	3,521,682	3,415,147	3,497,232	3,837,554
Wholesale Trade, Retail Trade, Restaurants and Hotels	15,841,016	16,953,006	16,814,233	17,529,099	18,489,005	17,469,129
Transportation, Storage, and Communications	3,936,280	4,125,429	4,153,707	4,206,067	4,553,855	4,448,279
Financing, Insurance, Real Estate and Business Services	688,037	656,724	617,722	633,744	882,600	1,127,823
Community, Social, and Personal Services	11,657,565	12,574,844	12,394,272	12,224,654	9,574,009	11,003,482
Others	1,215	3,161			522,560**)	1,091,120**)
Total	83,900,138	85,405,529	87,672,449	88,816,859	89,837,730	90,807,417

Source: Statistics Indonesia, Labour Force Survey, various years.

*) Excluding Maluku Province

***) Including electricity and gas, mining and quarrying, and others.

McGee and Firman (2000) reported that labour in Indonesia, especially those in the modern urban sector in Java, suffered heavily during the financial crisis and the subsequent crises that followed. The manufacturing sector also suffered heavily

during the crisis with employment in large and medium manufacturing falling by 449 000 workers (Thee, 2000, p. 437). However, due to their flexibility, Indonesian workers were able to find employment in the rural and urban informal sector (Manning, 2000; McGee and Firman, 2000). This is depicted in Table 4.2 where the number of workers in the agriculture, forestry, hunting and fishing actually increased by approximately 4, 625, 000, whereas other sectors experienced declines. The figure declined slightly in 2000, although the decline was probably attributed to those workers who shifted back to other sectors when the economy was recovering.

A major problem of the manufacturing industries in Indonesia is that the pressure of employment insecurity on labour is tremendous, especially with decreasing demand due to embargoes by United States on Indonesian textiles, the September 11 attacks and the WTO ruling on China's entrance into the WTO. Even prior of the crisis, the modern sector such as manufacturing only provided limited employment growth (Manning, 1993; Manning, 1998). As Table 4.2 shows, almost 50 percent of employment is still engaged in the agricultural sector. Moreover, only one third of the number of workers in the manufacturing sector is employed in large and medium firms where conditions were supposedly better. Now there are also growing labour freedoms due to a more democratic atmosphere, stemming from Indonesia's ratification of ILO Convention No. 87 on Freedom of Association (ILO, 2002). Yet, is there an economic rationale for allowing independent trade unions into Indonesian manufacturing besides human rights and social reasons? Economic recovery and industrial restructuring should also consider more balanced labour protection as a more efficient solution, e.g. taking into account both the needs of workers and business sustainability. More than any other reason, labour protection avoids costly confrontation between management and workers.

Even though in neo-classical economic theory wages are usually set at market clearing rates, there is evidence that in part of the Indonesian modern sector wages are set according to an efficiency wage concept⁵. The reason for paying wages above the

⁵ In economic theory, market clearing rates is an equilibrium condition where labour demand and labour supply, in terms of wage level and employment, are exactly the same. It is depicted by the intersection of labour demand and supply. See Chapter III, Figure 3.1, for an illustration.

market-clearing rate is to maintain high levels of productivity and to encourage greater commitment, reliability, and application of skills among workers (Manning, 1998, p. 35). Higher wages could also be attributed to different characteristics of workers, such as education, and to avoid industrial conflicts. However, this type of wage applies to more capital-intensive and foreign-owned firms such as electronics and automotive parts. On average, these firms paid workers higher than locally owned firms across most types of workers (Lipsev and Sjöholm, 2001). The efficiency wage model can perhaps be applied to these large, foreign-owned firms, but most firms in Indonesia are locally owned and considerably smaller in size and in capital accumulation.

One of the government's stated development goals is to increase labour productivity. However, the minimum wage policy may not be a viable policy to pursue due to a potentially damaging effect on employment growth (Manning, 1998, p. 286). This is especially crucial in light of the recent economic slowdown. Many manufacturing firms have had to lay-off their workers. Firms in the TGF sector were hard put to survive due to declining overseas demand. Basic economic theory suggested that the impact of minimum wages could only worsen the situation (See Chapter III). Significant increases in minimum wages in 2001 and 2002, at the start of the decentralisation process, could potentially be damaging to both workers and businesses. Moreover, the increasing collective power of labour unions could also add to the uncertainty of the economic climate.

Labour Market Conditions

Despite the fact that employment in Indonesia has been growing rapidly, both in terms of size and real wages in the past quarter of a century, unemployment and underemployment remain a major concern. Table 4.3 shows that the labour force grew at an average of two million a year prior to 1998. Even though the increase slowed down somewhat from 1998 and 1999, the rate of increase seemed to pick up again in 2001. It was suggested that to absorb this many entrants into the labour force each year, the economy must grow at least seven percent per annum (*Kompas*, 2001c). Furthermore, the figures did not account for disguised unemployment and underemployment that are common in Indonesia. Depending on the definition, the latter had

been emphasized as a more serious problem in Indonesia⁶. It was estimated that if the figures included disguised unemployment and under-employment the number of unemployed would have ballooned to approximately 38 to 40 million instead of around 8 million (*The Jakarta Post*, 2002; *Kompas*, 2003a). These are mostly found in small and cottage industries and the informal sector. Figures obtained from Statistics Indonesia show that there were about 200 000 small industries and two million cottage industries in 2000. Depending on definition, cottage industries that employed less than five workers could be considered part of the informal sector. The figures also did not include child workers (those below the age of 15) many of whom work in the informal sector and as unpaid family workers in factories and sweatshops. *Asia Times Online* (2000) reported that of the 6.5 million child laborers in Indonesia, 2.4 million work in the formal sector.

⁶ Manning (1993, p. 67) gave a definition of under-employment as people involuntarily working fewer hours than they wish. In addition, in Indonesia, people working less than 35 hours a week were considered under-employed. Disguised unemployment refers to a situation where too many people were working at low levels of productivity and effort (*ibid*). However, under-employment does not take into account the nature of Indonesian workers where some who work for less than 35 hours a week in one job, but takes on another job somewhere else.

Table 4.3 Labour Market Conditions in Indonesia, 1997-2001

Description	Year				
	1997	1998	1999	2000*)	2001
Population 15+	135,070,350	138,556,198	141,096,417	141,170,805	144,033,873
Labour force	89,602,835	92,734,932	94,847,178	95,650,961	98,812,448
Labour force participation rate (in %)	66.34	66.63	67.22	67.76	68.60
Working ⁷	85,405,529	87,672,449	88,816,859	89,837,730	90,807,417
Looking for work	4,197,306	5,062,483	6,030,319	5,813,231	8,005,031 (**)
Unemployment rate (in %)	4.91	5.77	6.79	6.47	8.10
Not in labour force	45,467,515	45,821,266	46,249,239	45,519,844	45,221,425

Source: Labour force surveys various years, Statistics Indonesia

*) Maluku province not included⁸

***) Unemployment: Looking for work, establishing a new business/firm, hopeless of job, and have a job start in future⁹

Workers in Indonesia's Manufacturing Sector

In terms of the number of workers, the large and medium manufacturing sector absorbed about 33 percent of the total manufacturing workforce in 2000. The rest of the manufacturing workforce is employed in small and cottage firms that numbered around two million throughout Indonesia. As shown in Table 4.4, employment in large and medium manufacturing tended to decline from 2000 to 2002. This situation contrasts with the post-crisis environment where there was a significant increase of about 6 percent during the 1998-2000 periods. If this trend continues, it would not look good for the manufacturing sector. The number of workers in manufacturing decreased from 4.37 million in 2000, to 4.32 million in 2001, to 4.17 million workers in 2002. It was predicted that if economic growth in 2003 would be a mere 3.3

⁷ Working refers to a part of the labour force working at least 15 hours a week

⁸ Due to sectarian violence in that province data for 2000 could not be collected

⁹ Definition for unemployment in 2001 data is different and thus, the unemployment rate appears much higher in 2001 than previous years.

percent, the number of unemployed in Indonesia would increase by 1.6 million people (*Kompas*, 2003c). A substantial number of those unemployed would come from the manufacturing sector.

Table 4.4 Number of workers in Large and Medium Manufacturing in Indonesia, 1998-2002

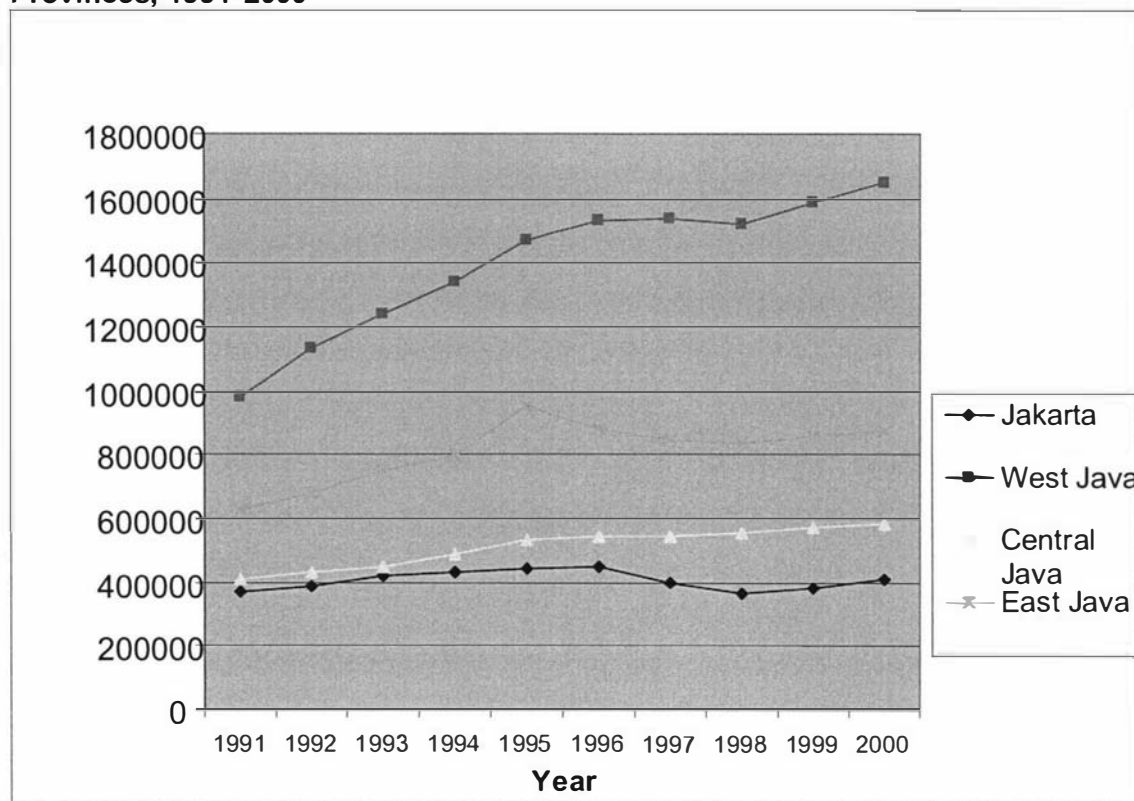
Description	Year				
	1998	1999	2000	2001	2002
Whole Sector	4 123 612	4 234 983	4 366 816	4 385 923	4 364 869
Textile, Garment and Footwear	1 293 337	1 341 843	1 422 199	1 339 062	1 289 338
Other sectors	2 830 275	2 893 140	2 944 617	3 046 861	3 075 531

Source: Statistics Indonesia, Large and Medium Manufacturing Data, 1998-2002

The textiles, garments and footwear sector followed the same pattern as the whole large and medium manufacturing sectors. The sector also enjoyed increases in the number of workers after the 1998 crisis. However, the number of workers dipped again from 2000. The number of workers in this sector declined from 1.42 million in 2000 to 1.29 million in 2002. Other sectors increased slightly from 2.94 million in 2000 to 3.08 million in 2002.

The number of workers followed a similar pattern as the number of establishments. Figure 4.4 shows that manufacturing industries in West Java absorbed about one third of the total workforce. Most of these workers tend to work in the industrial belt of Jabotabek and the greater Bandung area. In addition, the downward spike between 1997 and 1998 reflects the impact of the 1998 crisis on large and medium manufacturing establishments. The number of workers increased again in 1999 and 2000, close to the pre-crisis level.

Figure 4.4 Number of Large and Medium Manufacturing Workers in Four Major Provinces, 1991-2000



Source: Statistics Indonesia, Large and Medium Manufacturing Industry, various years

Informal Sector Employment

The informal sector in Indonesia can be considered as an important vehicle of economic development. Employment in the informal sector can be divided into those who work in urban areas and those who work in rural areas. The majority can be found in rural areas. Table 4.5 shows that from 1995 to 1999 the percentage of informal sector workers to total number of workers was above 60 percent. The percentage of informal workers had not changed over time, except during the crisis of 1998. Of the total number of informal workers, less than 40 percent work in the urban areas. The percentage was higher in the rural areas. This means that there were less formal jobs in rural areas than in urban areas. The percentage of the informal sector has slightly increased from 61 percent in 1997 to 64 percent in 1998, though it decreased by one percent in 1999. Urban informal sector workers increased from 35

percent to 39 percent and rural informal workers also increased from 74 percent to 77 percent during the same period.

Table 4.5 Percentage of Formal and Informal Sector Workers in Indonesia, by Year and Urban/Rural, 1995-1999

Description	Year				
	1995	1996	1997	1998	1999
Total					
Formal	38	38	39	36	37
Informal	62	62	61	64	63
Urban					
Formal	65	66	65	61	61
Informal	35	34	35	39	39
Rural					
Formal	25	24	26	23	24
Informal	75	76	74	77	76

Source: Statistics Indonesia, Labour Force Survey various years

The reason for the change was that, during the crisis of 1998, many workers in the formal sector were laid off. McGee and Firman (2000) argued that a labour market adjustment occurred where these people shifted to the informal sector, especially in rural areas. Indonesia has no unemployment benefit to speak of and people must work to some extent to obtain a livelihood. Table 4.5 shows that the percentage in the informal sector decreased slightly in 1999 and this is probably attributed to some of those workers who came back to work in the formal sector again when the economy slightly improved in 1999. The threat posed by significantly increasing the statutory minimum wage, based on the traditional economic approach, is that workers who are laid off in the formal sector because of adjustments due to wage increases would have

to find employment in the informal sector, thereby increasing its size. Thus, it would make it difficult for the informal sector workers to sustain their livelihood and also face increased competition. This employment dilemma further hampers the efforts of the government to assist them as part of the overall development program.

The Employment Dilemma

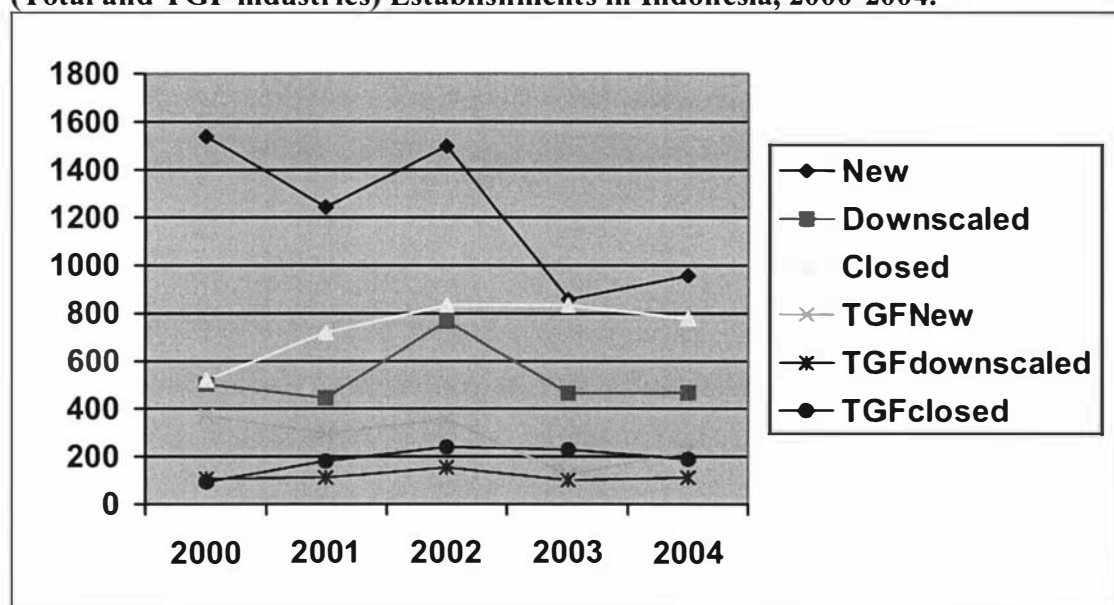
The economic crisis of 1998 exposed Indonesia's employment dilemma or, rather, the unemployment dilemma. There is no denying that high economic growth had many benefits to workers, such as the creation of many new jobs. Nonetheless, it was not sufficient because the role of the modern sector was still small and the informal sector was still relatively large (Manning, 1993, p. 73). In addition, economic growth was achieved at the expense of workers' freedom and working conditions. The crisis had also created mass lay-offs due to many firm closures, including firms in the manufacturing sector. The lay-offs also included firms which had to shed their workers because they could not afford to employ them. In addition, prior to the crisis, workers were not allowed to join independent trade unions not sanctioned by the government. Furthermore, poor working conditions were also blamed for the plight of workers in some sectors of the industry.

Firm closures

The condition of large and medium manufacturing establishments in 2002 appeared to confirm the fears of many scholars and businesses alike. Year 2002 seem to be a dreadful year for establishments in the manufacturing sector. Although this sector seemed to have recovered slightly from the 1998 crisis as reflected by the fact that the number of firms increased slightly to over 22, 000 in 2000, the situation is a significant blow to the government because it has been making a lot of effort to revitalize the manufacturing sector. The number of establishments dipped below 22, 000 in 2001 and less than 21, 000 in 2004. A combination of factors, i.e., the economic crisis, domestic political instability, increasing labor cost and the recent Iraq war were blamed as the main reasons for the decline in exports of textile products (*BharatTextile.com*, 2003). In the domestic market, the industry was also under threat from the import of cheap fabrics from China and other countries. The number of new establishments was offset by closures and downscaling.

Figure 4.5 shows that the number of closures in 2002 had increased from 719 establishments in 2001 to 835 establishments. In the case of the textile, garment and footwear sector, the number of closures was also substantial (from 111 in 2001 to 154 in 2002). Moreover, the number of new establishments had significantly decreased from well over 1000 establishments between 2000 and 2002 to less than 1000 establishments in 2003 and 2004. The fact that there were fewer new firms possibly indicates a deteriorating investment climate in manufacturing. In addition, the condition was worsened by the fact that demand for exports from Indonesia had been significantly decreasing.

Figure 4.5 New, Downscaled and Closed Large and Medium Manufacturing (Total and TGF industries) Establishments in Indonesia, 2000-2004.



Source: Statistics Indonesia, unpublished registration of large and medium manufacturing establishments, 2000-2004.

Note: Data are preliminary figures based on pre-survey registration of establishments¹⁰

¹⁰ The researcher cautions that the data is based on unpublished manufacturing industry registration. This directory is used as a frame for the Annual Large and Medium Manufacturing Survey. It is continuously being updated by births and deaths of manufacturing establishments, as well as other weaknesses in the system. It is used as an approximation only and not to be compared with the annual data and cannot be compared year by year.

The textile, garment and footwear sector appears to be the hardest hit. In 2002, there were 242 closures and 154 firms that shed workers and thus, became small firms. However, there were 242 new firms in 2002 as compared to 183 in 2001. In 2004 the number of closures and downscaled firms appeared to decrease substantially compared to 2002 and 2003. The number of new firms increased to over 200 in 2004 compared to less than 150 in 2003, but still far below the 2000-2002 level. The trend indicates that investors were reluctant to set up new manufacturing firms for some reasons. Could it be because of problems associated with the labour policies in Indonesia, or because of lower demand from overseas? Thus, the thesis also attempts to address these questions by interviewing employer associations as well as estimating employment loss to seek out the reasons.

Unemployment and Under Employment

As stated earlier in the chapter, unemployment has been a major concern facing the Indonesian government, especially that such a concern includes under-employment. If anything, the economic crisis of 1998 made this problem worse. Table 4.6 shows that open unemployment increased nominally during the start of the decentralization process from a little over three million in 2000 to almost five million in 2003. The rate of unemployment was actually significantly higher than before the crisis. Suryahadi et al. (2003) reported that open unemployment was less than three percent in 1988 and 1992. However, in 1996, just prior to the crisis, it rose to almost six percent and increased to more than six percent in 2000.

Under-employment, arguably a more dire concern than open unemployment, also increased in 2001, but somewhat decreased in 2002 and 2003. Male workers appeared to bear the brunt of being under employed as their number increased significantly from 13 million in 2000 to 15 million in 2002. It is apparent that these underemployed had joined the informal sector. An additional dilemma is also due to the fact that a large proportion of those considered underemployed were female workers.

Table 4.6 Open Unemployment and Under Employment, 2000-2003 (000 persons)

Gender	Year			
	2000	2001	2002	2003
Open Unemployment				
Male	3 341	4 032	4 728	4 928
Female	2 473	3 973	4 404	4 603
Under Employment				
Male	13 911	15 174	14 442	14 812
Female	16 181	15 258	14 426	13 655
Total				
Open Unemployment	5 813	8 005	9 132	9 531
Under employment	30 092	30 432	28 869	28 467

Source: Sakernas (Employment Survey), various years

A special interest is the plight of female workers who were considered under-employed. The number of under employed women seemed to drop from 2000 to 2003 (see Table 4.6). This decrease did not mean that these women became fully employed in the formal sector. As Table 4.7 shows, the number of openly unemployed female also increased significantly from over two million in 2000 to over 4.6 million in 2003. It maybe that they either dropped out of the labour force and became housewives or they became openly unemployed because for some reason the firms they worked for laid them off. There is a tendency for firms to lay off unskilled female workers if they are not doing well. It is these concerns that observers see as the tradeoff to significantly increasing minimum wage levels. However, it would not be prudent to dismiss the minimum wage policy based on unemployment concerns alone as the merit of the minimum wage policy also has a lot to do with economic and political stability.

Industrial Conflicts

Another major dilemma facing the government is the industrial disputes between workers and management. The bulk of the conflicts were caused by trade union activities and poor working conditions, especially concerns over low wages. Table 4.7 shows that industrial conflicts rose sharply from about 61 in 1990 to 350 strikes in 1996. The strikes in 1996 caused an unprecedented 2 796 488 loss of work hours. However, the number of strikes decreased significantly after 1998. It appears the

increase in strikes in 2002 was a result of disagreement over the new minimum wage levels. Several districts delayed the imposition of the minimum wage due to court action by employer associations that consequently prompted workers to strike, with some strikes happening at provincial and city offices. The majority of these strikes occurred in the Jabotabek (Jakarta and the West Java districts of Bogor, Tangerang and Bekasi) regions. However, the most violent strike occurred in Medan, North Sumatra where thousands of workers took to the streets (Levine, 1997). The government blamed the leader of the banned SBSI trade union for inciting the riots, thereby causing major damage and even death. Apparently, the cause of the riot was over non-compliance with the provincial minimum wage. There was also a sharp increase in strikes from 1994 to 1996. In addition, the majority of strikes occurred in the manufacturing sector. However, post-crisis 1998 witnessed a decrease in strike activity. Two reason could be cited: allowing freedom of association for workers and a more vigorous pursuit of the minimum wage policy decreased the number of strikes dramatically from 234 in 1998 to 125 in 1999.

Table 4.7 Number of Strikes in Indonesia, 1980-2003

Year	Number of Strikes	Year	Number of Strikes
1980	100	1992	251
1981	200	1993	185
1982	142	1994	278
1983	96	1995	276
1984	63	1996	350
1985	78	1997	161
1986	75	1998	234
1987	35	1999	125
1988	39	2000	273
1989	19	2001	174
1990	61	2002	220
1991	130	2003	161

Source: Ministry of Manpower and Transmigration and LPPES (2000)

Note: This is the official version of the number of strikes. The number of actual strikes may differ if compared with other sources.

Workers' patience appeared to be tested again in 2000. Table 4.7 shows that the number of strikes increased significantly from 125 in 1999 to 273 in 2000, but decreased to 174 in 2001. Because the year 2000 was an election year, it was apparent

that workers seemed intent on exercising their constitutional rights. Other probable factors were the recent euphoria of political openness and the ratification of ILO Convention Number 87 on the Freedom of Association, by which workers are allowed to form their own trade unions. In addition, the number of strikes increased again in 2002 due to the problems associated with the new minimum wage setting process in several provinces, especially in West Java. Table 4.8 shows that in 2002 strikes in West Java increased by almost 100 percent. The significantly high increases in minimum wage levels in some provinces prompted the employer associations in several districts and cities to take the matter to court and trade unions felt the need to counter challenge that move by staging demonstrations at the local Manpower office, as well in the firm where they worked.

Table 4.8 Number of Strikes by Selected Regions, 2001-2004

Region	Year			
	2001	2002	2003	2004 ^{*)}
Jakarta	57	71	51	19
West Java	53	96	61	22
Rest of Indonesia	64	53	49	22
Total	174	220	161	63

Source; Ministry of Manpower and Transmigration

*) Up to May 2004

The majority of these strikes occurred in the manufacturing sector. Table 4.9 shows that strikes in the manufacturing sector made up more than 70 percent of all the strikes in Indonesia, with services in a distant second with about 20 percent. Strikes in the services as well as trade and banking sectors were mostly located in Jakarta. It is apparent that most of the strikes in manufacturing occurred in the industrial areas of West Java due to the concentration of manufacturing firms there. This pattern, along with the fact that West Java and Jakarta were the two largest contributors to GDP, made the writer select the two regions along with Banten as the fieldwork area.

Table 4.9 Percent of Strikes by Economic Sector, 2001-2004

Economic Sector	Year			
	2001	2002	2003	2004 ^{*)}
Manufacturing	72.99	74.09	77.64	79.37
Trade and banking	3.45	0.00	0.00	0.00
Services	16.09	23.64	20.50	17.46
Other Sectors	7.47	2.27	1.86	3.17
Total	100.00	100.00	100.00	100.00

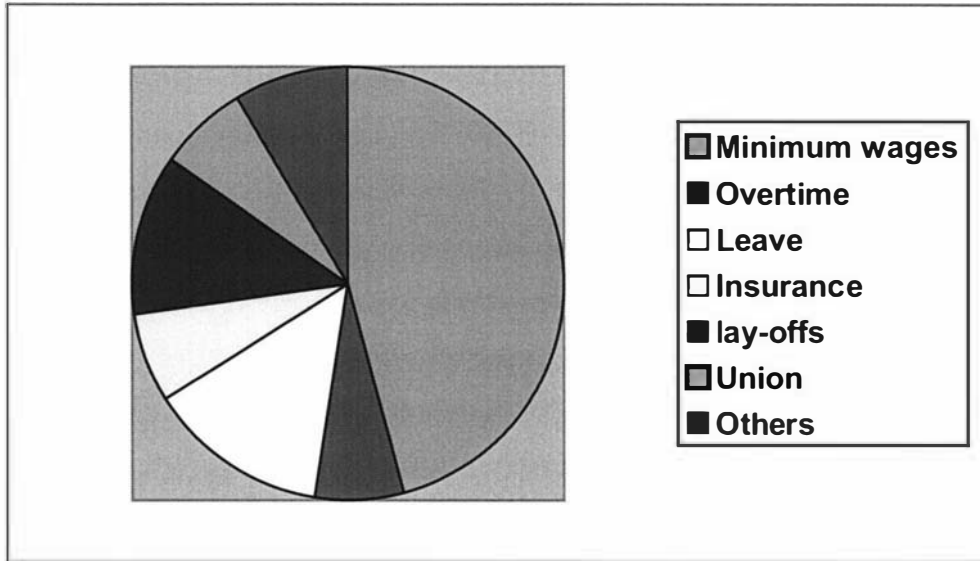
Source: Ministry of Manpower and Transmigration

Note: *) Up to May 2004

The non-compliance in paying the minimum wage was overwhelmingly the chief reason for many of the strikes, along with other benefits such as leaves, overtime and membership in trade union. Figure 4.6 shows that in 2002 (similar to previous years), almost half of the strikes were caused by workers demand for minimum wages. These strikes normally targeted firms that did not pay the required minimum wages in their area. However, as early as 2000, when regional governments took over the task of determining minimum wage levels in their areas, workers started to protest against local governments and their officials for not increasing minimum wages to desirable levels. Incidents such as these also occurred in the Jabotabek areas. Thus, delegating minimum wage fixing down the chain of command (from provincial to district government) would complicate the process further and would jeopardize efforts to increase the welfare of workers.

There were few demands to join a union mostly due to, the recent democratization process in Indonesia where workers could now join any union they wanted without fear of repercussions, even though the fieldwork (see Chapters VII and IX) revealed several cases where the issue of joining a union still posed problems for workers. Most of the strikes occurred in the manufacturing sector and in the Jabotabek areas, especially the Tangerang area. This reason, along with the fact that minimum wage violation was the major reason for strikes, strengthened the justification of choosing these areas as the fieldwork area.

Figure 4.6 Main Factors for Strike Incidences in Indonesia (2002)



Source: Ministry of Manpower and Transmigration

Summary

Development in Indonesia was marked by phenomenal economic growth reminiscent of the Tiger economies of East Asia. Prior to 1998, GDP growth of more than seven percent per annum was generally recorded. Unfortunately, the Asian financial crisis ended those golden years and plunged Indonesia into a multi-dimensional crisis which encompassed economic, social and political issues. In addition, the so-called development trilogy in Indonesia prior to the crisis mainly focused on economic growth and political stability, but lacked focus on an important part of this development trilogy: social justice. The welfare of Indonesian workers is a vital area that required a socially responsible development. Low wages and lack of labour freedom are the two paramount concerns in today's Indonesia, although the lack of these had previously been the attraction for foreign investment in the country. In the aftermath of the crisis, the transition from an authoritarian government to a more democratic government had produced the tools to change the situation; more empowerment for workers via freedom of association and a vigorous pursuit of the minimum wage provision.

The employment crisis has deepened so much that recently the Ministry of Manpower and Transmigration and the House of Representatives made a declaration aimed at preventing more unemployment in Indonesia (*Majalah Nakertrans*, 2004). The development goal of the declaration was to decrease unemployment by limiting open unemployment to 5.5 percent, decreasing under employment to 20 percent, increasing formal sector employment to 60 percent by 2009, increase job opportunities to 108.97 million and develop linkages between the central government and local government at district/city level (*Majalah Nakertrans*, 2004). This declaration would impact heavily on the welfare of workers, namely wages and trade union activities in wage negotiations. The lobbying of trade unions to improve wages via increasing minimum wages could suffer as a consequence of this declaration.

This thesis focuses on the impact of the minimum wage fixing process by district and city authorities. In addition to decentralization of the minimum wage fixing process to district and city levels, the study focuses on certain districts and cities in West Java:

- a. It has the highest concentration of industries compared to other provinces, especially the export-oriented sub-sectors 32 and 38
- b. Its importance in terms of its share of GDP, and
- c. It has the highest incidence of industrial conflict in which minimum wage violation is, by far, the number one reason.

The decision to include Jakarta as an additional field study area was due to its close proximity to West Java, its tradition as a standard of minimum wage setting, and its value for comparative purposes in the analysis. The Banten Province was included because it was part of West Java prior to the decentralization process and its districts and cities employed the same minimum wage fixing method as those of West Java. As always, and especially in the context of the decentralization process, the minimum wage setting process is, above all else, a political commodity.

Chapter V

Wages and Minimum Wages in Indonesia

Introduction

There is no question that Indonesian workers have benefited from the last quarter century of economic development. The benefit included rising employment as well as increased nominal wages. As explained in the previous chapter, the labour force participation rate reached more than 68 percent in 2001 and the number of working Indonesians exceeded 90 million people in the same year. Unfortunately, the increases in employment did not proceed far enough to off-set Indonesia's employment problems from suppression of labour rights and standards to unemployment and underemployment. Growth in the modern sector was not sufficient to absorb the growing labour force. As a result, the majority of working Indonesians still work in the rural and urban informal sector. Wages, though they have also increased nominally, as well as in real terms during the same period, still fell short of providing an adequate livelihood for the average Indonesian worker. The minimum wage policy was primarily designed to solve this problem by providing a wage floor which meets the basic needs of workers. This chapter discusses the development of wages, mainly wages in manufacturing, and the minimum wage policy in Indonesia, especially wages in the regions where the industries are concentrated. The main focus of this chapter is during the period just before and after the economic crisis of 1998.

Overview of Wage Differentials in Indonesia

Based on a study conducted by Manning (1998) on Indonesian employment, during the New Order regime wages in manufacturing were determined by several factors; regions (by provinces or islands), industrial sub-sectors (classified by ISIC), size of establishments, ownership, and capital intensity. According to Manning, there are wage differences between Java and other islands, between manufacturing and non-manufacturing, and between the public and private sector. Most manufacturing activities, especially EOI products are concentrated in the Java and Bali regions (Manning, 1997). Most manufacturing in the outer islands are mostly agricultural-based manufacturing, such as palm oil and rubber plantations in Sumatera Island, and wood

industries in Kalimantan Island¹. However, even though real wages in Java and Bali grew faster than the outer islands, real wages also increased substantially in the outer islands (Manning, 1997). In addition, there were also large differences between the formal (modern) sector and the informal sector wages.

Manning summarized that although there were substantial real wage increases particularly in non-agricultural real wage rates during the New Order government, that increase had not been sustained throughout the period (1994, pp. 106-108). Table 5.1 shows that real wage in some sectors grew rapidly during the oil boom period, especially textiles and the public sector. However, real wage growth during the 1980s slowed down considerably. Real wage in textiles and the civil service even experienced stagnation. Real wages increased again in the early 1990s, partly due to increases in minimum wages levels and enforcement (Manning, 1994, p. 108).

Table 5.1 Real Wage Growth in Selected Economic Activities during the New Order Period (% per Annum)

Activity	Early Oil Boom 1971-1976	Late Oil Boom 1976-1980	Slower Growth 1980-1987	Non-oil Export Boom 1987-1993
Rice	-	0.3	1.6	4.6
Estates	-0.2	7.5	0.7	-
Textiles	12.3	12.3	0	5.2
Construction	3.5	15.4	2.9	0.1
Civil Service	15.1	9.5	-1.4	0.7

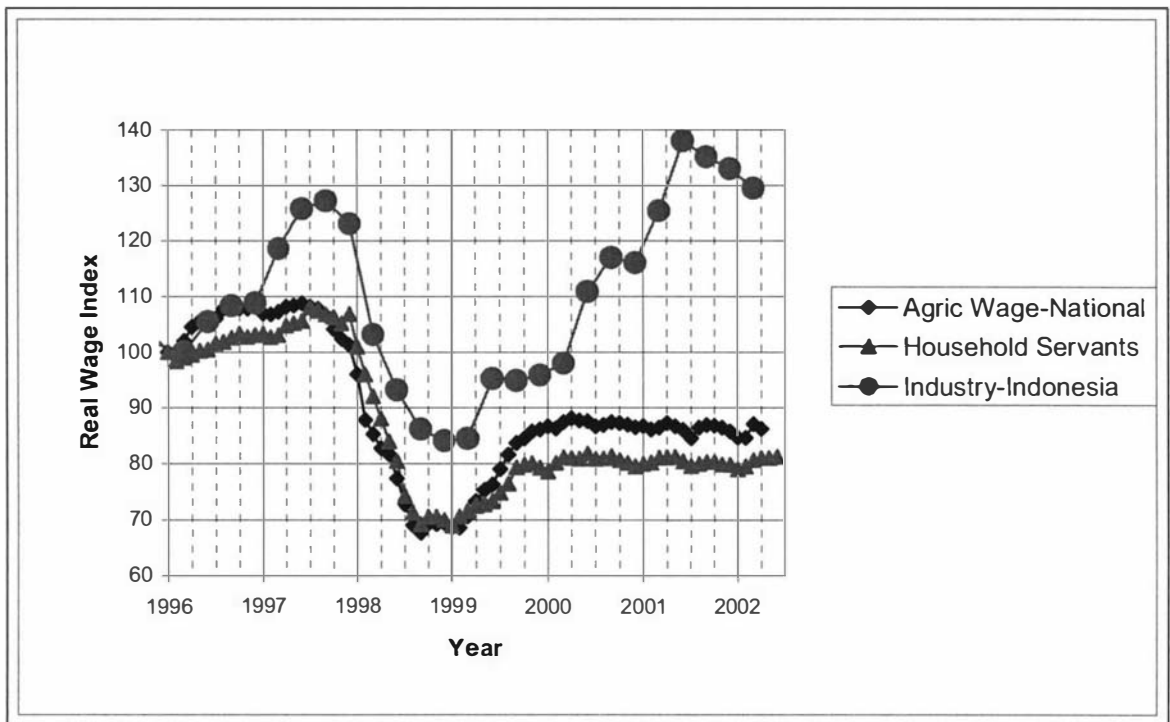
Source: Manning (1994, p. 84)

Real wages of all workers in Indonesia experienced a sharp decline in 1998 due to the economic crisis that swept many Asian countries. Initially, there were signs that a crisis was looming when the real wages started falling towards the end of 1997. The situation deteriorated early in 1998 and had worsened towards the middle of the year. Figure 5.1 shows real wages of three sectors, which roughly represent wages in the agricultural,

¹ The thesis mostly focuses on EOI development in Java. Thus, agricultural-based manufacturing is not discussed in the thesis.

informal and modern sector. The figure shows that real wages in all three sectors declined in 1998. However, while wages in the modern sector recovered in 2001, the agricultural and informal sectors could not recover to the 1996 level and remained relatively stagnant. It is also worth mentioning also that minimum wage levels, which apply more to the formal sector, also increased substantially in 2001 and 2002.

Figure 5.1 Summary of Real Wages in Indonesia, 1996-2002



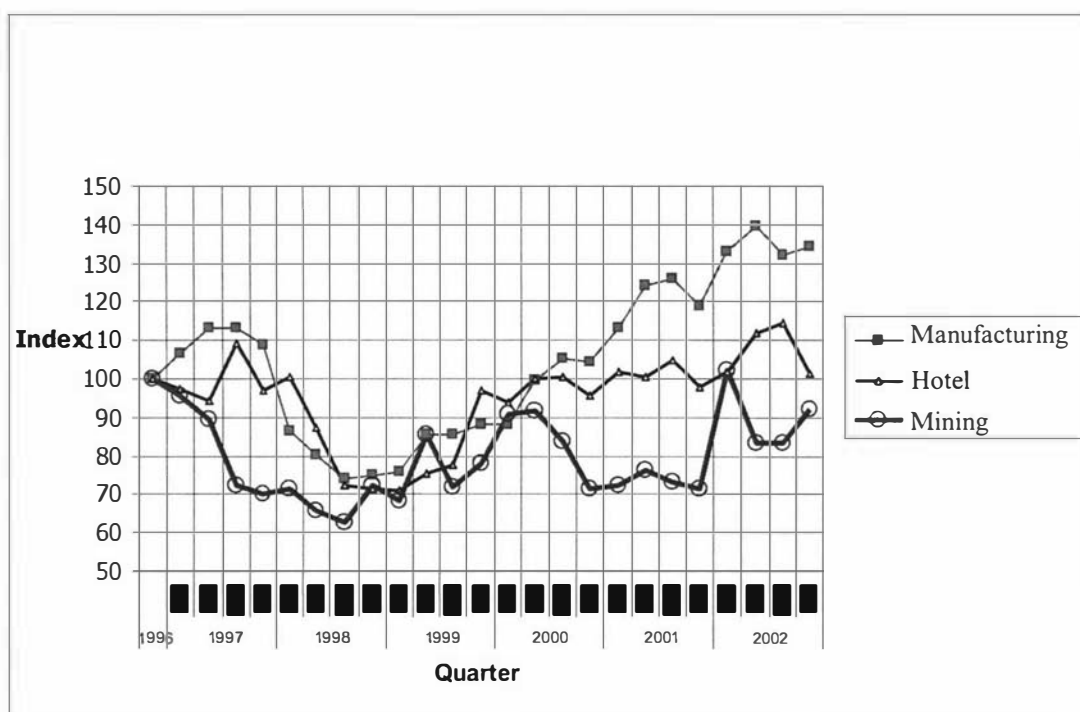
Source: Statistics Indonesia.

- Note:
- Agric Wage-National wages represent real wages in traditional agriculture
 - Household servant wages represent real wages in the informal sector
 - Industry wages represent real wages in the modern sector.

It is difficult to classify the manufacturing sector by urban and rural because many are located in industrial areas on the urban periphery, especially in the Jabotabek area (Jakarta, Bogor, Tangerang and Bekasi). White (1994) suggested that these areas be called the urban periphery or peri-urban areas. Large and medium manufacturing in Indonesia has been highly concentrated and specialized in several provinces. More than 50 percent are located in the island of Java. Others such as rubber processing and palm oil are located on Sumatra Island, with the exception of Batam, which is an export-processing zone for electronic components and, to a lesser extent, garments. The wood

industries, especially plywood, are concentrated on Kalimantan Island. During the crisis real wages fell by as much as 40 percent in some sectors (Ahmed and Dhanani, 1999, p. 27). This is reflected in Figure 5.2 for three main industry sectors, manufacturing, hotel/accommodation and mining. In manufacturing, for instance, the wage index fell from slightly higher than 110 in the mid-1997 to a little over 70 in mid-1998. It was a decline of 40 percent from 1997 and 30 percent compared to the 1996 level. Real wages in mining also fell by a similar margin.

Figure 5.2 Real Wage Index of Workers below Supervisor Level by 3 Main Sectors, Indonesia 1997-2002



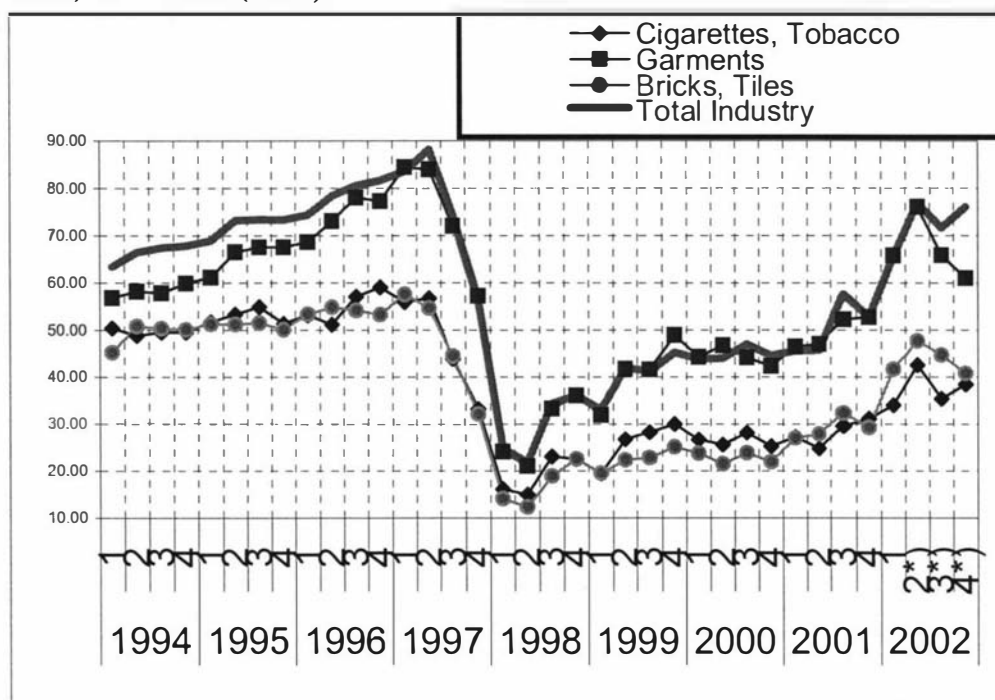
Source: Statistics Indonesia, Quarterly Wage Surveys, various years.

However, the three sectors recovered somewhat to the 1996 level by 2002. In fact, wages in the manufacturing sector show the best recovery by posting a 34.2 percent increase in the average real wage in 2002. The sector performed much better than the hotel and mining sector which shows a declining trend in 2002. The increasing wage in the manufacturing sector might be attributed to the more vigorous minimum wage policy and, perhaps, the increasing activity of labour unions in expressing the workers' right to decent wages. A recent survey by Statistics Indonesia (2002) revealed that more

than 60 percent of firms complied with the minimum wage levels set by regional governments. In addition, labour unions had been increasingly involved in the minimum wage fixing machinery at the start of the decentralization process. In addition to increasing enforcement, firms also tended to comply to avoid costly conflict with their workers.

Wages within the manufacturing sector appeared to follow the same rate of increase. Figure 5.3 shows that average wages (in US dollars) steadily increased from 1994 to mid-1997, and then sharply declined when moving into 1998. Average wages started to increase again towards the end of 1998 as the economy stabilized. The trend continued in 2000 and 2001. However, towards the end of 2002 the rate of increase for several sectors, except that of metals appeared to decline and even stagnated in the last quarter of 2002. It is likely that the delay of imposing the 2002 minimum wages in several regions could have caused the decline because some firms still applied 2001 minimum wages during the legal proceedings which lasted for some time in 2002. Average wages in the metal sector still experienced an increase because many firms in this sub-sector (including electronics and automotive parts) were capital-intensive firms which tended to pay wages significantly above minimum wages.

Figure 5.3 Average Monthly Wages of Manufacturing Workers below Supervisors Level, 1994-2002 (US \$)



Source: Statistics Indonesia, Wage Survey various years
 1, 2, 3 and 4 refers to quarterly period within a year
 *) Data for 2000 is still temporary due to low response rate

Wages can also be differentiated between the formal and informal sector. Table 5.1 illustrates the difference between informal sector wages and formal sector wages. On average, informal sector wages were consistently slightly more than 50 percent of the average wages of formal sector workers. Table 5.2 shows that, except for 1998 when the average wages of informal rural workers appeared to increase compared to rural formal workers, average wages of informal sector workers stayed constant from 1995 to 1999 at between 50 to 60 percent of the average wage of formal sector workers. The fear of the negative impact of the minimum wage policy on informal sector wages does not appear to be justified based on this evidence.

Table 5.2 Ratio of Average Wage of Informal Workers to Formal Workers by Urban and Rural, 1995-1999

	1995	1996	1997	1998	1999
Urban	54	56	50	52	56
Rural	52	52	52	62	50

Source: Statistics Indonesia, Labour Force Surveys, various years.

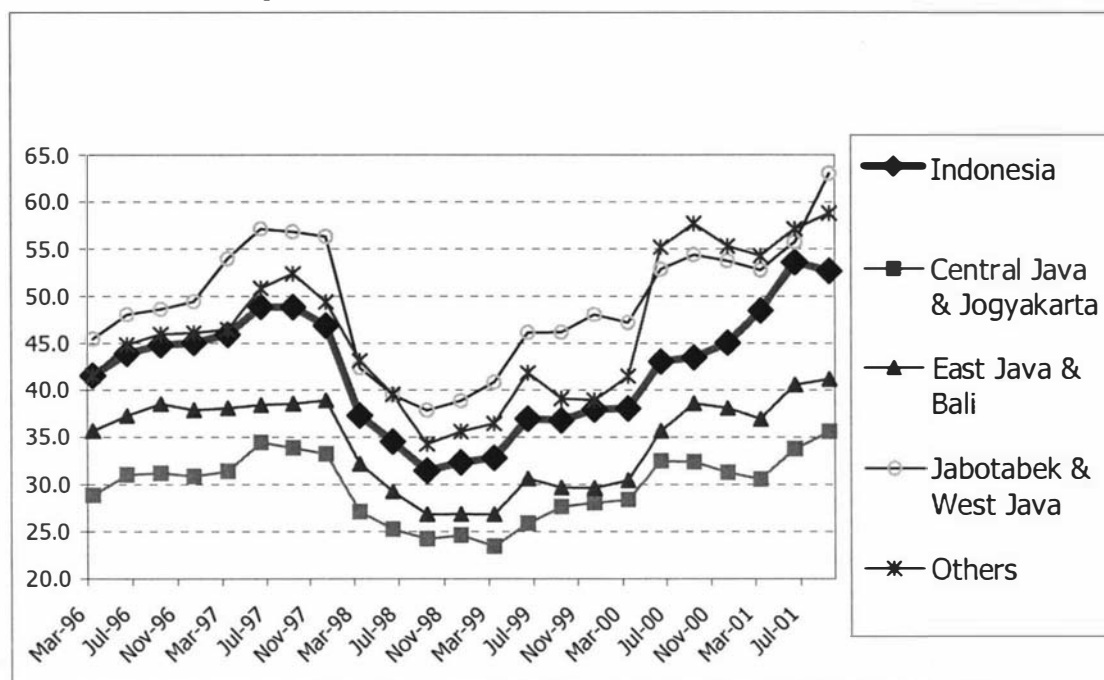
In addition, the wage gap between the informal and formal, especially those in the manufacturing sector appeared to widen. BPS (2003) reported that real wages in the rural sector and the informal sector stagnated after the 1998 crisis. The report stated that, after a sharp fall in real wages due to the crisis, real wages in the manufacturing sector started to recover and reached its 1997 peak in 2001, and also appeared to continue increasing in 2002. Real wages in the agricultural sector and the informal sector started to rise again after the crisis. However, the rate of increase was far less than that of manufacturing, fell short of the 1997 level, and appeared to stagnate in 2001 and 2002. The likely cause of the increase in real wages in manufacturing was the significant increases of minimum wage levels in 2001 and 2002. The minimum wage policy is unlikely to cover the informal sector. The concern would be, if one relates the situation to the competitive theory of labour demand depicted in Chapter III, that large increases in minimum wages would decrease employment opportunities in the formal sector and eventually increase the size of the informal sector, thereby putting pressure on and depressing real wages in the informal sector. In a country where the unemployment benefit is nonexistent, workers who lose their formal sector jobs must work in the informal sector or risk starvation.

Wages in the Fieldwork Area

Real wages in Jabotabek and West Java surpassed the pre-crisis level of 1997 and continued to rise during 2000 and 2001 (See Figure 5.4). It was likely that the increase was attributed to the vigorous pursuit of minimum wage fixing in 2000 and 2001. Other developments, such as the decentralization of the minimum wage fixing machinery and the increasing strength of trade unions, also have the potential to cause further changes to wage levels. Other regions tended to experience a similar pattern, but seemed to slacken off in 2001. One of the objectives of the fieldwork was to assess the impact of these two factors on economic variables such as wages and employment. However, the employment effect of this increase in minimum wage levels remains to be seen. If the theory and subsequent studies were to be taken into account, the increase could pose dire consequences on workers. If increases in minimum wage levels are too high, there could be large employment losses resulting from firms' responses to the wage increase. By definition, the formalization of independent trade unions also has the potential to increase wages, as unions will push for higher wages as well as improvement in

working conditions². Chapters VII and VIII will address the extent of the impact of minimum wage increases on employment.

Figure 5.4 Real Weekly Manufacturing Wages, Indonesia & Selected Regions, 1996 - 2001 (000 rupiahs)



Source: Statistics Indonesia; Quarterly Wage Survey various quarterly

Social Protection

Changes in the political landscape would make social protection even more important in the Indonesian context. Beattie (2000) argued that the political situation of a country is the first and most crucial factor in terms of the wider economic, social and political context. This means that in a more democratic environment, greater social protection would be highly demanded. He further argued that not only does democracy favour the development of social protection, but its extension is of vital importance in promoting social stability and democratic participation by all groups in society (Beattie, p. 133). Social protection ranges from providing a safety net for the poor during the crisis to providing education for the poor. The labour force, especially those at the lower end of the wage scale, is one group which is in need of such protection. In addition, the newly

² For more explanation on the theoretical framework see Chapters II and III.

found democratic atmosphere in Indonesia could demand greater protection for workers. Unlike developed countries, there is currently a lack of social safety net for workers. One such protection is the benefit to the unemployed.

Unlike the system of welfare in developed countries such as New Zealand where an unemployment benefit exists, Indonesia cannot rely on an unemployment benefit to assist workers who are in the labour force but cannot find work. In developing countries such as Indonesia, many people who could not join the workforce in the formal sector simply could not afford to be without any job because the government does not have the budget to provide an unemployment benefit. These workers must join the ranks of those in the informal sector to make ends meet. Those lucky enough to be employed in the formal sector can receive employment insurance, which can be used as start-up capital in the informal sector³.

Nevertheless, Manning (1993) argued for a country at the current stage of development Indonesia had a comprehensive labour protection legislation. In addition to substantially increasing the minimum wage level during the 1990s, the Indonesian government also had other forms of social protection designed for workers, such as the Worker's Social Security Law dubbed JAMSOSTEK including life insurance, retirement benefits, free health care, and workers' compensation, which raised labour costs by 12 percent (Devarajan et al., 1997, p. 148). The system was designed to protect Indonesians working in the formal sector from, among other things, ill health (through health insurance) and unemployment. The social security scheme was not designed as an unemployment benefit similar to developed countries. However, it does provide workers who are laid-off with a compensation package.

The Jamsostek was also designed to redistribute income from employers to employees. Firms were supposed to contribute to the workers' social security by paying the benefit. Nonetheless, McLeod (1993) considered Jamsostek as a poor strategy as it made promises to distribute income which it could not fulfill. He argued that Jamsostek might be responsible for lower wages because employers would consider this benefit a burden

³ Firms partly or wholly contribute to employment insurance called JAMSOSTEK, best translated as Worker's Social Security, thus arguing for redistribution from employer to employee (McLeod, 1993). However, he also argued that for Jamsostek to be an effective tool for redistribution, it would be necessary to have effective minimum wage regulation (McLeod, 1993, p. 93).

and pass it on to workers. He also added Jamsostek encouraged rampant corruption where employers could 'negotiate' this form of tax with officials. In addition, he also argued that Jamsostek has the same (negative) impact on employment as the minimum wage legislation (McLeod, 1993, p. 93). However, one of the attractions of the minimum wage policy is that it does not have direct budgetary consequences for the government and could avoid this type of corruption (See Chapter III).

The Minimum Wage Policy

The minimum wage policy is another form of social protection for workers designed as a safety net wage to prevent real wages from falling. The minimum wage legislation covers the whole economic sector, but is more prominent in the formal sector. Compliance with the minimum wage appeared to be weaker initially, especially in medium-sized firms. In fact, many medium textile and garment firms in the Majalaya area of West Java do not comply with the minimum wage provision (*Kompas*, 2003d). There is no evidence that small firms pay their workers minimum wages, although the minimum wage is subject to firms employing at least 25 workers.

Historical Overview

In Indonesia minimum wages was introduced in 1956, even though efforts to assess the level of minimum wage by establishing the minimum wage study commission had only started in 1969 (Simandjuntak, 1993). However, during its initial stages in the 1970s and, with its extension to all the provinces in Indonesia in the late 1980s the minimum wage policy was largely symbolic (Manning, 1993, p. 72). The minimum wage law was first passed by the government in the mid-seventies, when provincial and provincial-sectoral minimum wages were initiated (McCawley and Manning, 1976; cited in Manning, 1998, p. 207). During these periods the government, in line with the capitalist development strategy of export-oriented industrialisation, was more concerned about labour control than labour protection. Not until the late 1980s was the minimum wage legislation vigorously pursued when the government revamped the minimum wage law and passed the law on social security and insurance (Manning, 1998, p. 206). Political pressures, mainly from human rights activists and the United States, in the context of the GSP (Generalized System of Preferences) rights had prompted the government to increase minimum wages significantly as well as increase enforcement (Levine, 1997;

Harrison and Scorse, 2003)⁴. From 1990 onwards the government paid more attention to the implementation of provincial minimum wage legislation in establishments with 25 or more workers across all regions of Indonesia, and especially in larger firms close to the major cities (Manning, 1994, p. 81). As a result, adherence to a minimum wage policy from global firms (firms with foreign ownership and/or export orientation) increased during the 1990s. The government appeared to be even more committed to enforcing the minimum wage policy after the cataclysmic event of 1994, when massive labour riots increased international pressure on Indonesia to improve labour conditions.

In the early stages, the problem with the minimum wage was that it was set below the so-called minimum physical need (KFM-Kebutuhan Fisik Minimum). Manning reported that up to 1994 the minimum wages were always below the KFM figures (ibid, 1998, p. 208; Levine, 1997, p. 181). The stated goal of the minimum wage policy was to raise wages to at least the level of the minimum physical need by 1995 (Manning, 1993, p. 72; Simandjuntak, 1993, p. 70). The government was also planning to adjust it to the minimum subsistence need (KHM) by the year 1997⁵. This meant that the minimum wage prior to 1994 constantly fell short of providing a decent standard of living. In addition, women workers in manufacturing tended to receive wages below the minimum wage level (Robinson, 1999, p. 254). One wonders how these workers could even work under these conditions. However, in 1995 the government pursued the minimum wage setting vigorously by significantly adjusting the minimum wage rates to suit the basic needs of workers. It is apparent that the increasing number of violent strikes from 1991 to 1994 and the subsequent political pressures triggered a more vigorous pursuit of the minimum wage policy by the government. Levine (1997) reported that strikes increased from 1991 and culminated in a violent riot in Medan, North Sumatera in 1994. The main reason for many of the strikes was the failure of many firms to pay their workers the minimum wage (Levine, 1997, p. 197). It appears that the Medan strikes encouraged other workers to stage more strikes, as the number of strikes increased in 1995 and 1996 (See Chapter IV).

⁴ Minimum wages were increased four times in nominal terms or doubled in real terms. See also Rama (1996, 2001).

⁵ As a comparison, the KFM is equivalent to a 2600-calorie intake in one day and the KHM is equivalent to a 3000-calorie daily intake.

Thus, the fall of the New Order regime transformed the application of the minimum wage policy. Firstly, the central government maintained the minimum wage provision to a greater degree by allowing local governments set up their own minimum wage in their own area. Secondly, the establishment of independent labour unions also meant that workers, represented by unions, took an active part in determining the level of the minimum wage. No longer do workers rely on the state-controlled SPSI to voice their grievances. Major unions could now influence to some degree the level of minimum wage in a given year. Thirdly, the decentralisation process also caused minimum wage setting to be delegated to a lower administrative level, the district and city, against the mandated rule where the provincial office has the authority to conduct such a task.

As explained in Chapter II, Law Number 22, 1999 on Decentralisation required the central government to shift many of the administrative authority to local governments, especially to district and city governments. The central government has devolved decision making that allows local governments to generate their own income and recruit their own staff. The authority to determine local minimum wage levels was one of those functions being decentralised to local governments. That authority fell on provincial authorities, except for West Java where the governor delegated that task to district and city authorities. Moreover, the central government had also deconcentrated many regional offices which had previously been under the jurisdiction of the central government. One of those offices was the regional manpower office which was merged with the local manpower office under the jurisdiction of the governor or district/city office. This office is currently responsible in setting the minimum wage level within its border. Thus, the impact of the minimum wage fixing within a region could also affect its ability to generate its own income.

Pre and Post Crisis Minimum Wage Levels

Prior to 2001 the minimum wage was called the provincial minimum wage that applied to each province, except for special industrial areas such as Batam. Significant increases in minimum wage actually started in 1991 when the government became more concerned about the welfare of workers. The average annual increase of minimum wages during the pre-crisis period never exceeded more than 16 percent. During the post

crisis, particularly in 1997 and 1998, real minimum wages deteriorated due to the high inflation rate. Table 5.3 shows that during the 1997-2001 periods several provinces such as East Java experienced a decrease in real minimum wage. However, after the democratic transformation in 1998, the rate of increase started to rise again due to a more stable economic situation. In fact, Table 5.3 shows that in several provinces, such as Jakarta, the increase in the real minimum wage was higher than 20 percent. Consequently, the decentralization process had created more complications in several provinces, particularly in the regions next to Jakarta where the minimum wage became obsolete because minimum wage fixing had been delegated to district or city government.

Table 5.3 Real Provincial Minimum Wage Increases (% per annum) Pre and Post Crisis

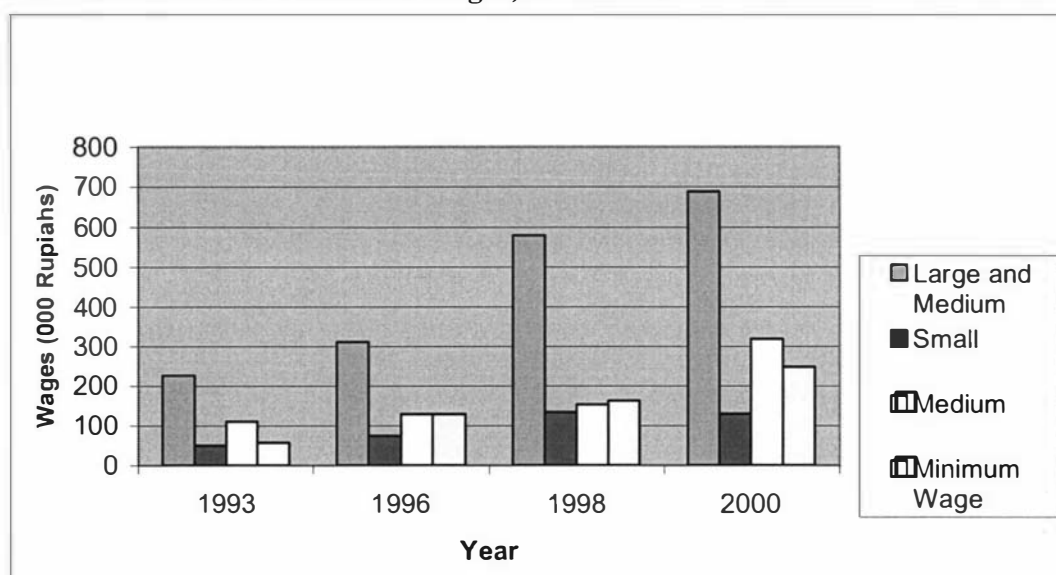
<i>Province</i>	<i>Pre-Crisis 1991-1997</i>	<i>Post Crisis 1997-2001</i>	<i>1999-2001</i>	<i>All years 1991-2001</i>
<i>Aceh</i>	7.1	0.7	18.7	4.5
<i>North Sumatra</i>	11.0	1.1	17.1	7.0
<i>West Sumatra</i>	10.5	-2.8	13.0	5.2
<i>Riau (outside Batam)</i>	11.3	2.9	17.9	7.9
<i>Riau (Batam)</i>	1.6	-0.2	19.4	0.8
<i>Jambi</i>	10.7	3.5	16.8	7.8
<i>South Sumatra</i>	12.1	-3.3	10.2	6.0
<i>Bengkulu</i>	15.4	-2.9	16.9	8.1
<i>Lampung</i>	10.2	-4.5	11.5	4.3
<i>Jakarta</i>	8.2	3.9	22.0	6.5
<i>West Java</i>	15.1	2.4	19.7	10.0
<i>Central Java</i>	10.5	2.7	16.7	7.4
<i>Jogyakarta</i>	18.7	3.8	27.6	12.7
<i>East Java</i>	13.2	-3.0	11.8	6.7
<i>Bali</i>	12.3	0.0	19.6	7.4
<i>West Nusa Tenggara</i>	12.9	0.5	18.7	7.9
<i>East Nusa Tenggara</i>	9.3	5.1	24.8	7.6
<i>West Kalimantan</i>	9.5	3.1	21.4	7.0
<i>Central Kalimantan</i>	13.5	6.3	23.2	10.6
<i>South Kalimantan</i>	15.5	4.5	23.3	11.1
<i>East Kalimantan</i>	15.0	-1.1	13.7	8.5
<i>North Sulawesi</i>	6.0	8.1	33.8	6.8
<i>Central Sulawesi</i>	15.5	-1.5	15.1	8.7
<i>South Sulawesi</i>	13.2	5.5	27.7	10.1
<i>Southwest Sulawesi</i>	10.5	-1.6	17.6	5.7
<i>Maluku</i>	12.0	-6.5	5.2	4.6
<i>Papua</i>	9.9	3.8	19.4	7.5
Indonesia	12.1	1.1	17.6	7.7

Source: Ministry of Manpower and Transmigration

Minimum Wages and Average Wages

The impact of the minimum wage policy is reflected in Figure 5.5. It shows that the nominal average wages of large and medium firms were higher than the average minimum wage from 1993 to 2000. The average nominal wages of small firms were always below the minimum wage level. The average nominal wage of medium firms from 1993 to 2000 hovered around the minimum wage level. It may reflect the low compliance of minimum wages by medium firms. Depending on geographic areas and type of industries, the field visit conducted by the researcher and by studying other relevant documents revealed that in some areas and industries many medium firms, notably garment firms in the Bandung area, did not pay minimum wages.

Figure 5.5 Nominal Monthly Wages of Large, Medium and Small Manufacturing Establishments and Minimum Wages, 1993-2000

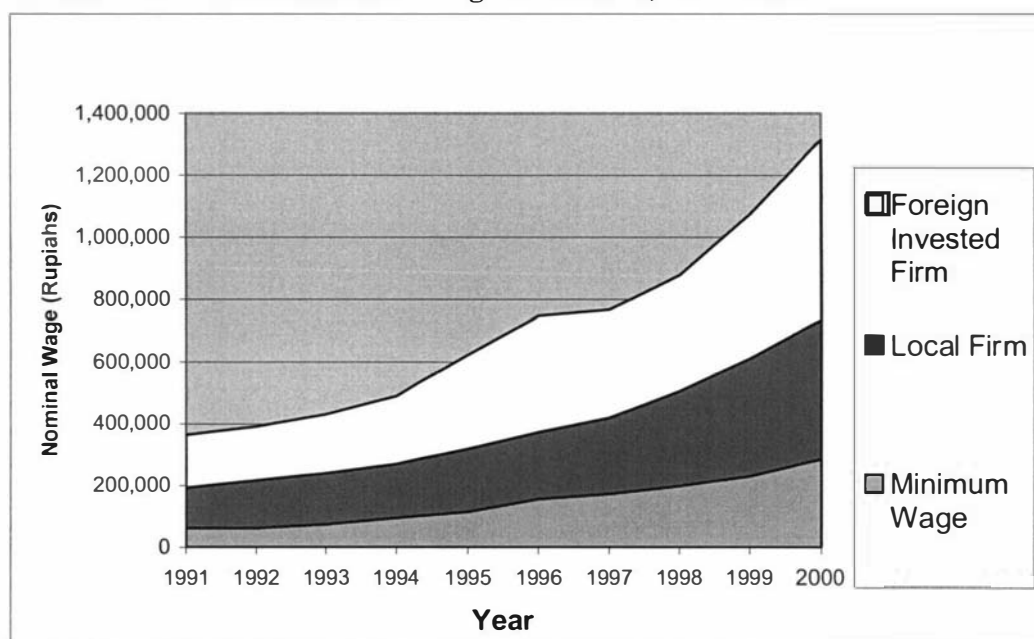


Source: Statistics Indonesia (Large and Medium Manufacturing Statistics, various years) and Ministry of Manpower and Transmigration website

Average wages in large and medium manufacturing have stayed significantly above the prevailing minimum wages, notably from 1994. The more vigorous pursuit of the minimum wage policy in 1994 might be the main reason this. Average wages in Indonesia and each selected province were significantly above the minimum wage rates in the same year. For instance, Figure 5.6 shows that average wages in Jakarta was significantly higher than the prevailing minimum wage. Even average wages in labour

intensive sectors such as the textile sector was far above the minimum wage and even the average manufacturing wage. However, average wages in Central Java were only slightly higher than the minimum wage and lower than the average manufacturing wage. This meant that wages in Central Java are still significantly lower than in Jakarta or even West Java. This fact could be the reason some businesses were planning to relocate to Central Java, as well as other areas such as East Java and Lampung (Barrattex.com, 2001). In fact, the wages in Central Java was still lower than average wage in China (425 000 rupiahs equivalent) and still competitive with average wages in Vietnam and Cambodia (about 382 500 rupiah equivalent) (Barrattex.com, 2001).

Figure 5.6 Average Nominal Monthly Wage of Local and Foreign investment Establishments and Minimum Wage in Jakarta, 1991-2000



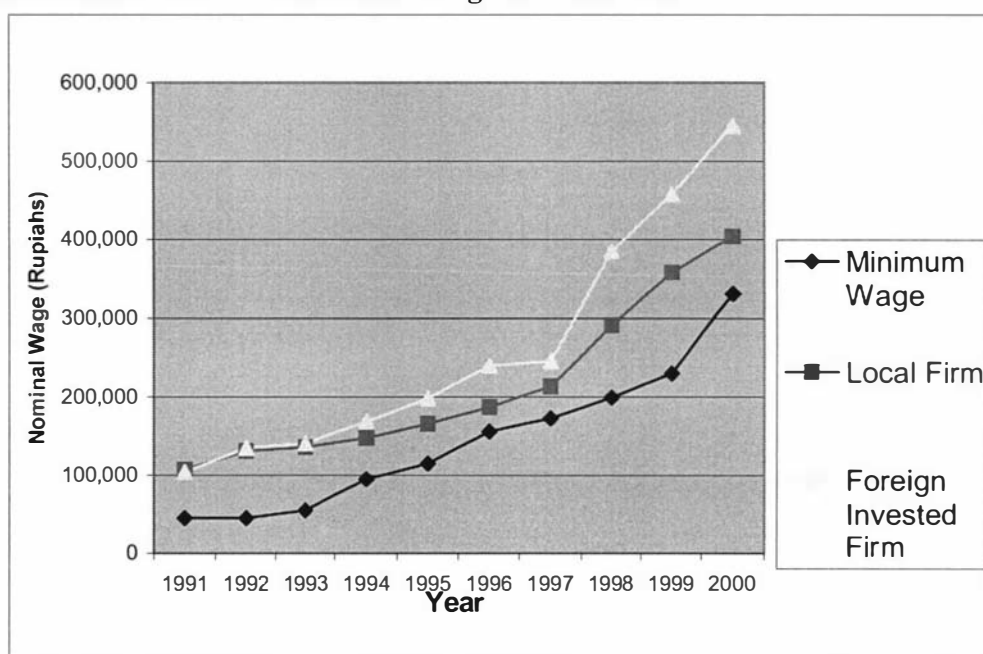
Source: Statistics Indonesia (Large and Medium Manufacturing Statistics, various years) and Ministry of Manpower and Transmigration website

The presence of foreign direct investment seems to have a positive effect on the average manufacturing wages in Indonesia. Figure 5.7 shows that establishments in West Java that were partly or wholly owned by foreign investors had higher average wages than 100 percent locally-owned establishments in the three provinces⁶. In fact, average wages in these firms were far above the prevailing minimum wages. The same pattern also occurred in establishments in other provinces, such as Jakarta and Central and East

⁶ Foreign invested firms refer to firms which have at least one percent of foreign ownership.

Java. The figures were consistent with a study conducted by Lipsey and Sjöholm (2001) on the effect of foreign direct investment on Indonesian manufacturing. They concluded that foreign direct investment has had a positive effect on average wages in Indonesian manufacturing. They also added that the presence of foreign ownership in domestically-owned firms also raises the average wages. However, it was actually after 1994 that wages in these industries increased significantly relative to the average wages of locally-owned industries. In addition, these firms were also more affected by the crisis, whereas local establishments did not experience any significant changes in the trend.

Figure 5.7 Average Nominal Wages of Local and Foreign Investment Establishments and Minimum Wage in West Java

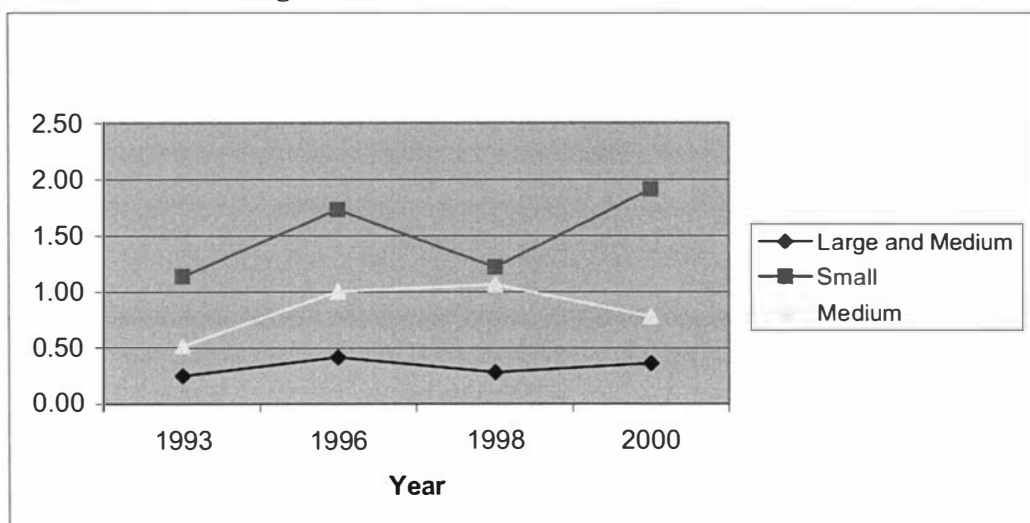


Source: Statistics Indonesia (Large and Medium Manufacturing Statistics, various years) and Ministry of Manpower and Transmigration website

Average wages in large and medium manufacturing always stayed above the prevailing minimum wage. Figure 5.8 shows that the average wages of large and medium establishments far exceeded the minimum wage in the same year. However, average wages in medium manufacturing were only slightly higher than the minimum wage, especially in 1996 where the minimum wage was virtually the same. In addition, average wages in small industries had been lower than the minimum wage. In fact, in

year 2000 average wages of small establishments significantly decreased, whereas the nominal minimum wage increased.

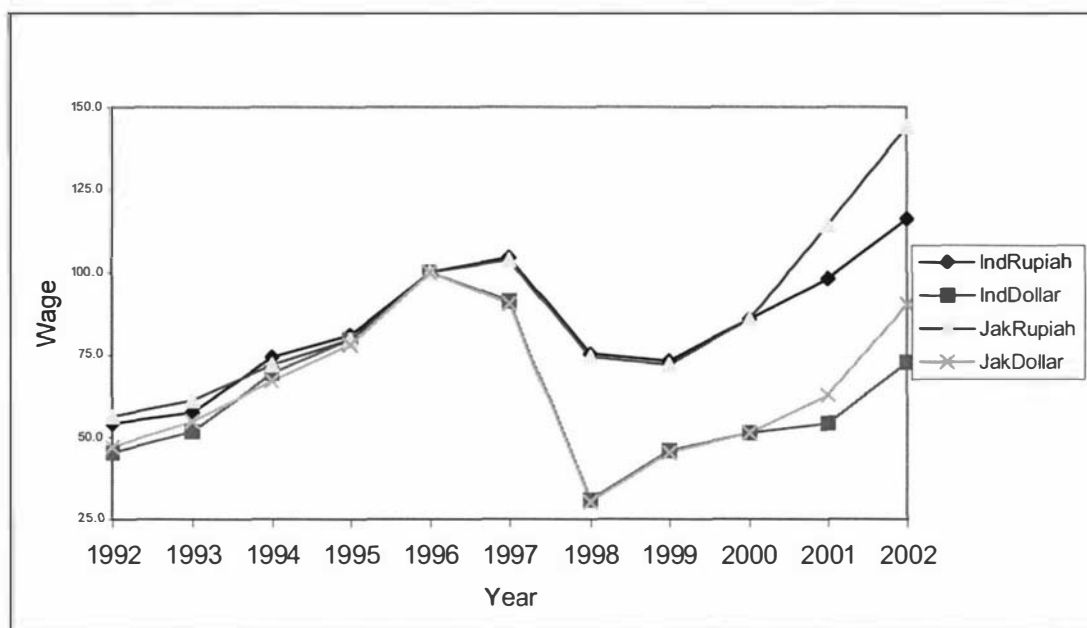
Figure 5.8 Ratio of Minimum Wage to Average Wages in Large, Medium and Small Manufacturing Establishments



Source: Statistics Indonesia (Large and Medium Manufacturing Statistics, various years)

If viewed in real terms, real wages started to recover in 2000. Two types of deflators were used to calculate real minimum wages; one was by using the consumer price index and the other by using US dollars. Figure 5.9 shows that, in real terms, the minimum wage decreased in 1998 due to the crisis. However, it has recovered above the 1996 level in 2001 and 2002. However, in terms of US dollars, the minimum wage had already decreased in 1997. It further decreased in value in 1998, because at the time the rupiah lost more than 70 percent of its value. In terms of US dollars, the minimum wage had not surpassed the 1996 level in 2002. Thus, it would be prudent to use the consumer price index as a price deflator rather than use the US dollars. Fluctuations in the US dollar value, especially during the crisis and recovery period of 1998 to 2000 might not provide a consistent result.

Figure 5.9 Real and Dollar Values of Minimum Wages in Indonesia and Jakarta



Note: JakRupiah and JakDollar refer to Jakarta region

IndRupiah and IndDollar refer to Indonesia in general

Source: Statistics Indonesia and Ministry of Manpower and Transmigration

The increase in minimum wages in recent years was one of the reasons blamed for the difficulties faced by Indonesia in recovering from the economic crisis. With regard to the decentralization process, local governments were already struggling to balance their objective of generating regional specific revenues and to appease local labour. The decentralization process also caused changes in the way minimum wages were being set. No longer does the central government determine the level of regional minimum wages. Recent developments have also decentralized the minimum wage fixing further down the administrative level, at district and city level. West Java was the first province that allowed district heads or mayors to approve the minimum wage level proposed by the district or city wage councils. There were also reports that Central Java province was planning to follow suit (*Kompas*, 2001c).

Determinants of Minimum Wages

The minimum wage was considered a non-negotiable basic right that workers must receive as compensation for their services from the firm where they worked. The minimum wage became a basic right and has been binding in Indonesia since 1989 through a ministerial issued regulation (*Permenaker* No. Per-05/1989). The minimum

wage was designed as a social security net to prevent real wages from falling, minimize the wage gap between the lowest tier wage and the highest tier wage and to improve the income of the lowest paid worker (Manpower Office of West Java, 2002). The minimum wage was also designed to increase productivity through discipline and the encouragement to work harder. The determination of the minimum wage level has been a much more dynamic process since minimum wage fixing was decentralized. Labour and business representatives are now much more involved in the minimum wage setting process, as well as local officials in regions where the minimum wage is being applied. Previously, the central government, that is the Ministry of Manpower, appointed the regional officials who determined the minimum wage levels. Ultimately, the Manpower Minister was the final authority that determined the minimum wage level.

Under the justification of the new decentralisation law (Law Number 22, 1999 on Regional Autonomy), the minimum wage legislation was further complicated by the transfer of authority to set minimum wages from the provincial government to district and city government by several provinces, notably West Java. For instance, the area around Jakarta known as Botabek, had set its own minimum wages in 2001. The area which consists of Bogor, Tangerang and Bekasi districts and city has a concentration of manufacturing industries such as electronics, automotive parts, garments and footwear. The Botabek area was part of the West Java Province prior to 2000. Since the start of the decentralization process, Tangerang District and City became part of the newly introduced province of Banten. In 2001 the minimum wage of Botabek was more than 70 percent higher than that of West Java.

The wages were set by the minimum wage council or the commission of the city or district and approved by the district or city head. Prior to the new decentralization law, regional governments could only recommend regional minimum wages for their respective regions. However, final approval for the provincial minimum wage level was given by the Minister of Manpower (currently called the Ministry of Manpower and Transmigration). With the advent of the decentralization process the Ministry of Manpower no longer has any jurisdiction over the setting of the minimum wage at provincial or district/city level. Nor do the local manpower regional offices, which are now under the jurisdiction of the district/city authority. Based on the new employment

law, the Ministry of Manpower now has the task of setting the criteria for determining minimum wage levels, plus monitoring the implementation of policies.

Under the current authority, the provincial minimum wage level is set according to the lowest minimum wage level among the districts within that province. The provincial wage council would receive all the district/city minimum wage levels from the respective district/city wage councils. Then the council would decide the level at which the overall provincial minimum wage level would be. There are six criteria in determining the level of the minimum wage in a province. They are:

1. Minimum daily needs⁷
2. Inflation rate of each district, city or province
3. Economic condition or Gross Domestic Regional Product (GDRP)
4. Labor market condition
5. Capability, development and continuity of firms⁸, and
6. Minimum wage in neighboring district or province⁹.

The provincial wage council consisted of stakeholders of the minimum wage within the region, they are:

- a. Trade unions: they are represented by the largest trade unions in the region, for instance, in Bandung district, the trade union members of the council came from the seven largest trade unions within the Bandung District
- b. Employer associations: they are often dominated by the Association of Indonesian Employers or APINDO, although other business associations also attend
- c. The government: they are represented by officials from various government institutions in the region and organized by an official from the local Manpower office.

⁷ The wage council conducted a market survey in five selected traditional markets to determine the level of minimum daily needs in the district. This value will be the initial proposed minimum wage to be discussed further between employer and employees in which the other 5 criteria are considered.

⁸ The employer association report their members' capability in paying minimum wages

⁹ Findings in Bekasi, Bogor and Tangerang districts suggested that this criterion was used as the base for the minimum wage level after considering the minimum daily need. Unions argued that these districts are in such close proximity to Jakarta that it is understandable that the minimum wage level in these districts should be near to the Jakarta level. They also argued that the markets used to determine the minimum daily need did not reflect the true expenses of workers, many of whom lived in Jakarta.

In addition, there is an additional designated chairperson normally chosen from a reputed local university in the region. The chairperson would act as an objective referee during the minimum wage fixing process.

The determination of minimum wage levels is a complicated task due to the multiple criteria for calculating the minimum wage value and the political implications such values may have on both businesses and workers. The main criteria for determining the minimum wage level is the minimum daily (subsistence) need¹⁰. The wage council conducts market surveys to determine the level of the workers' minimum daily need¹¹. The minimum daily need (dubbed KHM) consists of about 43 types of tradable items consisting of food, clothing, transportation and recreation¹². The types of items were based on the location of the survey, quality of products, brand, size and other specifications. The lowest district minimum wage level in the province would be used as the provincial minimum wage level. Nevertheless, the fieldwork found that even though the minimum daily need is the major consideration for setting minimum wage levels eventually political considerations often influenced the final outcome of the minimum wage setting in 2002 and 2003. What is disheartening is that, in the end, the wage council would abandon the market study in favor of other criteria. The time spent on the survey and the possibility of government intervention tend to favour employers more than workers.

Indeed, the early part of the minimum wage determination at district levels were fraught with problems. Hendarmin (2001) identified several crucial negative aspects of decentralizing minimum wage fixing in West Java. The first is that the provincial directive to decentralize minimum wage fixing at district level was against the ministerial decree Number 226/men/2000, which stipulated that the provincial

¹⁰ Minimum daily needs are a bundle of 43 different tradable goods which workers usually need for their everyday activities, such as food, clothing, soap etc.

¹¹ The district or city wage council consisted of an equal representation from the employers association, at least APINDO and KADINDA, workers association, the dominant unions in the district or city, and government representatives as facilitators i.e., providing data and information, and acting as mediators. The chairperson of the council was usually a representative from a major university from the district. University scholars were considered the most neutral person in the council. As an example, the Jakarta wage council in 2003 consisted of 6 government, 6 employer, 6 labor union, and 1 university representative.

¹² The Ministry of Manpower and Transmigration (2002) published a document which specifies the types of items and how to calculate the level of KHM.

government has the final verdict on minimum wage levels. In addition, the capability of district officials to handle such politically complicated procedure is suspect. Minimum wage fixing also tended to take into account only the social and welfare aspects, without considering the economic and business aspects. Many problems eventually emerged that could not be properly solved by district officials.

Box 5.1 The Minimum Subsistence Need (KHM), on which the minimum wage is based, consists of 43 items (The Bandung district used only 42 for the 2003 KHM calculation). The only difference among districts or provinces is the quality of the items. The 43 items are items a worker normally need for a month. The first 11 items is grouped under food and beverages, including rice, meat, fish, fruits, vegetables and drinks. The second groups, consist of 19 items, are the accommodation items including, housing rent, bed and its accessories, plates, stove, soap and clean water. The third group, clothing, consisted of 8 items. The last group, miscellaneous items, consisted of 5 items, including transportation costs, medical, education and recreation costs. However, the KHM does not guarantee that it would be used as the minimum wage because there are other factors to consider. Perhaps the most crucial is the minimum wage of neighboring district or province. There in lies the problem because district officials often wait for the other to set the minimum wage, thus creating confusion for workers. It is not surprising to find one district with the KHM higher than the minimum wage and, at the same time, find another district with the KHM level lower than the minimum wage, as the case occurred between Bandung city and Bandung district. Most recently, trade unions have recommended that the KHM be expanded to include 55 items. They argued that urban dwellers would need more items than their rural counterpart.

The local government was also subjected to pressure from local unions. Several district heads had to cancel minimum wage levels that were already approved. In Jakarta and several districts in West Java in 2001, 2002 and 2003, the employer association had taken the local governments to court for reneging on the approved minimum wage. It was alleged that the governor of Jakarta had unilaterally and suddenly changed the minimum wage level of 2002 from the agreed 519 thousand rupiahs per month to 620 thousand rupiahs per month (Kompas, 2001d). The matter was taken to court, but was left unresolved for some time (Kompas, 2002). The employer associations charged that the wage commission is useless because the government took matters into their own hands instead of being a mediator. During the fieldwork interview with local employer associations, it was reported that in two cases in the research area, Bekasi in 2002 and Bandung in 2003, the local employer association took the local government to court.

Banten, a relatively new province, also followed the method used by districts in West Java in setting the minimum wage. The reason for this is because Banten was part of the West Java province before its separation in 2001. Another reason is due, perhaps, to the lack of experience in the provincial apparatus for setting minimum wages. When the researcher visited the province it was found that dispute resolution at tripartite level was still being conducted in Bandung, West Java's capital.

Another more ominous aspect of the political sensitivity of minimum wage setting is the intervention of the central government. It appears that since the political transformation which resulted in the ratification of ILO Convention Number 87 on the freedom of association, the central government has encouraged the development of trade unions. There was also no indication that the central government intervened in the early process of minimum wage fixing. The central government delegated the authority to set provincial and district/city minimum wages to local authorities. That might change if the central government feels that the level of increases in minimum wage levels is so high that they threaten economic growth. Furthermore, a change in the political structure of the central government through a general election could also upset the balance of power in minimum wage setting. After all, the minimum wage, as much as it is a serious economic issue, is above all else a political one (Levin-Waldman, 1998). As proof, minimum wages and other workers' issues often dominate the headlines. During the initial research there were hundreds of articles that, to some extent or another, mentioned minimum wages or related issues, while empirical studies on minimum wages were few in Indonesia.

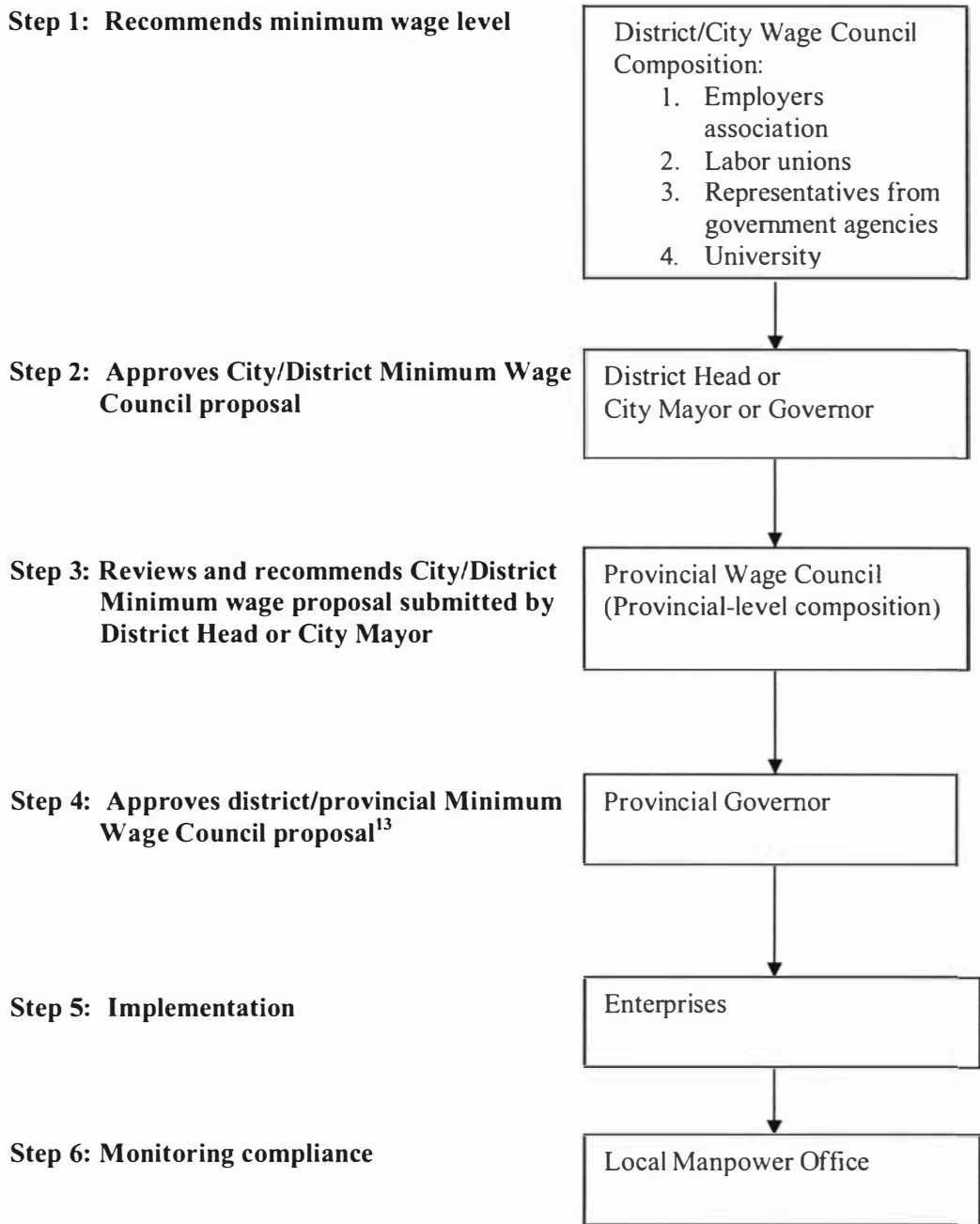
One positive note from all this was that minimum wage setting is much more democratic than in the past. The wage council has the same number of labor representatives as employer representatives. The government side of the council only acts as facilitators by providing information, technical assistance and advice to the council. However, when there is a deadlock in negotiations a vote that includes the government members of the council must be taken. It is often alleged that the government chooses the side of employers over workers. This is a charge that local governments vehemently reject (Interview G01, February 2003). Even so, the fieldwork found that in 2001 and 2002, and in certain areas, the pendulum appeared to swing to

the workers' favour as local governments granted significantly higher minimum wage increase than the earlier years.

The Minimum Wage Setting Process

The new minimum wage setting process differs in the regions where the researcher visited. Based on Ministerial Decree Number 226, 2000 (*Kepmen No. 226/Men/2000*) and under the new employment law discussed later in Chapter IX, minimum wage determination was delegated to provincial offices. Moreover, ever since the increased freedom of labor unions after the ratification of ILO Convention Number 87 on Freedom of Association, the government also allowed much greater union involvement in the council in setting the minimum wage level. In Jakarta, for instance, the provincial wage council has the authority to set the minimum wage with the approval of the governor. Figure 5.10 shows the general step by step process of minimum wage fixing at provincial level. The diagram also includes the minimum wage policy stakeholders: trade unions, employers and the government. The government depicted in the diagram includes local as well as central government representatives at the local level. Even though most central government functions were delegated to local governments, some functions, such as the statistics office, remains under the central government's authority. Members of each stakeholder group are equally represented in numbers, with an additional representative from the reputed local university as chairperson.

Figure 5.10 Minimum Wage Setting Process according to the New Employment Law Number 13, 2003



West Java and Banten did not exactly follow the prescribed minimum wage setting process shown in Figure 5.10, although the provincial authority did set a provincial minimum wage by choosing the lowest minimum wage level among the districts/cities within the province. Minimum wages in these provinces are set by the district or city

¹³ Except for West Java and Banten

wage councils with the approval of the mayors or district heads, but without the approval of the governor. The West Java governor, through an official written memo (crudely described as radiogram), has delegated minimum wage setting to district or city offices¹⁴. The city of Bogor even went so far as to set a sort of sub-minimum wages in 2003 for small and medium TGF (Textile, garment and footwear) firms in addition to the general minimum wages within the city, whereas the adjacent Bogor District applied a sub-minimum wage for non-manufacturing firms since 2002. This process of wage setting differs from the stipulations of the ministerial decree where the governor has the authority to approve district as well as provincial minimum wages. There appeared to be speculation that the process was more politically motivated than merely a way of simplifying the approval process. This process has resulted in one trade union in Bandung refusing to sign an agreement on the minimum wage level in Bandung, though their representatives still attended meetings to discuss the minimum wage levels.

The most important and arguably the most time consuming step in the process is the setting of the minimum wage level. As early as July, the council would meet to discuss the minimum wage level for the start of the next year. Based on the criteria for the minimum wage level, the council would start discussing the minimum subsistence need for the next year. The council has to prepare the appropriate minimum wage level and recommend it to the final authority before the start of the next year because the new minimum wage is applicable from the 1st of January of the next year. To achieve that target, the council breaks down into teams who conduct price surveys of selected items at the designated local markets. Depending on the number of markets to be surveyed, the team consisted of at least one representative from each stakeholder. After collecting information on the prices of selected groups of items, the team would meet and discuss how best to calculate the value of the minimum subsistence needs (KHM). Thus far, the process of calculating the KHM normally proceeds without much argument. It is usually the next phase of the process when discussion on the minimum wage level starts.

As explained earlier, the KHM is not the only criteria in determining the level of minimum wage. It is often the trade unions who insisted that the KHM should be used

¹⁴ Unlike other provinces where districts need the approval of the governor to make minimum wage level official, districts and cities in West Java only need the approval of district/city heads. The provincial office still set their own provincial minimum wage, but the provincial minimum wage only reflects the lowest minimum wage among the districts in the province.

as the minimum wage level. It is likely that trade unions would refer to the promise the government made in 1997 that the minimum wage would be based on the KHM. Trade unions often disregard or pay little attention to the other criteria. It is the argument resulting from the failure to reach an agreement which drags the minimum wage process on for some time, and in some cases, results in walk outs by the trade unions if negotiations do not proceed their way. Usually the state of the economy, and to a lesser extent, the conditions of local businesses dominate the discussion on the new level of the minimum wage. The researcher observed that if the minimum wage is far below the KHM, the employers have most likely won the day. If the KHM is applied as the new minimum wage, then it is likely the trade unions have won the day.

The next steps of the minimum wage process are mostly conducted by the local government. The governor, district head or mayor produce a binding approval letter based on the recommendation of the council. The local Manpower Office then disseminates the information on the new minimum wage to all stakeholders, as well as informs businesses and workers. The local Manpower office is also obligated to monitor compliance with the new minimum wage, although they can also ask trade unions to help them monitor minimum wage compliance because the local Manpower office has limited staff to perform such tasks. Those businesses who can not afford to pay the new minimum wage could apply for a delay in implementing by registering at the local Manpower office to have their case considered. The writer noted that the Manpower office would have knowledge on how the new minimum wage would affect business operations. Several officials explained that they would know this by regular visits to some firms and their evaluation of the businesses' ability to pay. However, a lack of manpower prevents them from visiting all firms that are affected by the new minimum wage.

Studies on the Impact of Minimum Wages in Indonesia

As explained in Chapter III, studies on the impact of minimum wages were numerous, but only a few were conducted on the employment impact of the minimum wage in Indonesia. The conclusions from these studies ranges from modest to significant, depending on the authors, methods and the data used in the analysis. These studies also

reflect the ongoing debate on the benefit of the minimum wage policy. Manning suggested that minimum wage increases are likely to increase the degree of inflexibility of the labour market and encourage employers to conserve on unskilled labour to an even greater extent in the future (1998b; cited in Thee and Hill 1998, p.199). Recent studies by Rama (1996 and 2001), SMERU (2001) and Suryahadi et al. (2003) reiterated the lack of studies on the impact of minimum wages in Indonesia. These studies focused on the impact on employment and wages, but did not address other implications of the minimum wage policy on other variables, such as productivity, non-wage benefits, structural adjustment of the firm and non-economic variables. Moreover, these studies focused on provincial minimum wages that are now obsolete in several provinces since the start of the decentralisation process. All in all, the general conclusions pointed to a small reduction in labour demand and an increase in Indonesian labour costs relative to other East Asian countries (World Bank, 2002).

The study by Rama (1996 & 2001) analysed the impact of minimum wage hike in Indonesia during the 1990s. He concluded that the impact was quite modest in Indonesia. Nevertheless, he warned that the result could be misleading. The main reason for the modest result was due to the low level of compliance by firms to adjust to the new minimum wage, especially small firms. A further examination found that employment in small firms might decrease substantially even though employment would increase in large firms. However, the study did conclude that in the short run, workers from large firms were the ones who benefited from the increase of minimum wages. Any increase in minimum wages tended to increase wages of more skilled and experienced workers. These so-called white collar workers also tended to remain employed due to their skill and experience. Firms tended to keep these types of workers and lay-off unskilled workers so that they could remain competitive. Rama also concluded that this type of policy might not be suitable for poverty alleviation, which the minimum wage was intended for. However, the policy may be consistent with the government's stand of avoiding costly confrontation with workers in large firms who are more likely to be unionised than workers in smaller firms (2001, p. 580).

Table 5.4 Significant Empirical Studies on the Effect of the Minimum Wage Policy in Indonesia

STUDIES BY	Method Used	Data Sources	Results
Rama (1996 and 2001)	Cross section provincial data similar to method used by Neumark and Wascher (1992)	The Labour Force Survey of Indonesia 1993 and additional data from Quarterly Wage survey and Annual Manufacturing survey	Modest negative impact of minimum wage increase on employment; However, modest effect may hide disparities across sectors; minimum wage increase has positive effect on employment in large firms. But negative effect on small firms.
Islam and Nazara (2000)	Pooled province level data (cross section and Time series) and cross tabulations	The Labour Force Survey of Indonesia 1990-1998 (from Employee Situation in Indonesia Publication)	No evidence of significant negative impact of minimum wage increase on employment and business profitability of large and medium firms.
SMERU (2001) and Suryahadi et al. (2003)	Panel (pooled) Data analysis and qualitative survey of 200 workers from 40 firms around Jakarta	The Labour Force Survey of Indonesia 1998-2000 and the inter-census population survey of 1995. Minimum wage data came from the Ministry of Manpower office.	Significant negative impact of minimum wage increase younger employment. Minimum wage increase benefited white-collar workers. But not young and female workers.
Alatas and Cameron (2002)	Difference in Difference approach similar to Card and Krueger (1995)	Large and medium manufacturing data 1990 to 1996	Similar to results of Rama (1996) study. Some negative impact on small firms but no effect on large firms
Bird and Manning (2002)	Panel data	The Labour Force Survey of Indonesia and informal sector data 1990-2000	Minimum wage has a positive impact on informal sector employment but depress wages

A study by Alatas and Cameron (2002) echoed the Rama study. Using similar a data source but using the difference in difference approach employed by Card and Krueger (1995, p. 33), the study also concluded that the effect of minimum wage increases on employment in the Jabotabek area was minimal and mainly affected smaller firms. Nevertheless, the paper argued that the study was conducted at a time when economic growth in Indonesia was quite high. It contended that it was not clear how the minimum wage changes affected employment when the post-crisis macro-economic situation is more fragile (p. 32). In addition, the decentralisation process has also caused uncertainty among the business community, especially when local governments now have the authority to set minimum wages. These issues are addressed in this thesis.

A study by Islam and Nazara (2000) also claimed to have exonerated the charge that the impact of the Indonesian regional minimum wage impaired employment prospects. Using various econometric models they concluded that the minimum wage did not erode business profitability and could be used as a benchmark against which the incidence of the working poor can be measured. However, they cited ILO's concern about the degree of flexibility as a consequence of globalisation. The minimum wage policy may not be an effective policy if such flexibilisation of labour continues further.

Perhaps the most compelling result in terms on the negative impact of the minimum wage policy was obtained in the study conducted by SMERU (2001) and re-emphasized by Suryahadi et al. (2003). The Jakarta-based research institute found significantly different results on the impact of the minimum wage. The study was based on econometric analysis and qualitative studies and found that the minimum wage hike could potentially decrease aggregate employment in Indonesia significantly. The data used for the analysis was the Labour Force Survey data collected by Statistics Indonesia. The minimum wage hike benefited white-collar workers, but not young, female and unskilled workers. Even though minimum wages applied to new recruits, a minimum wage hike tended to have a spill over effect on the wages of other workers. White-collar workers who normally retain their jobs benefited from the wage increase because their salary also increased due to the spill over effect. Those who were

unskilled, young or female were disadvantaged and tended to be laid off due to the minimum wage hike.

Unlike the results concluded by Rama, the SMERU study found that the level of compliance with the minimum wage was significant enough to affect employment. A recent Statistics Indonesia survey (2002) on wages reported that approximately 26 percent of manufacturing firms surveyed paid their workers below minimum wage requirements. This means that 74 percent of firms complied with the minimum wage law. Higher compliance was particularly seen in Java, where efforts to implement the minimum wage law were higher (Manning, 1997, p. 16). The reason for much greater compliance may be due to increased government effort to punish employers who do not comply and due to employers' fear of labour unrest (Levine, 1997, p. 200). However, compliance might not extend to smaller and locally owned firms. Analysis in Chapters VII and VIII will shed some light on the matter.

The study by Bird and Manning (2002) confirmed the impact of the minimum wage policy on the informal sector. Using the Labour Force Survey data, or Sakernas of Indonesia, they found that increases in minimum wages lead to greater informalisation in the labour market (Bird and Manning, p. 14)¹⁵. Workers who lost their jobs due to the imposition of the higher minimum wage and new job entrants who could not find jobs in the formal sector will crowd the informal sector. They also found that increasing the minimum wage depressed the wages in the informal sector. They added that due to the negative impact, the minimum wage policy has the potential to increase poverty instead of alleviating it. Nonetheless, they do not suggest the abolishment of the minimum wage policy, but instead urge the balancing of the overall labour policies in handling the problem of labour.

The study used wages of household servants as a proxy for a wage in the informal sector. The weakness of this approach is that wages of household servants are considered a net disposable income, because in addition to receiving the wage

¹⁵ Manning (2000) reiterated that the crowding of workers in the informal sector was attributed to various factors such as the 1998 crisis.

household servant also live in their master's home, eat there and were even provided expenses when going home for the holidays. They incurred no cost and tended to receive better working conditions. Factory workers, on the other hand, received a gross salary from which they have to pay rent, food, and transportation costs from their home to the factory. The only benefit of working in a factory was that it was higher in terms of social status.

There were other studies which indirectly assessed the incidence of minimum wage provisions in Indonesia. A World Bank funded study conducted by Pangestu and Hendityo (1997) that focused on women workers in the TGF industries also produced several interesting conclusions regarding minimum wages. It found that women workers in factories knew more about the minimum wage law but less about other labour laws such as collective bargaining. The study also found that the workers said that state controlled labour unions did not significantly assist them in their struggle for workers' rights. This is crucial because marginalized workers, such as women and children, were on the receiving end of any detrimental effects of policies, such as minimum wage increases (SMERU 2001).

Still another study by Van Diermen (1997) compared the wages of small manufacturing firms with those of the modern sector. He concluded that although the enforcement of minimum wages in small industries was low, wages in the informal sector have kept pace with wages in the modern sector. The concern will be if the minimum wage hike in the modern sector might indirectly affect wages in the informal sector, especially during economic recession. However, his study was conducted before the crisis and before minimum wage setting was vigorously pursued by the government. The situation has changed dramatically since then. Theoretically speaking, a wage hike during an economic recession may exacerbate the adverse effect on employment (Shaheed, 1994, 53). It follows that as workers are laid off, they will join the ranks of the informal sector. Consequently, this event will force wages in the informal sector to decrease, especially in places where the minimum wage cannot be enforced. Figure 5.5 illustrates this clearly. In 2000, the average nominal wage of small manufacturing firms actually declined compared to the average nominal wage of large and medium firms.

Perhaps the other factor affecting the implementation of minimum wage fixing mechanisms is the development of labour unions in Indonesia. As explained earlier in Chapter III, collective bargaining, which many labour unions strive for, was a more economically superior mechanism than the minimum wage policy (Devarajan et al., 1997). Their study was based on a stylized general equilibrium analysis of union bargaining applied to Bangladesh and Indonesia. Their studies concluded that in Indonesia where both unionisation and import tariffs are low, allowing greater independence to unions may preserve flexibility and reward workers better than the current minimum wage policy. It is now increasingly regarded as an economically efficient mechanism with beneficial effects on enterprise performance and worker productivity (Egger and Sengenberger, 2001, p. 14). Moreover, the theory also suggested a wider union empowerment by concluding that wage flexibility could be better achieved by allowing greater union freedom. The minimum wage policy, on the other hand, created a wage rigidity which would not be beneficial in the face of economic reform. In collective bargaining, wages could still be negotiated by unions and management. The decentralization process and a more democratic environment in Indonesian created a situation in which both collective bargaining and minimum wage provision existed in the process of industrial relations. Both could become a double-edged sword, depending on the way in which the government handles them.

The Importance of the Minimum Wage Policy and Independent Trade Unions in Indonesia's Development

The main challenges in the future for the government, employers and labour are to work together in harmony to recover from the effects of the economic slowdown. The World Bank (2002) argued that delaying the improvement in labour relations could have serious repercussions in terms of workplace stoppages, labour strife and could even cause political instability. Changes from an autocratic to a democratic government have made the Indonesian government review their policies on labour. During the Soeharto era the government was more concerned about labour control than labour protection. These challenges include the government's recognition of the ILO Convention Number 87 on the Freedom of Association that resulted in the proliferation of independent labour unions and decentralisation of some of the central government's functions

concerning wage fixing to provincial and even district local government. Unions can now register at the factory, district, provincial, and at national level and form federations and confederations (Bennington and Habir, 2003, p. 377). They could also join other unions to form sectoral and intersectoral federations.

A low wage road to development may not be viable as Indonesia is already facing stiff competition from other lower wage countries (Thee, 2000, p. 421). Even though the potential benefits of minimum wages are still disputed, minimum wage legislation is unlikely to disappear. Workers' increased knowledge of the state-mandated minimum wages and its popularity ensured that the minimum wage policy would not be discarded. The value of minimum wages is also a symbolic one that establishes a social norm (Champlin, 2000). Moreover, the increasing political strength of trade unions also ensured the maintenance of the minimum wage policy because unions are die-hard supporters of the minimum wage policy.

There is a danger that the current minimum wage policy could have a detrimental effect on total employment. The main development policy for the government is still rapid employment growth and increase in worker productivity and income of the high proportion of workers (Manning, 1998, p. 287). A high road to development, one that relies on high technology sectors, may not be viable at this time because the majority of workers still have low education and skills. In fact, one of the attractions of Indonesia for global firms is due to its cheap and unorganised labour (Hadiz, 2000, p. 3). The minimum wage policy could improve the income distribution of workers, but could also negatively affect total employment growth. It is a potentially dangerous situation because the labour force is increasing by at least two million every year. While present employees may benefit from increasing nominal wages, other potential workers may miss out because firms would forgo hiring more workers in the face of increasing production costs¹⁶. In other words, some workers may benefit by this policy, but other workers may also suffer because of the minimum wage policy, especially marginalized workers such as women and younger workers. If Indonesia wished to promote decent

¹⁶ The minimum wage council only raises minimum wage levels in nominal terms. Although inflation is one of the criteria for determining minimum wage levels, increases in minimum wage levels does not necessarily mean increases in real terms. One of the complaints of workers is that increases in nominal terms could not overtake increases in prices.

work, problems such as these must be addressed if all workers were to benefit from any policies aimed at increasing the quantity and quality of jobs. In light of the decentralisation process, local governments must also take on a more active role in the promotion of decent work.

The transfer of authority for minimum wage fixing from the central government to regional government may also initially cause more distortions in the labour market. The concern is that regional governments may opt for more 'populist' approaches to social policy for short-term gains and sacrifice long-term economic growth (SMERU, 2001). The absence of a majority winner in the 1999 and, recently, the 2004 elections meant that coalitions and the balancing of public interests could decide the fate of workers. Again, it is an opportunity for the labour movement to pursue their goals and put pressure on the government to fulfil any promises on increasing the welfare of workers. It would be certain that popular support would take precedence over economic reasoning in the name of stability.

In addition, the different setting of minimum wage rates by different provincial governments may widen the wage differential across regions, which in turn, may affect potential and present investors. This is especially crucial as one of the main goals of regional development is to increase the regional sources of revenue or PAD (*pendapatan asli daerah*), especially when the current PAD is very limited (Tambunan, 2000, 60). Financial support from the central government would be limited and regions must find their own way of generating income. Recently, Indonesia was ranked as the second most expensive country to do business with in Asia (*Kompas*, 2002). Development tax or rent seeking was one of the reasons for the high transaction cost, as well as increasing labour cost. Furthermore, in attempting to increase their own revenues, regional governments had levied more taxes and regulations.

The dilemma faced by regional governments is to balance the need to attract investment from outside the provinces, increasing their own revenues and the need for stability by conforming to workers' demands for greater social protection. To encourage export-led growth regional governments must encourage investment in the manufacturing sector. Since Indonesia's manufacturing firms are concentrated in certain areas, each province

must concentrate on their main industry. To increase taxes to an unsustainable level could scare off present investors, let alone potential investors, and leave the province worse off because a loss of investors would eventually decrease overall revenues. There is also a need for regional governments to maintain political stability by mediating the needs of workers and firms.

If the regional governments do not manage the minimum wage policy properly, workers will suffer the most. As the studies of the impact of minimum wage in Indonesia revealed, if the minimum wage is set too high, there will be many job losses and the informal sector will be put under pressure, although increases in minimum wages may have little effect on global firms operating in Indonesia. These firms usually already pay wages above the minimum wage. However, local firms with limited budgets may suffer as a result. Many of the workers who lose their job will be forced to accept less satisfying jobs in the informal sector. Increases in minimum wages will also put pressure on small and medium firms that could ill-afford an increase in their cost structure.

The role of independent trade unions becomes a crucial factor in maintaining the integrity of workers in relation to fair wages and improved working conditions. It is their objective to truly represent workers, especially low paid workers. During the 1950's, trade unions were powerful, and there were many conflicts (Saptari, 2000, p. 13). However, stagnant economic conditions during that period did not allow for better wages and working conditions. Independent unions are now facing the challenge of dealing with both the central and regional governments. The development of greater regional autonomy should be a great opportunity to integrate improved labour standards into regional planning so that development can proceed with a human face. However, it may also be that responses to increasing development of trade unions and the minimum wage may lead to more precariousness as businesses revert to more non-permanent workers, such as outsourcing and fixed term contract. Thus, the question being answered in this thesis is not whether or not the minimum wage policy should be discarded, but whether it is sustainable in the short, medium or long run. In the era of democracy and the empowerment of labour, the question should point to the

sustainability of the minimum wage policy and whether collective bargaining could replace it in the long run.

Summary

Previous studies on the impact of the minimum wage on Indonesian workers produced mixed results. Nonetheless, the main argument stated that the impact was modest in general, albeit with other implications. White-collar workers were the clear winner of any minimum wage increases because an increase in the minimum wage would spill-over to other workers and also increase their wages. Women, unskilled and younger workers were seen as the losers because businesses would lay-off these workers to adjust to the increase in minimum wages. Workers in the informal sector would also suffer because workers laid-off from the formal sector would have no choice but join the informal sector. As a consequence, more workers would compete in the informal sector and would depress wages. A more dynamic collective bargaining mechanism was offered as a better policy because it called for a more flexible wage setting system than the minimum wage policy. Instead of a rigid wage system provided by the minimum wage setting, negotiations between workers and firms could make wages more flexible depending on the conditions of each firm. As mentioned in the earlier chapters, as a consequence of globalisation, flexible work is becoming more and more common in modern sector employment.

Regulations on both the minimum wage policy and flexible work are part of Employment Law Number 13, 2003. In addition, under the new decentralization law the local government has the authority to set the minimum wage levels and also deal with trade unions. Under these circumstances, it would be next to impossible to dislodge the minimum wage policy. It is a popular political weapon which labour unions can use with great effect. Trade unions have more freedom and more power to pressure the government concerning workers' welfare. Moreover, workers in Indonesia have also become aware of their rights and view the statutory minimum wage as a non-negotiable basic right. More freedoms also mean that workers can engage in increased participation in determining their welfare, including bargaining for better (minimum) wages. Therefore, it is not only important to explore the impact of the novel process of local minimum wage fixing on employment, but also on the participation of workers in that process.

The most important impact of the new local minimum wage setting process is on employment, wages and industrial relations. Previous studies had focused on the impact of the minimum wage policy mainly on the employment effect of minimum wages and at provincial level. Moreover, the data used for their analysis were based on conditions prior to the decentralization process that started in 2001 and, in some cases, before the 1997 financial crisis. The current minimum wage setting process is complicated by the decentralisation process where district and city government set minimum wage levels in their own locale. The West Java province is an excellent area of research due to such conditions. The success of the minimum wage setting process is crucial because it appears the province is viewed as a model for other provinces such as Central Java to follow suit. Thus, it is worth exploring the minimum wage fixing process in West Java's districts and cities as well as its impact. The next three chapters are devoted to analyses of the impact of the decentralized minimum wage setting on other economic variables, as well as industrial relations.

The next chapter, Chapter VII, discusses the results of the fieldwork and identifies crucial variables needed for analysis. It provides a description of selected interview respondents on the local processes of minimum wage fixing and the relevant questions needed for analysis. In addition, the chapter also assessed the impact and potential impact of decentralized minimum wage fixing on businesses, labour productivity, especially global firms that operate in Indonesia, based on the views of employers, unions and government officials.

Chapter VIII assesses the employment impact of the decentralized minimum wage fixing machinery on employment based on empirical evidence using secondary data sources. The current state of affairs in labour market policy combines more open industrial relations with an active pursuit of minimum wage policy at local level. Does the empirical analysis support the results found during the fieldwork? Did the minimum wage increases in 2001 and 2002 contribute to the loss of employment?

Chapter IX addresses the impact of decentralized minimum wage fixing on trade union participation. The chapter also explores other factors that play a role of the interaction between both stakeholders, including the newly approved legislation on Employment

and on Industrial Relations Dispute Resolution. The government, both central and local, plays a vital part in keeping a delicate balance between the two antagonists. Would the two pieces of legislations succeed to in achieving a *decent work* ideal? Or is there a trade-off between them so that we must go back and choose the better policy ingredients?

Chapter VI

Methodology

A cost-benefit analysis of the minimum wage is narrow, is uninspiring to the public, and generally misses the point. The value of the minimum wage is primarily a symbolic one that establishes a social norm. The economists' preoccupation with empirical analysis of how many individual workers actually benefit at any one time is a case of counting the trees and missing the forests (Champlin, 2001).

Introduction

This chapter introduces the qualitative and quantitative methods utilized by the thesis for research and analysis. The research combined two methods: one obtaining information from interviews obtained from stakeholders of the minimum wages, chosen from the West Java and Jakarta regions and second using existing quantitative data to measure the impact of the minimum wage policy. The qualitative method was the main analysis tool in this thesis. It was used to obtain relevant information required for the thesis and information that could not be obtained using the quantitative method. The quantitative method was used to complement the main method. One advantage of the quantitative analysis was using population data to analyze the general conditions of workers.

The qualitative data analysis is presented in Chapter VII and IX. The data for the analysis consisted of interviews and micro-survey results from various stakeholders of the minimum wage policy. The main theme of the interviews questioned respondents on the impact of the minimum wage provision and the implications it had on other labour issues, such as trade union development and investment climate. Some tabulation resulted from the interviews and micro-survey of 24 manufacturing firms from the Jakarta-West Java-Banten area of study. The analysis also presents interview results obtained from ten trade unions, at various levels, and several relevant government officials at regional levels. The qualitative analysis is extended to Chapter IX that focuses on issues beyond the minimum wage setting and includes discussions on other

employment outcomes, discussion of the new employment laws and its potential implications, and a detailed study of two closed firms.

The quantitative analysis consisted of descriptive statistics and regression models to assess the impact of minimum wages on employment. The descriptive statistics mainly showed the labour force situation in Indonesia and the area of study. The bulk of the descriptive statistics are shown in Chapter IV and Chapter V. Descriptive statistics, tabulated from data obtained from the Productivity and Investment Climate Survey (World Bank, 2003), is shown in Chapter VIII. The regression analysis, also presented in Chapter VIII, consisted of two economic models of minimum wages, based on the neo-classical labour demand model. The first model used the Ordinary Least Squares (OLS) method using the 2000 to 2003 data from the Productivity and Investment Climate Survey. The second model used the Two-stage Least Squares (2SLS) method with IV (Instrumental Variables), using data from the 2000-2002 Annual Survey of Large and Medium Manufacturing. A third method, based on deaths and births of plants, provided a rough estimate of employment change during the 2000-2004 period, where significant increases of minimum wages occurred.

Qualitative Analysis - The Fieldwork

The fieldwork was an essential part of the data collection with qualitative information obtained through a series of interviews. The fieldwork was also an important part of data collection for the analysis because it was able to incorporate information from employers as well as workers (in this case represented by trade unions), and the government as the policy maker. In addition, the fieldwork was also useful for gathering secondary data needed for the quantitative analysis. The fieldwork consisted of three instruments:

1. A small-scale survey of large and medium establishments using a pre-designed questionnaire. This combined a structured interview survey with human resource managers and a drop and retrieve survey involving the completion of a questionnaire
2. A semi-structured interview with trade unions

3. An open interview with officials from the local government and employer associations.

The main objective of the fieldwork was to strengthen and complement the analysis of the quantitative data. Quantitative analysis would have significant weaknesses due to measurement errors or limited data. However, the fieldwork could complete the missing pieces, namely, information on the political and social dimensions that might also be affected by the changes in wages in the medium and large establishments. In addition to minimum wages, the study also attempted to understand other factors related to wages, such as employment laws and regulations, as well as macro-economic conditions. It was crucial therefore to interview all the stakeholders of the minimum wage policy.

Method of Fieldwork

The fieldwork employed the following methods:

Interviews with independent trade unions to assess their development and the potential benefit of independent unions on addressing workers rights. A semi-structured interview was employed to interview trade union officials and members. Some of the interviews were elite interviews because some respondents were top officials in trade union federations. Elite interviewing proved to be a useful method of collecting data and information, which was of strategic importance to the study, e.g. an organisation's policies, past history, vision and strategies, and future plans and programmes (Marshall and Rossman, 1995). A questionnaire was designed to help the writer/researcher with interviewing trade union officials. Initially, the writer/researcher attempted to use a structured, one on one interview with each top official from the trade union federations who represent workers in the manufacturing sector. However, rather by accident than design, during the fieldwork some trade union federations preferred to have group interviews, where the researcher had to face three or more officials at once¹. In the end, most of the interviews became semi-structured due to the additional questions which arose during the interviews. Interviews were held at the trade union headquarters in

¹ The group interview is essentially a qualitative data gathering technique that finds the interviewer/moderator directing the interaction and inquiry in a very structured or unstructured manner (Fontana and Frey, 1994, p. 365). During the fieldwork, the writer (as the interviewer) started out conducting a structured interview. However, the number of respondents, sometimes numbering up to seven people, caused the interviewer to sometimes lose control of the proceedings. In addition, group interviews are not recommended for sensitive topics such as the minimum wages (Fontana and Frey, 1994, p. 365).

Jakarta. However, whenever possible, the researcher also interviewed local trade union officials, as well as officials from firm level unions and workers belonging to the union. The questions asked included:

- Their views on the minimum wage; how the minimum wage should be set: should the government still be involved in fixing the minimum wage: should the minimum wage be discarded and be replaced with collective bargaining and enforcement?
- Their ability to adapt to changes in the decentralised minimum wage fixing mechanism,
- Their views on other conditions at work, such as occupational health and safety, compensation and working time,
- Their views on how to improve relations with employers, etc.

Interviews with officials of the local Manpower and Transmigration who set the minimum wage in provinces, regency or city and who oversee the setting up of the minimum wage at provincial or regency level. These interviews were non-structured (open) elite interviewing designed to unearth information which would be used to develop other interviews. Unstructured interviewing encouraged interviewees to express themselves in their own terminology and allowed them to cite their experiences (Fontana and Frey, 1994) in a natural conversation because the questions asked, and the order by which the questions were asked, flowed from the respondent's own replies, without the influence of predefined questions (Wilson, 1996, p. 113). The target was to interview officials in Jakarta, West Java and Banten provinces and district/city who were involved in the wage council/commission. It also included representatives from trade unions and employer associations. This non-structured interview included:

- Questions on the setting the minimum wage, sectors and types of workers covered by the policy and its enforcement,
- Questions on the historical development of the minimum wage policy in Indonesia,
- Questions on the role of the central government, i.e. the Ministry of Manpower after the minimum wage fixing was delegated to regional governments,
- Questions on the role of regional government in minimum wage fixing and enforcement.

Interview survey with large and medium manufacturing establishments to complement the analysis of the secondary data sets. These interviews were structured elite interviews using a pre-designed questionnaire because the interviewees were mostly human resource managers of the firms. The interview was conducted to support and supplement information obtained from the questionnaires. The interview served as a guard against confusing questionnaire items, as well as minimizing the number of “don’t know” and “no answers” from the questionnaire (Babbie, 2001, p. 258). The fieldwork was planned to take place in periphery districts around Jakarta. This included cities and districts located at the fringes of Jakarta, since the majority of manufacturing establishments are located in these areas. Analysis of these three regions determines the potential wage differentials from the minimum wage policy. Interviews were also attempted at closed establishments to find out the reasons why the firms closed.

Interview with small establishments was not possible, as the researcher did not have any sampling frame to work with. However, the writer was able to interview two small-scale firms in Bogor and East Jakarta². In addition, the researcher was able to visit two medium firms in Jakarta which downscaled to small firms. These firms were not interviewed in detail, but indicated that they did not pay minimum wages to their workers. In any case, the researcher assumed that most small establishments do not pay minimum wages in Indonesia because the average wages of small establishments are below that of the minimum wage (see Chapter V). Moreover, minimum wage monitoring mostly occurs in large firms, as the local Manpower office does not have the manpower to monitor all establishments.

Review of relevant documents included newspaper articles, documents from the Manpower and Transmigration Ministry, and journals from research institutions. The main document obtained during the field visit was the new Employment Law Number 13, where regulations on the minimum wage and other labour issues are included. Other important information collected was provincial and district minimum wages for 2002 and 2003 in West Java from several sources, mainly the local Manpower offices and other government offices, such as the regional statistics office, as well as regional trade

² These two firms were footwear firms that employed about 20 to 30 workers. Even though they were categorized as medium manufacturing firms by Statistics Indonesia, the one in East Jakarta was located inside a small business industrial park and the other considered itself to be a small business.

unions. Interestingly, officials from Statistics Indonesia have had a significant influence in helping to determine the minimum wage levels in the district where the researcher visited. Some of the decisions, concerning the minimum wage level, are based on economic data which Statistics Indonesia provided, such as inflation, labour market conditions and economic growth (GDP).

Review of the pertinent literature on the subject, i.e., current academic journals and prominent newspaper articles to complement the data. The newspapers chosen were those with a wide circulation in the areas visited, such as *Kompas*, *Suara Pembaruan* and *Bandung Pos*. The researcher also reviewed the new Manpower Law Number 13 that was approved in March 2003. The minimum wage provision, which previously had been legalised by ministerial decree, has now been included under the new employment law. Many consider the new law will have considerable impact on labour conditions, as well as the investment climate in Indonesia.

The success of the fieldwork varied depended on the method of fieldwork and the respondents. The planned process of the interview/survey was a follows:

1. Sending formal letters to respondents
2. Calling respondents by phone to set up appointments for the interview
3. If respondent declined an interview, there followed a request to send a questionnaire
4. Visit respondents for interview or drop questionnaire to be filled out by respondents
5. Second visits, if necessary, for interview or to retrieve questionnaires.

The interviews with trade unions and government officials were quite successful but only partly successful with manufacturing establishments. As with interviewing, the questionnaires sent to manufacturing firms were also partly successful, as some firms either rejected the interview or rejected the whole visit. Some of the answers to questions in the questionnaire could be obtained through interviews and some had to be filled out. In some cases, the researcher had to leave the questionnaires to be filled out by respondents and picked up at an agreed time. In other cases, the researcher had to return to respondents repeatedly in order to set up interviews because respondents were unavailable at certain times.

The interview analyses were set-up in two ways: the first was to tabulate the information from the questionnaires; the second was to transcribe and interpret the opinions of respondents, based on the taped interviews. The interviews with manufacturing firms were used if the respondents were willing to be interviewed. Otherwise, the researcher had to be content with the questionnaires, which were used to cover for those interviews that were not realized, due to the limited time rejection from respondents. Information was obtained from interviews with human resource managers and from employer associations. Interviews with trade union officials and government officials were used to back-up and re-confirm the information gained from firms.

Choosing the Sample for the Fieldwork

The samples for the fieldwork were drawn from an existing sampling frame with the likelihood of choosing the sample purposely in the field, such as the snowballing method or guerilla/ambush tactics, if time was limited. The samples were chosen as follows:

Trade union federations were drawn purposively from a list of registered trade unions obtained from the Ministry of Manpower and Transmigration. The researcher had chosen four of the largest unions in Indonesia in the area of study plus several significant minor unions. Of the 65 national level unions, the researcher only targeted those with members in the manufacturing sector. The biggest unions, such as the All Indonesia Trade union (SPSI) and its rival, the All Indonesia Prosperous Trade union (SBSI) were chosen with certainty. The researcher also chose the Textile, Garment and Leather Trade union (SPTSK) and the Metalworkers Union (SPMI) because these are the biggest unions in their respective sectors. In addition, the researcher also chose several smaller unions based in Jakarta. Furthermore, the researcher also chose regional branches, as well as firm-level unions, to be interviewed. The consents for the interviews were obtained from their respective federations. An alternative way of obtaining interview consent was through firm management, although this method was less likely to succeed, given the antagonistic relationship between labour and management, the writer was successful on two occasions.

30 manufacturing establishments were initially chosen from the list of large and medium manufacturing establishments in the Statistics Indonesia office, using the stratified random sampling method. An extra sample consisting of 15 establishments were also chosen as a replacement sample to account for eventual non-responses among the 30 initial samples. The researcher targeted between 20 to 30 final interviews but ended up with 24 questionnaires, in which 14 included interviews. Target interviewees were human resources managers or persons in charge of human resource affairs in a firm. The *strata*, in this case, were the sub-sectors within the whole manufacturing sector. The stratification was used because the manufacturing sector consists of nine two-digit ISIC sub-sectors, and more than 200 five-digit ISIC sectors. The sectors chosen for the field study were sub-sector 32 and 38. Sub-sector 32 consisting of the so-called TGF industries. Sub-sector 38 consists of metal products, electronic and automotive parts. The two sectors were chosen purposively because they represent labour intensive and capital-intensive sectors and exactly the type of industries that had shifted from the centre to the periphery areas. Many firms in sub-sector 32 pay minimum and sub-minimum wages, while those in sub-sector 38 usually pay above average wages. In addition, many strikes and employment problems occurred in the garment, textile and footwear sectors. Also, due to the time constraint placed on the researcher and to focus more on the analysis, it seemed prudent to limit the type of establishment in the study. The random sample was also limited to the study area. Thus, the sample was limited to two sub-sectors and three provinces (Jakarta, Banten and West Java).

Other unconventional methods of obtaining interviews with management of firms were employed. Firstly, a snowballing technique was employed to draw more samples, if the replacement samples would not be sufficient to close the non-response gaps, as some firms could and tended to reject interviews. The use of the snowballing technique was quite useful because manufacturing establishments in Indonesia tend to concentrate in one area, i.e., industrial parks or bonded (export processing) zone and it was quite convenient to find establishments with similar characteristics within an industrial park. The writer was successful twice. The second unconventional method was the guerilla/ambush tactics, in which the researcher directly confronted firm management at the location of the firm who initially rejected an interview request. The writer was only

successful once with this tactic. These techniques were useful in avoiding an extension of the limited time available for the fieldwork.

Total Samples Obtained from the Fieldwork

In total, the writer has compiled information from:

- a. 24 manufacturing establishments
- b. Ten national and regional labor unions
- c. Five firm-level trade unions
- d. Four research institutes
- e. 11 government officials
- f. Four regional employer associations

Characteristics of the Sample

The characteristics of the 24 manufacturing firms in which information were collected were as follows:

Table 6.1 Characteristics of the Sample for Establishments

Regions	Manufacturing Sector							
	Textile		Garment		Footwear		Electronics	
	L	M	L	M	L	M	L	M
Jakarta								
East			2			1		
West			1				2	
North			3					
West Java								
Bekasi	1		1				2	1
Bogor			1			1		
Bandung (city)	1							
Bandung (district)	2			2				
Banten								
Tangerang (city)								2
Serang					1			
Total	4		8	2	1	2	4	3

Notes: - L – large establishment employing 100 or more workers
 M – Medium establishment employing 20 to 99 workers

The most difficult task was the interviewing of manufacturing firms. Initially, the original sample called for 30 establishments to be interviewed or surveyed, thus making it an 80 percent response rate. The researcher could only obtain eight medium establishments, due to the high turnover rate of these firms, as well as refusals to be interviewed or surveyed. In addition, there were an additional 12 establishments to cover for non-responses among the original 30 establishments. Many of the non-responses occurred in the footwear and garment sectors. The majority of non-responses were due to the inability of firms to return the questionnaires before the final cut-off date. In addition, interview rejections were also encountered from five footwear firms and six garment firms. There were also three firm closures (two garments and one footwear firms) and four firms among the intended samples that did not return questionnaires on time. However, the researcher was able to interview trade union officials from one of the closed garment firm and footwear firm (See Chapter IX for the interviews). At the end of the fieldwork, only 24 questionnaires from 24 establishments were collected by the researcher, in which 16 included interviews with the firms' human resource managers. The researcher had to be content with completed questionnaires for the other six firms. These firms were not interviewed because of insufficient time and the fact that all six were located in distant locations, such as Bandung and Tangerang. Thus, the researcher was only able to retrieve the questionnaires from these firms.

In addition to the 24 establishments, officials from three Indonesian Employers Associations (Apindo) in Bekasi, Bogor and Bandung were interviewed during the field visits. These officials were mainly human resources managers representing the management of many firms throughout these regions. It was crucial to interview these officials because some of them were part of the wage commission/council in their respective districts or city³. The researcher was not able to interview Apindo officials from Jakarta and Tangerang, due to lack of time.

The researcher devised several methods of applying the additional samples. The first method was to choose another firm from the sampling frame to replace the non-respondents. The second method was using the snowballing techniques, i.e. choosing a

³ For some reason the city authority of wage determination was called wage council and the district authority was called the wage council. Both have similar functions.

firm in close proximity to the non-respondent firm with similar characteristics. The third method was to link the firm with the trade unions the researcher was also investigating. He was able to succeed with two firms, an electronic firm in Bekasi and a battery firm in West Jakarta. In addition to manufacturing establishments, the researcher also interviewed officials (often in groups) from three local employer associations (Bogor, Bekasi and Bandung). These interviewees confirmed the labour market conditions of the areas.

Support for the Fieldwork

The researcher employed two field assistants who helped in obtaining information. The main field assistant, a university graduate from Bandung, was helpful in securing interviews, delivering questionnaires, maintaining fieldwork diaries, photocopying documents and accompanying the researcher to and from the field, especially in Bandung. The field assistant was quite knowledgeable within this field, especially in Bandung and Bekasi areas, as he sometimes helped the Statistics Indonesia office as an enumerator of surveys. The second field assistant was only used sparingly to help the researcher when the main assistant was unavailable. The second field assistant was a university student attempting to finish a master's thesis. He mainly helped the researcher in copying documents from relevant sources, as well as obtaining other relevant information concerning minimum wages and other key labour issues.

During the field study, the researcher used several modes of transportation. The main mode of transportation was a motorcycle which was very useful for short distances, (within and around the periphery of Jakarta) and for avoiding the congested Jakarta traffic. The motorcycle was mainly used in Jakarta and the periphery districts of Bekasi, Bogor and Tangerang. In other cities, such as Bandung and Serang the researcher used public transportation such as buses, a small van, a pedicab and sometimes commuter trains. Only on two occasions did the researcher use a private car, both times to visit two electronic firms in Bekasi. This occurred because of time constraints and because the researcher had to use the toll road on which motorcycles were not allowed.

Additional information

The researcher was fortunate to attend a workshop discussing the new Employment Law Number 13, 2003 in Bandung organised by the Association of Indonesian Employers (APINDO) of Bandung. One of the interviewees from the field study was a member of APINDO. He was kind enough to allow the researcher to attend the workshop as an observer. Approximately 20 human resources managers from firms in the greater Bandung area attended the workshop. The main focus of the workshop was to review the new law and how firms had adapted and overcome the potential costs associated with the new employment law. The workshop introduced three speakers, one from the association and two from the provincial Manpower office. The workshop participants did not express grave concern about the new law, but rather they were interested in finding ways to adopt or accommodate the new law.

During the one-day workshop, the researcher was able to learn about the potential implication of the new law on the production costs of the firms. The workshop introduced two speakers from the local Manpower Office who stressed the importance of the new employment law on regional development. The workshop also revealed managers' views on the development of trade unions and their impact on present and future firm performance.

Pilot Study of the Productivity and Investment Climate Survey

In addition to conducting his own field work, the researcher was also involved in formulating and conducting pilot studies in the recent Productivity and Investment Climate survey, a study conducted by Statistics Indonesia and jointly funded by the Asian Development Bank (ADB) and the World Bank. The survey was not directly related to the field study, but the data was needed for quantitative analysis. The researcher joined a workshop on developing the concept and the questionnaire for the survey in April 2003, and was previously assigned to the field to test the questionnaire on four textiles and garment manufacturing firms in the Bandung, West Java area. The pilot was designed to develop the questionnaire to suit the needs of the field enumerators. Being involved in the planning stages of the survey helped the researcher in understanding the nature of a survey and the information needed for his own field study and research. The researcher was able to interview the human resource manager

from a textiles firm in Bandung city. Fortunately, the human resource manager was a member of the local employer association. Thus, the manager was kind enough to refer the researcher to the chairperson of the association for a subsequent interview related to the field study.

The survey itself was conducted in 12 major provinces of Indonesia, namely North Sumatera, Riau, Jakarta, West Java, Banten, Central Java, Jogjakarta, East Java, Bali, Central Kalimantan, East Kalimantan, and South Sulawesi. These provinces represent more than 80 percent of the entire large and medium manufacturing firms in Indonesia. The result of the survey, as explained earlier in the chapter, was used as a major part of the analysis.

Limitations of the Fieldwork

Due to time and budgetary constraints, the researcher limited the areas for study to Jakarta and its periphery districts, plus the capital of West Java, Bandung and the capital of Banten province, Serang. The main reason for selecting areas in West Java was due to its high concentration of industries, its function as satellite cities to Jakarta and the fact that, unlike other provinces, each district has the independence to determine its own minimum wage level. Banten province was chosen because it was previously part of West Java and some of its labour issues were still being resolved in Bandung, the capital of West Java. Since the start of the *reformasi* in 1998 and the decentralisation process in 2000, regions were given wide-ranging powers to determine their own future. One of those powers was to set their own minimum wages.

The fieldwork faced several constraints prior to and during the actual field study. The first and most important was the funds needed for the field study. The fieldwork could only be conducted on a small scale in order to suit the budgetary and time limitations. The study area mainly covered industrial areas in West Java and Jakarta. Moreover, the field study could only cover a small area in the periphery of Jabotabek (an area covering Jakarta, several regencies in West Java and the soon to be new province, Banten). Jakarta was chosen because of its close proximity to West Java and, based on the interviews of several respondents, was still being used as the barometer for minimum wage setting in other regions. In addition, many of the people who work in factories in Jakarta reside in the periphery districts of Bekasi, Bogor and Tangerang. As explained

in the previous chapter, these districts determine their own minimum wage, based on the minimum wage in Jakarta. Many manufacturing establishments are located in and around the border areas of this region. An alternative site was found in the small industrial estate in East Jakarta to obtain information on small industries, although data for some of these industries are available in the industry data. Small industries in this estate are industries classified by the size of their initial investment, not by number of employees⁴.

The study was limited to several sub-sectors of large and medium manufacturing sectors in Indonesia. The sub-sectors selected for the study were the textile, garment and footwear sub-sectors and the electronic and automotive assembling sub-sector. Ethical considerations, stated in the letter of introduction, also limited the researcher to those firms that complied with the request to be interviewed/surveyed. Thus, information could not be obtained from those firms that rejected the offer to be interviewed. These non-responses could undermine the results of the qualitative analysis of the interviews. Nevertheless, the researcher endeavored to obtain limited information from these firms through other sources, i.e. labor unions and secondary data sources.

The second limitation was the time constraint. With only three to four months of the time allocated for the fieldwork, it was difficult to complete the four tasks scheduled. Tasks were therefore conducted according to priority. The first priority was the interviews with selected officials who have authorization to change the minimum wage and the independent unions representing workers. The second priority was to obtain additional data from Indonesia's Statistical Office, the Ministry of Manpower, and provincial offices. Due to time constraint, however, it was also not possible for the researcher to interview all the respondents, especially in outlying areas. Interviews in far-away places such as Bandung and Banten required precise timing for the interview. Even if the researcher was late by only a few minutes, a whole week of interview schedules could be wasted. This was especially true for human resource managers who were usually too busy to wait for even a few minutes.

⁴ When the researcher visited the area, he found that some of the workshops employed more than 20 workers in which, by Statistics Indonesia definition, falls under the category of medium industries. In fact, the researcher interviewed a manager of a shoe workshop that employed more than 20 workers.

The researcher also faced the daunting tasks of obtaining interviews with respondents, i.e., managers of manufacturing establishments. The researcher needed to visit more establishments than the number of establishments in the sample. The researcher employed the snowballing method to add more replacements to the sample. Many manufacturing establishments in Indonesia, with similar characteristics, are concentrated in certain areas, such as in industrial parks. In a North Jakarta Export Processing zone, called the KBN (Kawasan Berikat Nasional) Cakung, it was convenient to replace a garment firm with another firm nearby with similar characteristics. The park was mostly inhabited by export-oriented garment or textile manufacturers. Thus, it was not too difficult to replace one establishment with another one within the time limit. However, if non-responses are quite high, the researcher was not always able to obtain the necessary respondents.

A last factor but perhaps a crucial one, in terms of fieldwork ethics, was that the researcher had to tread carefully when proceeding in the field. Labour issues, especially concerning minimum wage and independent trade unions, are politically sensitive and contentious issues, even after the labour reforms of 1998. The researcher refrained from interviewing potential respondents during labour rallies, protests or even when workers were on strike. These labour congregations have often turned violent in the past, especially when the authorities such as the police and the military were brought in to keep peace and order. During visits to the local Manpower Offices, the researcher witnessed several labour demonstrations by trade unions. The names of the trade unions were clearly seen on the banners that were placed at the head or the rear of the gatherings. Unfortunately, the researcher had to refrain from interviewing any of the workers for safety reasons. Instead, the researcher chose to meet the workers or the leader of the trade union in their own office. Fortunately, most of the trade union officials that were interviewed did not show any hostility and even welcomed any scrutiny with apparent zest.

Furthermore, the researcher had to tread carefully when attempting to conduct direct documentation in the field, due to the sensitivity of the situation, although conditions were much more improved than during the New Order Regime. In addition, there was also uncertainty in terms of security in the fieldwork locations. One of the products of the economic crisis is the rise in crime, especially in more remote areas. The researcher

opted to refrain from photographing any event or any of the research locations as a means of documenting them for the same reason. Interview tapes and written interviews were probably the only evidence of any consequence concerning the fieldwork.

Fieldwork Experiences

The results of interviews were treated differently in the analysis. The results were divided into several formats, with a different format for each different type of interviews. The purpose of the different formats was because of the differences in the interview approach as well as the results. Interviews with trade union officials were presented individually. Each trade union, whether it be federation or regional level, was presented separately. The researcher felt that each union is considered a collective voice of the members of that particular union. Therefore the views presented by each trade union were treated as a collective voice of the workers belonging to that union. The interviews of local government officials were also treated individually, because the voice of each individual official was considered to be the stance of the local government to which that particular official was accountable. Interview results of establishments, on the other hand, were presented cumulatively because the researcher was only interested in the average opinion of firms, not individual opinions of respondents. In addition, the researcher also presented one detailed study from interviews coming from two different firms that recently closed. The objective of the comparative analysis was to assess the reasons for their closures. Early findings suggested that the militancy of the firms' unions were partly responsible for the eventual demise of the two firms.

Interview with human resource managers

The interviews with managers (mostly human resource managers) were subdued, due to the sensitive nature of the subject. It is likely that the managers being interviewed were constrained by confidentiality and obligation to the firm. The outcome of the interviews was similar to the interviews with government officials. For example, when asked about the firm's stance on independent trade unions, at best the managers provided limited information regarding the subject. Several managers, especially in firms where union activities are limited or non-existent, declined to answer any questions regarding the relationship between workers and management.

Nonetheless, the researcher regarded the interviews with human resource managers to be fruitful, especially in firms where the relationship between trade unions and employers were relatively amicable. For instance, in two electronics firms, the researcher was able to interview management officials and trade unions, as well as several workers belonging to the unions. Furthermore, the researcher also supplemented the interviews with a questionnaire containing most of the interview questions, as well as information related to the firm's characteristics. The questionnaires became even more useful when, on several occasions, interviews were not successful. As mentioned before, several firms declined the interviews. However, some of them agreed to fill out the questionnaires. The researcher surmised that they were too busy for interviews, while those who declined an interview and filled out the questionnaire simply did not want to be bothered with an interview.

Interview with trade union officials

In contrast, the researcher did not encounter any significant problem when interviewing trade union officials. There were no rejections whatsoever and appointments were mostly met without any delay or cancellation. Unlike other elite interviewing, where a barrier existed which made it difficult for the researcher to access to the interviews, most trade union officials were eager to accommodate the researcher with a wealth of information. Elite interviewing with trade union officials, at federation level, was also found to be different than interviewing officials at regional or firm level. Sometimes the information provided by these elite interviews did not have any bearing on the objective of the fieldwork. Thus, the researcher had to isolate that information deemed useful for the research. Only on two occasions did the researcher encounter problems locating and obtaining permission for interviews with regional and firm-level unions. However, contacting the federation to which the regional or firm-level unions belonged, and tracking down the contact person with the help of officials from the federation, soon solved the problem.

Nonetheless, on more than one occasion, the researcher did have to improvise on his methods in dealing with some trade union officials. In three out of ten interviews, with national and regional branch trade union, the researcher had to conduct a group interview instead of the planned one on one interview. In addition, most of the interviews with trade union officials were elite interviews in which top officials tended

to control the pace and the subject of the interviews. One group interview, with five top officials of a large trade union based in Jakarta, took three hours to complete. Even then, most of the conversation had little to do with the subject at hand. Most were concerned with the strategic objective of the trade union and its conflict with the government and other trade union federation.

During the group interviews, the researcher had to face three to five respondents at the same time. In two cases, the researcher had to conduct a deeper investigation in order to obtain information from two firm-level unions. The researcher had to begin with the federation, to which the firm-level union belonged, find out as much as possible about the structure of the organization, the names of the important officials and local branches, and then discover the contact person in the firm-level union. In the federation main office the researcher interviewed five officials. Afterwards, locating and obtaining permission for interviews was less difficult than directly attempting to contact the firm level union. Regional branch trade union officials, as well as firm level officials, were more than willing to be interviewed, once approval from the main office was obtained.

Table 6.2 List of Trade Unions Interviewed during the Fieldwork

Name of Trade Union	Description	Number of members	Branches
KSPSI (FSP LEM) – Serikat Pekerja Logam, Elektronik dan Metal (FSPSI, a branch of the metal workers union)	Sectoral union branch (metal, Electronics and Automotive), part of the KSPSI confederation (24 federation)	69,000 workers in Jakarta out of the 300,000 members from 720 firms nation-wide	Indonesia
SBSI – Serikat Buruh Sejahtera Indonesia (Indonesian Prosperous Trade union)	All sectors	12,000 in Jakarta of less than 100 firms (50 percent female), but claimed more than 200 000 members nationwide	Indonesia
SPTSK – Serikat Pekerja Tekstil, Sandang dan Kulit (Textile, Garment and Leather Trade union)	Largest Textile, Garment and Footwear Union	546,100 workers in 506 firms (80 % female)	Java, plus North Sumatera
KSPSI (West Java) – West Java regional branch of KSPSI Confederation	West Java branch of KSPSI	From 1,883 firms (number of members not given)	West Java
KSPSI (Bekasi)	Bekasi branch of KSPSI	136,000 workers from 180 firms (60 % female)	Bekasi city and district
KSPSI Reformasi – Reformed All Indonesia Trade union	Splinter group from the KSPSI confederation	18,000 workers from more than 100 firms	Mostly in Java
Gasbiindo Jakarta	Industrial union	1000 in Jakarta	In 24 provinces
GSBI - Gabungan Serikat Buruh Independent (Independent Trade union Federation)	Grass-root union covering all sectors, including the informal sector	12,000 workers (85 % female)	Jakarta, Banten and Central Java
FNPBI – Front Nasional Perjuangan Buruh Indonesia (The National Front for Labour Struggle in Indonesia)	Grass-root union covering all sectors, not including informal sector	45,000 Workers from 80 firms (70 % Female)	Mostly in Jakarta
SPMI – Serikat Pekerja Metal Indonesia (Indonesian Metalworkers Union)	Metal, Electronics and automotive parts trade union	171 firm level unions as members with over 95,000 workers	Mostly in Industrial areas of Java

Source: Fieldwork and the Ministry of Manpower and Transmigration

The national level trade unions in Indonesia consist of three types: national, federation and confederation. A confederation is an amalgamation of several federation and regional trade unions. There are currently two confederations, the Confederation of All Indonesian Trade unions (KSPSI) and the Confederation of Indonesian Trade unions (KSPI), formerly known as GSBI. The KSPSI is actually a reformed version of the old state-controlled All Indonesia Trade union (SPSI). On the other hand, the newly formed KSPI consists of breakaway unions from SPSI, plus other independent trade unions. KSPSI has been trying to step out of the shadow of the old SPSI which is perceived by many as a union that fought for capitalist's interests rather than workers' interests. Evidence from the field showed that this trade union was still considered an anti-workers' union rather than pro-workers' union. However, many firms who accepted the existence of trade unions still prefer this union than other independent unions. Many of these unions operate in large and medium manufacturing firms in Indonesia.

The KSPSI is still considered the largest union in Indonesia. However, KSPSI's past dominance is being challenged by other large unions such as the SBSI and the SPTSK. The SPTSK only operates in the TGF sectors, but has hundreds of thousands of members. Approximately 80 percent of its members are women, but the researcher found that, as in other unions, most of the leaders were men. It was not known whether this is due to cultural reasons or genuine gender bias. One union official jokingly said that the leader should be a man rather than a woman. The SBSI was actually the union that suffered a great deal during the New Order regime. They were also blamed by the government for mobilizing workers to stage massive strikes in the Medan and Jabotabek areas.

The smaller unions interviewed during the field were just that - small. Although many of these unions were active during the recent discussions on the formulation of the new Employment Law Number 13, they were not included in the discussion because they were considered insignificant in terms of the number of members. However, the researcher interviewed several minor unions, such as the FNPBI, Gasbiindo and GSBI. GSBI is perhaps the smallest of the three and it only had approximately 12,000

members. This union only operates in the Jabotabek region. Another 'small' union in terms of membership is the SPMI. However, this union makes up in quality what it lacks in size. It is considered a white-collar union because of having relatively high wage members, being paid higher than the minimum wages. Workers in SPMI mainly worked in metal product industries, including the assembling of electronics and automotive components. For the purpose of the study, the researcher had chosen two firm-level unions belonging to SPMI as the subjects for the interview. In addition, one firm-level union, from a now defunct electronics firm, also belonged to this trade union.

In addition to national and regional trade unions, the researcher was also able to interview six firm level trade unions, in which two were trade unions from firms that were recently closed. Of the six unions, the researcher was also able to interview the managements of the firms where the unions operated. This led the researcher to believe that both unions had relatively good industrial relations with the management of the company. However, one of the trade unions belonged to the formerly state-controlled SPSI federation. The researcher did not see any bias in the interview because the unions were interviewed separately from the management. Perhaps this type of industrial relations should be used as a model for other unions.

One significant weakness of the study of the interviews with unions was that the researcher was not able to interview many TGF firm level unions. This is significant in light of the fact that many TGF firms, especially garment firms outside Jakarta, did not pay their workers minimum wages. The antagonistic nature of the relationship between management and unions in the garment industry made it difficult for the researcher to obtain interview consent from firm level unions in the garment industry. The researcher had to rely on the interview from SPTSK, which is the biggest TGF union in Indonesia, plus other unions that operate in the TGF sector.

In addition, on more than one occasion, the leader of the firm-level union was also part of the management. Most unions being interviewed were usually not part of the management. However, the researcher found that in two firms, one electronics and one automotive parts firm, the union leaders were also middle managers in their respective firms. Although they appeared sincere during the interviews, the researcher

felt that the nature of their positions was in conflict because both positions were at the opposite end of the collective bargaining process. This condition could mean an attempt by the management to either maintain a harmonious relationship, or to assume a measure of control over trade union activities.

Interview with government officials

Most of the interviews with government officials centered on officials connected with the wage council/commission, which oversees the determination of minimum wage levels⁵. These were also elite interviews with ranking local government officials at provincial or district/city levels. In the West Java and Banten Provinces, the minimum wage setting was conducted at district or city level, even though, under the legislation, the governor has the final decision on district or city minimum wage level. As explained in the previous chapter, the West Java governor allows district head and mayors to conduct their own minimum wage setting. Thus, most of the interviewees were government officials from various departments that belong to the wage council. The Jakarta wage council, however, is different from those of West Java.

The wage council in Jakarta is responsible for setting the minimum wage level for the whole city⁶. The researcher made the mistake of interviewing an official from East Jakarta who did not have authority over the minimum wage level in East Jakarta. The official was an official in charge of the wage division, but was not a member of the Jakarta wage council. In fact, the East Jakarta city Manpower office does not have a wage council and they only have the authority to monitor the implementation of minimum wage fixing, conducted by the wage council and based at the governor's office. In light of this revelation, the researcher did not interview similar officials from the West, North, South and Central Jakarta because it would be inadequate for the purpose of the fieldwork. Thus, the researcher had to shift his target respondent to the provincial wage council.

⁵ The 'wage council' is the term used in the district Manpower and Transmigration office. The term 'wage commission' is used at city level such as Jakarta and Bandung. Often in the thesis the two terms are used interchangeably.

⁶ Jakarta administration is the same level as a provincial administration and consists of five cities, North, East, Central, West and South Jakarta.

In addition to district, city and provincial wage councils, the researcher also interviewed an official from the national wage council. The national wage council does not have the authority to set minimum wage levels. Unlike the provincial and district/city wage councils that operate under the authority of the governor and district head/mayor, the national wage council is under the authority of the Manpower Ministry. Their authority only allows them to give recommendations on how to change the criteria for the minimum wage setting. They also have the task to promote the real meaning of regional minimum wage. The official was kind enough to explain this, as well as to provide an insight into the minimum wage legislation in Indonesia. Though most of the interviews had little bearing on the topic at hand, these officials provided some revelations about the difficulties of setting a minimum wage at any given time.

To support the qualitative method, it was prudent to pursue a quantitative method. Even though quantitative analysis suffers from several limitations; namely, the data could not be used to account for the social and political dimension of the minimum wage policy and the limited data available also produced a limited conclusion on the impact of the minimum wage policy. Moreover, data from government sources may encounter a range of bias in terms of method and subject matter (Overton and Van Diermen, 2003). Nevertheless, the debate on minimum wages centers on the economic argument of the impact of minimum wages on employment. Thus, quantitative economic analysis was needed for this thesis to support the argument resulting from the fieldwork, as well as complementing each other.

Quantitative Analysis

The quantitative analysis was divided into three parts. The first part involved the use of descriptive statistics i.e., tabulations, cross-tabulations and graphic illustrations, to describe the macro-economic and labour market condition in Indonesia and particularly in the study areas. The second part employed the use of regression data analysis to measure the impact of minimum wage changes on manufacturing employment in Indonesia. Since the decentralisation of minimum wage fixing in Indonesia started in 2000, it was appropriate to use the regression model to measure the impact of minimum wages by regions, i.e. provinces or districts. The analysis used

the Annual Survey of Large and Medium Manufacturing data as the primary data. This data is ideal for a time series and cross-section regression because it is available by years and by cross section, i.e. sectors and regions. In addition, it covers all the large and medium manufacturing sectors in Indonesia. The third part of the analysis used ordinary least squares method to calculate the impact of minimum wages at district level. The limited data available, and the fact that the decentralisation process started in year 2000, made it unlikely that data could be available for 2003. The second regression model of the analysis used the 2003 Productivity and Investment Climate Survey data as primary data source.

The regression models basically measured the effect of minimum wage increases on employment, wages and non-wage benefits in the manufacturing sector, and its potential implications to regional development. To measure the impact, the study referred to the standard model of the labour market. In Chapter III, the neo-classical model explains that, under perfect competition, an increase of wages above the market clearing rates prompted firms to respond by cutting back on low-wage workers and, by substituting machinery and more highly skilled workers, whose wages are unaffected by the increase in minimum wage. In addition, increasing the minimum wage might also negatively affect other benefits to workers.

The standard model however, based the abstract conclusions on several assumptions:

1. Perfect competition
2. Perfect flow of information
3. Homogeneous workers
4. Higher wages have no affect on worker productivity, or on the likelihood that employees shirk on the job.
5. Employees' productivity and turnover behaviour are unaffected by interpersonal wage comparisons. Employers need not worry about the perceived fairness of their wage structures.
6. Employers always operate at peak efficiency and exploit every opportunity for profit. For example, they cannot negotiate lower prices from their suppliers if their profits are squeezed by an increase in wages.
7. Highly profitable firms do not share some of their profits with workers by offering higher wages or bonuses.

8. Other externalities, such as increase in production due to factors such as increased overseas demand, is constant.

This study involves exogenous variables, such as growth in the industry, types of industry, size, foreign-ownership, and export orientation. These variables might have significant influence on the endogenous variables of wages and employment. In Indonesia, for example, wide wage differentials occur in different industries, one industry offering wages much higher than others. Wages may vary across industries, such as export-oriented firms, global firms, and labour intensive firms where most women are employed. Wages also vary across regions where industries are concentrated in a few provinces.

Econometric Analysis

The regression analysis used cross section data due to the limited data available. The quantitative analysis used two separate types of regression models. The first model used OLS method to measure the impact of increases of minimum wage levels on employment using firm level data from the Productivity and Investment Climate Survey (World Bank, 2003). The second model used two-stage least squares method (2SLS), with an emphasis on the employment effects of the minimum wage policy within districts and cities in West Java. The reason for this second model is that the minimum wage setting in West Java has been decentralized to district and city levels, unlike in other provinces where provincial authorities set local minimum wages.

Minimum wage levels, prior to the decentralisation process (pre-2000), were recommended to and then approved by the Minister of Manpower. Even though the local Manpower office had the authority to recommend minimum wage levels to the Ministry of Manpower, the local offices were not independent of the Ministry. Under the new decentralization legislation, local Manpower offices are independent of the central government and they only answer to the local government, i.e., mayor, regent or governor. Thus, only the years 2000, 2001 and 2002 were available for the analysis. In addition to local minimum wage setting, there have been minimum wage increases throughout these years, in particular minimum wage levels for 2002, when many firms had complained so vigorously that some local employer associations had

taken legal actions against local governments (see Chapter V). Thus, the models reflected the increases in minimum wage levels in 2001 and 2002.

OLS estimates of labour demand using the Productivity and Investment Survey data

The researcher also used OLS method to estimate the effect of minimum wage level increases during the 2001-2002 periods. The method used is similar to the natural experiment used by Card and Krueger (1995, p. 36), except that, for this purpose, the writer used firm level manufacturing data. The data did not have the GAP variable, employed by Card and Krueger, because the wage variable was actually average wage costs, which were notably much higher than minimum wages. The GAP variable measures the proportional increase in wages in firm i required to meet the new minimum wage. Thus, for the model used in this thesis, the writer replaced the variable with minimum wage dummy (mw) which referred to firms that pay their workers at least the minimum wage. Thus, the model is as follows:

$$\Delta \log E_{it} = a + b \Delta \log W_{it} + WJ_{it} + D + v_{it}, \quad (6.1)$$

where ΔE_{it} refers to the log employment change in West Java and Jakarta for firm i between year $t-1$ and t , ΔW_{it} refers to the proportional change in real wages in West Java for firm i between year $t-1$ and t , WJ_{it} refers to the West Java dummy, D is a set of dummy variables, and v_{it} is an industry, year specific and other unaccounted shocks. Dummy variables included in the estimates were minimum wage compliance (MW), union presence (Union, ISIC 32 (ISIC32), ISIC 38 (ISIC38), foreign ownership (Foreign), export orientation (Export), and size of establishment (Size). Trade unions are said to be the staunchest supporters of the minimum wage policy. Their presence theoretically increases wages. West Java was used because it is currently the only province in which minimum wage setting has been decentralized to district/city level. Consumer price index (CPI), with 1996 base year in West Java, was used as a deflator for real wages.

2SLS estimates of inter district/city employment change

The writer adopted the method of estimation employed by Kim and Taylor (1995). Using what they termed as a 'structural demand equation', the regression model used the relative change of employment in a given manufacturing sub-sector in West Java. The model was adopted from Kim and Taylor (1995), where they incorporated retail trade data to assess the impact of the 1988 minimum wage increase in the state of California, USA. However, for the purpose of this thesis, the large and medium manufacturing in West Java is used in this analysis. A two-stage least squares method (2SLS) was used to estimate the model. Instrumental variables were used as proxy in the model. The 2SLS method is different from the ordinary instrumental variable in that, in the 2SLS method, the best instrumental variable, where the correlation is the strongest, is used (Kennedy, 2003, p. 188). The method was used to solve the problem of simultaneity⁷. Simultaneity is a problem where the OLS estimator is biased so that an alternative estimator is necessary (Kennedy, 2003, p. 180). The model offers short-term effects of the minimum wage increases during the year. The minimum wage for a certain year is usually set at the end of the previous year and applies since the start of the year. For instance, the 2002 minimum wage was set in December of 2001 by the wage council and was obligatory since January 1st 2002. Thus, the 2002 minimum wage increases could have an immediate impact on the 2002 employment because firms already knew the minimum wage level for 2002 in December 2001.

The second model also used the 2SLS method to estimate the inter-district/city employment effect of minimum wage increases on employment. The model is derived from labour demand function, explained in Hammermesh (1993). The derived demand function is written as:

$$\Delta \ln E = b_0 + b_1 \Delta \ln W + b_2 \Delta \ln Y, \quad (6.2)$$

where b_1 is the elasticity of substitution between capital (Y) and labour (E). For the purpose of the regression model, capital is substituted with gross value added because

⁷ Simultaneity problem is a problem where an OLS estimator is not efficient and consistent. Two-stage least squares method and instrumental variables will give estimators that are consistent and efficient (Gujarati, 1995, p. 670).

of the unreliability of data on fixed capital formation. The estimate for the second model is based on inter-district/city variations. Thus, the model is as follows:

$$\Delta \log e_i = a + b_1 \Delta \log W_i + b_2 \Delta \log y_i + u_i, \quad (6.3)$$

Where,

Δe_i is the log of change in the district/city i large and medium manufacturing average employment between year t and $t-1$,

ΔW_i is the log of change in average real wage in district/city i between year t and $t-1$,

Δy_i is the log of change in average real gross value added in district/city i ⁸ between year t and $t-1$.

For the first IV model, the instruments used were 'log change of average establishment size' in each district/city between year $t-1$ and $t-2$ and 'log change of average employment cost' in each district/city between year $t-1$ and $t-2$. The second IV model used 'log change of average employment cost' between $t-1$ and $t-2$ as instrument and the third IV model used 'log change of average employment cost' between $t-1$ and $t-2$ and 'log change in minimum wages' in the districts/cities between year $t-1$ and $t-2$ as instruments. The consumer prices index, with a 1996 base year, was used as a deflator to obtain real values of wages and gross value added.

Alternative Methods

In addition to the econometric methods of measuring the effect of the minimum wage policy, a method using the births and death of manufacturing establishments, dubbed BGDC (Birth, growth, death and contraction), was used to provide a rough estimate of employment shock derived from the impact of the minimum wage policy. This method was adopted from Hammermesh (1995, Chapter Four, p. 137) which takes into account job creation and destruction based on establishment openings and closings. The BGDC method accounted for closed, as well as downsized, firms in the calculation. It is a method based on the quasi-elasticity concept of labour demand.

⁸ Gross value added is defined as the difference between gross output and intermediate input.

The quasi elasticity of labour demand, through openings and closing of establishments/plants, provides rough estimate of the industry response to employment shock. The concept of the quasi-elasticity calls for the impact of employment changes, through the effect of changes in wages, on establishment/plant openings or closings. It is derived from the neo-classical model of labour demand. However, the assumption is that establishment/plant closing does not depend on the profitability of the firm, i.e. profit stays constant. The period of 2001-2002 witnessed a low point in Indonesian economic growth. Even though the economy had stopped contracting, growth rate was relatively low, compared to the 1990s, and projected growth rates in 2003 and 2004. Thus, the writer assumed that growth in value-added was quite low and felt that the BGDC method could be used in the estimation.

Plant openings depend only on wage rates, where the lower the wage rates the higher the probability of an entrepreneur opening an establishment/plant. On the other hand, the higher the wage rates, the higher the probability of an establishment/plant closing. In addition, the higher the wage rates, the more likely workers are to prefer staying in one firm. Thus, in the context of a binding minimum wage policy, the higher the minimum wage level the more likely it is that the establishment will close.

The basic model for this estimate is based on four components: Births of new establishments (B); Growth of existing establishments (G); Death of existing establishments; and contraction of existing establishments (C). The components are linked to net employment change by the identity:

$$\Delta E = B + G - D - C, \quad (6.4)$$

Where, ΔE is the net percentage change in employment in some aggregate (Hammermesh, 1993, p. 150).

There is no question that the model is only used as a rough approximation to the conventional econometric model described earlier. The data used in the estimate is the Large and Medium Manufacturing Directory compiled by Statistics Indonesia. One advantage of this method is that it takes into account the death of firms, where a conventional model assumes continuous existence. Another advantage of using this

data, as compared to the annual data, is that it is somewhat more up to date. The Directory provides data two years in advance of the annual data. For example, while the Directory already has 2004 data available, the annual data could only provide data up to 2002. The Directory is compiled using a simple questionnaire in order to list new establishments, as well as monitoring growth of employment and deaths in existing firms.

The other regression model is a simpler, regression-adjusted model using data from the 2003 Productivity and Investment Survey. Unlike the first model, it could capture the effects of decentralization, albeit in the short term. It incorporates data for 2000 to 2002 in which the early stages of the decentralisation occurred. The survey, conducted from May 2003, is based on a sample of 1000 large and medium manufacturing firms in 10 major provinces in Indonesia where manufacturing firms are concentrated. Most of the questions asked in the survey may not be relevant to this analysis. Fortunately, several questions are crucial for the analysis. Included in the questions were inquiries on whether or not the firm paid minimum wages and whether or not the workers were allowed to join trade unions. The former is important to determine how binding the minimum wage law is in large and medium manufacturing firms. It was hoped that the response rate would be significant for the purpose of the analysis. The latter is equally important in order to find out the significance of trade unions in monitoring and enforcing the minimum wage law. Both variables are employed in the model as control variables. The model provides district level effects of minimum wage which could not be provided by the panel data. In addition, the district level effect also explains the dynamics of minimum wage setting due to decentralisation.

The regression model is similar to the one employed by Card and Krueger (1995, pp. 36-37). The main reason for the simpler method is due to the limited years available. In addition, the GAP variable, used by Card and Krueger as a measurement of minimum wage impact, is replaced by another measure, i.e., real minimum wage increases or proportional increase of real minimum wage to real average wage per firm. Due to the absence of a starting wage, which Card and Krueger incorporated into the model, a GAP variable is not possible. Instead, the variable is replaced by minimum wage and trade union variables. In addition to the minimum wage-average variables and the control variables, the model also includes industry characteristics

such as size of firm, sectors, foreign-ownership and export orientation, to account for the effect of globalisation.

Other Quantitative Methods

The descriptive statistical analysis was used to describe general information on the characteristics of the labour force in Indonesia, including characteristics, employment growth and unemployment. These descriptive statistics were used as *decent work* indicators described in various studies, e.g. Field (2003). It is important to describe the general characteristics, such as age, number of workers by sectors, the ratio of women to men in the labour force and their wages. Since wage data cannot be segregated by sex in the regression analysis, this data was used to provide a description of the wage conditions between women and men workers in manufacturing. A description of the labour intensive sector is also important in order to describe where low-wage workers in manufacturing, arguably dominated by women, are located.

In addition to the labour market conditions in Indonesia, it was also important to show the socio-economic situations in Indonesia. Data on the economic condition before and after the economic crisis was presented to describe the deteriorating conditions in Indonesia before and even after the crisis. Data on the gross domestic product of Indonesia and the gross regional product of the provinces could also be used to describe the macro-economic and social conditions of Indonesia.

Data Sources

Quantitative data is available mainly from Statistics Indonesia supplemented from the Ministry of Manpower and Transmigration, local labour offices and trade unions. Data obtained from Statistics Indonesia office consisted of the Large and Medium Manufacturing Data from the annual survey, the Directory and the Quarterly Wage Survey. In addition, the writer was also able to obtain data from the 2003 Productivity and Investment Survey, a one-off survey conducted by Statistics Indonesia and funded by The World Bank and The Asian Development Bank. Additional data, such as data on minimum wages, was obtained from the Ministry of Manpower and Transmigration, the local Manpower office in West Java, as well as media articles.

The data obtained from the Statistics Office in Jakarta is rich with information on labour in Indonesia. The main data for analysis of the first part of the study was obtained from the annual survey of large and medium manufacturing establishments in Indonesia. The survey covers all manufacturing establishments with 20 or more persons engaged in production or non-production throughout the administrative regions of Indonesia. The number of establishments changes every year, but approximately stands at 20,000 establishments. Although the 1998 economic crisis had somewhat decreased the number of establishments, the number seems to have recently come back to the pre-crisis level.

The data from the Annual Survey of large and Medium Establishments was obtained through questionnaires sent to establishments in all the administrative regions of Indonesia. Special field enumerators are sent to the establishments to request officials from these establishments to fill out the forms. These enumerators then return to the establishment to retrieve the completed questionnaires and send them on to the central office to be processed. After processing, the data is then published in the annual Statistics Indonesia report called, 'The Annual Large and Medium Manufacturing Industry'.

This rich data set consists of important variables, such as:

1. Size of firms
2. Number of firms
3. Geographical locations of firms (by province, regency and village)
4. Number of workers by type of workers (production, non-production) and sex
5. Education of workers (available only in 1995 and 1996)
6. Workers compensation, including wages, overtime and other benefits
7. Production values
8. Value added
9. Ownership of firm to find out whether the firm is a global firm
10. Export orientation
11. Capital stock.

Other important data includes industries where women are dominant, such as the textile, garment and footwear (TGF) sub-sectors. An important variable in this data set was the export orientation and ownership. Firms that export some or all of their products and/or firms with foreign ownership can be considered firms engaged in the global market. Thus, analysis using this data can also address the effect of minimum wage policy on globalised firms and local firms.

The Directory of large and Medium Manufacturing data actually contains the same information as the annual data. Prior to conducting the annual survey, the same enumerators also conduct a listing of establishments to compile a sampling frame to be used for the annual data. However, unlike the annual data, the Directory only lists the name of firms, contact person and, more importantly, the number of workers. One of the primary reasons for conducting this exercise is to list new establishments, as well as report any closures. These enumerators request information from provincial offices, regional offices of the Ministry of Industry and Trade, the Ministry of Manpower offices, and even the village heads. Once the enumerators have obtained information on the whereabouts of the firm, they relay that information to the central office. The central office then includes these new firms in the database. Questionnaires for the next round of surveys are then sent to these new firms. Thus, information on the firms is updated every year to provide more complete information on the number of manufacturing firms.

The data for the second regression model comes from the recent ADB/World Bank/Statistics Indonesia's Productivity and Investment Climate Survey. The survey consisted of two questionnaires for the same firms. The purpose of separating the questionnaire into two was for convenience because the different nature of the questions required different officials to answer them. The data was obtained by interviewing the relevant officials, whenever possible. Thus, two enumerators were required to carry out the interviews. Part one of the questionnaires was designed for the purpose of direct interviewing and the second part was to be filled in at the firm's leisure. The survey was conducted from May until the end of September 2003. The most difficult part of the survey was obtaining responses. Despite this problem, of the 1000 firm sampled, the response rate was more than 60 percent. The high response

rate meant that the analysis could be conducted because of the adequate number of firms involved in answering questionnaires.

The other main data source was the minimum wage data from the Ministry of Manpower and Transmigration. The data consists of historical minimum wage level from 1990 to 2003 by provinces. This was important data for the purpose of the regression analysis. The data was merged with the manufacturing data to create a panel data for the regression analysis (time series from 1990 to 2001 across provinces).

Additional supplemental data consists of the following:

1. Data from the Labour Force Survey and Quarterly Wage Survey conducted quarterly by Statistics Indonesia. The labour Force Survey data contains information on the number of persons employed, and looking for employment. Employment is classified by type of employment, sectors and sex. The survey however, does not cover the informal sector. The Quarterly Wage Survey obtains information on the average wages of workers by sector. This data can be used to support the main data and provide description to the overall picture of employment in Indonesia in the formal sector. It is available in Indonesia's Statistics Office.
2. Data on the minimum wage is mainly available from the Ministry of Manpower and Transmigration office in Jakarta. The data is available annually and by province. However, district minimum wage data is based on a sample survey on the wage conditions of workers in selected sectors, including the manufacturing sector.
3. Data on inflation was also needed to deflate wages data into real wages. This information is available on a yearly basis and is also provided by the statistics office.
4. Data on Gross Domestic Product was needed to describe the macro-economic conditions of Indonesia. This data is compiled on a year on year basis by sectors.

Time was allocated during the field study to obtain more data from Indonesia's statistical office, the Ministry of Manpower, and provincial offices in Jakarta.

Additional data was gathered from independent trade unions, especially on workers' grievances.

Scope and Limitations of the Quantitative Data

The coverage of the field study was limited to large and medium manufacturing firms in Indonesia. Information on large and medium manufacturing is readily available from Indonesia's Statistics Office from 1975 to 2002. However, the writer only used data for 2000 to 2002 because the decentralization of authority actually started in 2001. Moreover, the minimum wage setting process has only been decentralized since 2001. The data consists of variables of manufacturing establishments with 20 or more workers. The variables include the number of workers by sex, annual wage cost and other workers' compensation, with value added. Unfortunately, the data was limited to non-oil and gas manufacturing, since this data is not as complete as the large and medium manufacturing data. In addition, data on small manufacturing was not available annually and therefore could not be included in the regression analysis.

Data on the educational attainment of workers is actually available in the annual data described above. Nevertheless, the data for this study was limited to the years 1995 and 1996. This limitation has made it difficult to include education variables into the analysis. Even though the variable cannot be included in the regression analysis, it was still useful to analyse the characteristics of the workers in manufacturing. However, one of the crucial limitations of the annual large and medium manufacturing data was the availability of the data at the start of the decentralisation period.

Other information from the annual data was also not reliable. For example, data on fixed capital formation is useful information when used in a model derived from production function. However, when the writer examined the contents of the data, i.e., values contained in the fixed capital formation variable, many of the values were missing and other values appeared not to correspond to the size and output of the firm. As mentioned earlier, the writer opted to exclude the variable and opted a proxy, output or, in the case of the annual data, the gross value added. Additionally, data on

wages was not available so another proxy was used, the variable called total labour cost. Wage cost, as a part of total labour cost and more appropriate as a wage proxy, was not available for 2002. Thus, the writer was forced to use total labour cost.

The data from the Directory of Large and Medium Manufacturing Establishments is of lesser quality compared to the annual data. The data from the Directory was mainly used as a population framework for the annual data. The name and location of the establishment was the main concern. The data only consisted of several variables and was not edited properly. The data on employment was also less believable than that of the annual data. One of the main reasons for reporting the number of employees was simply to determine if the establishment was small, medium or large. If small, that establishment was excluded from the survey. More reliable employment data comes from the annual data. However, because the data is more up to date, it is still useful to use it as an approximation.

The data from the Productivity and Investment Climate Survey (2003) in Indonesia is based on a sample of 1000 large and medium establishments from 12 provinces. The data was obtained through a combination of interviews. The survey, which was supposed to be conducted in four to six months, was delayed until January 2004, due to the general election preparation of 2004, in which Statistics Indonesia was heavily involved in the registration of voters. The data from the survey was not sufficient enough to explain the impact of minimum wage at national level, but it was used to illustrate the impact of the decentralized minimum wage fixing machinery and its accompanying factors, in places where labour problems had occurred. A response rate of over 60 percent was also reasonable for the analysis⁹. The survey was intended to better understand in-depth conditions in the local investment climate and how they affect firm level productivity, rather than solely look at labour issues. Nevertheless, the data from this survey was rich for it contained several questions relevant to the analysis of the impact of minimum wages. These variables were:

1. Minimum wage compliance
2. Wages
3. Number of full time and part time employees, as well as by gender

⁹ Response rate of more than 60 percent meant more than 600 firms out of 1000 firms had returned the questionnaires.

4. Trade union presence
5. Industrial dispute
6. Location (province and district).

Furthermore, the data from this survey could be linked to the annual large and medium data, since the sample was drawn from the list of establishments in the 2001 annual large and medium survey. This annual data provides additional variables and historical data from 1975, for those establishments that have historical information. Linking these data sources together helped the writer to widen the analysis.

The last limitation of data sources is that quantitative analysis only accounted for the employment impact of the minimum wage policy. This issue brings into focus the question of representation of quantitative method (Overton and Van Diermen, 2003, p. 50). The data was obtained through questionnaires filled out by respondents from firms. Although the data can effectively measure firm behaviour, i.e. employer response to increase in minimum wage levels, it does not represent the real subject of the research - the workers. It would be appropriate to obtain more information from workers, or those who represent workers, as to the impact of minimum wage increase on them.

Summary of Methods

The main focus of this chapter centers on the fieldwork that took place in 2003. The main objective of the fieldwork was to obtain information from interviews and important data from the questionnaires, as well as engaging in other activities related to the research. The researcher was successful during most of the fieldwork. The interviews were surprisingly successful, despite several refusals. On that score, the researcher was able to minimize the damage by resorting to questionnaires in order to obtain the information. The only drawback was the time and budgetary constraints, in which the sample size had to be limited to a certain number. For example, given the sample size of less than 30 firms, it is unlikely the results would be used to represent any population. Nonetheless, the researcher gained a lot of qualitative knowledge that could be used for future research on the subject of minimum wages.

The fieldwork experience revealed some intriguing results. An important occurrence during the fieldwork was the fact that the researcher often had to struggle with obtaining consent for interviews. Failure to do so would constitute changes in the sample, as well as changing the location, that could have resulted in an extension of time limit. More importantly, the researcher also gained additional knowledge, which would otherwise have been difficult to obtain outside the fieldwork. For example, the researcher was able to attend an important seminar discussing the prospects of the new employment legislations. This seminar, held in Bandung during the fieldwork, provided supplementary materials from the fieldwork. The fact that the seminar was attended by many human resource managers, government officials, and organized by the employer association APINDO, was even more useful for the analysis. Thus, the information gained from the fieldwork will be used to the greatest extent in the following chapters.

Quantitative analysis was used to supplement the results from the fieldwork. It used two econometric models, using OLS and 2SLS regression methods to estimate the effect minimum wage level increases had on employment in West Java, at the start of the decentralization process. The model used inter-district/city variation in the models. In addition, a quasi-elasticity model, based on firm births and deaths, was also used to estimate employment changes. Both methods are used in Chapter VIII. Furthermore, other descriptive statistical tools are also used in Chapters IV and V as *decent work* indicators, such as the labour market situation and trade union activity.

CHAPTER VII

The Impact of the Minimum Wage Policy

Introduction

Complaints about Indonesia as a “high cost economy” range from corruption to illegal levies to labour issues. Indonesia is also experiencing a difficult transformation to a more democratic state. The danger of state disintegration, political instability and the continuing impact of the 1998 economic crisis have forced the government to perform radical steps to stabilize the situation. A significant step toward that direction is the decentralisation of power from the central government to local government. Currently, the decentralisation process that was implemented in January 2001 has created additional uncertainty as regional governments now have authority over minimum wage setting and the implementation of other labor regulations. In addition, there are also problematic regulations issued by local governments concerning new local taxes and levies (*KKPOD*, 2001, p. 8).

Another significant step toward openness was the ratification of ILO Convention 87 on the freedom of association and protection of the right to organize in 1998, as stipulated in Law number 21 on labor unions. With a minimum of ten employees, workers are now able to form unions without interference from anyone (*SMERU*, 2002, p. 36). A more active role for trade unions could play an important part in minimum wage negotiations at local government level. Thus, it can be contended that the combination of new powers to local governments and to workers via trade unions will create a significant impact on the investment and employment decisions of firms in Indonesia.

The purpose of this fieldwork was to assess the relative implications of the decentralisation of minimum wage fixing machinery and other labour market outcome. The minimum wage policy referred to in this study involved the impact of the process of the minimum wage setting, as well as the level of increase. The study also attempted to establish that the minimum wage was not a major factor in affecting employment and investment decisions. Pertaining to developing countries, the issue of minimum wages

is much more complex than simply the relationship between wages and employment. Other factors such as development of trade unions, economic recession, corruption and socio-political conditions affected employment and investment decisions much more than mere wage changes. The assessment is based on interviews, data collected and other documents obtained from stakeholders of the minimum wage policy during the fieldwork. The researcher focused his analysis on the manufacturing sector in Jakarta, West Java and Banten provinces due to their importance with regard to the decentralised minimum wage fixing process.

The analysis spans the next three chapters: this chapter discusses the degree to which the decentralized minimum wage fixing process is a major factor affecting employment and other economic development decisions. It focuses more on the whole process of decentralized minimum wage fixing, rather than just increases in nominal or real minimum wage levels. Chapter VIII deals with the quantitative effect of minimum wage changes based on secondary data sources. Chapter IX discusses the social impact of decentralised minimum wage fixing, i.e. that is its impact on industrial relations, particularly trade union activities.

Findings

There are 10 issues discussed in this chapter:

1. Levels of minimum wage
2. Minimum wage and basic living
3. Misconceptions on the meaning of minimum wages
4. Respondents' views on the decentralized minimum wage fixing
5. Minimum wages of 2001 and 2002
6. The Impact of the minimum wages
7. Spillover effect of minimum wage increases
8. Minimum wage and firm closures
9. Minimum wage and labour productivity
10. Sectoral or industrial minimum wage.

Levels of Minimum Wages

Since the *Reformasi* in 1998 the government has been vigorous in pursuing more welfare-oriented labor market policies, including increasing the minimum wage level¹. The basis of the minimum wage has also been elevated from minimum physical need to minimum subsistence/daily need, which is slightly higher in nominal value than the minimum physical need. It was estimated that the minimum daily need is about 15 to 20 percent higher than the minimum physical need (Rama, 2001, p. 865). Increasing the minimum wage appears to be the central government's aim in relation to improving the welfare of workers. The 2000-2004 five year development plan, dubbed PROPENAS, did not specifically state minimum wages as a means to achieve that goal. However, Article 18 reiterated the need to increase employment via increasing workers' compensation, welfare insurance, protection and freedom of association. In addition, regional governments have also been given sole authority in determining the minimum wage levels in their own regions.

Table 7.1 Monthly Real Minimum Wages in Selected Provinces and Districts in Jakarta, West Java and Banten, 1999-2003 (000 rupiahs)

Province/ District	1999	2000	1999- 2000 Change (%)	2001	2000- 2001 Change (%)	2002	2001- 2002 Change (%)	2003*	2002- 2003 Change (%)
Jakarta	112	162	44.64	178	9.88	216	21.35	226	4.63
West Java									
- Bandung	112	162	44.64	155	-4.32	172	10.97	192	11.63
- Bekasi	112	162	44.64	174	7.41	210	20.69	225	7.14
- Bogor city	112	162	44.64	174	7.41	211	21.26	206	-2.37
Banten									
- Tangerang	112	162	44.64	178	9.88	216	21.35	225	4.17
- Cilegon	112	162	44.64	178	9.88	210	17.98	227	8.10

* Projected inflation of 6 percent

Source: Ministry of Manpower and Transmigration, Statistics Indonesia, Local Manpower Office and Labor Unions

¹ *Reformasi* is an Indonesian term which refers to the period of transition from an authoritarian government to a more democratic society which started after the economic crisis of 1998.

As shown in Table 7.1, minimum wage levels have increased substantially since 1999. In the year 2000 minimum wage levels increased by a maximum of almost 50 percent in some regions. The trend continued in 2001 and 2002, except in Bandung where real minimum wages slightly decreased by 4.32 percent. However, since the authority to actively set minimum wages had been given to local government in 2001 increases have varied somewhat across districts and city, even though evidence in the field suggested that minimum wage determination in periphery districts and cities such as Bekasi, Bogor and Tangerang were based on minimum wage levels in Jakarta. In Bekasi for instance, the wage council waited for Jakarta's announcement of its minimum wage before announcing its own minimum wage in 2003 (Interview G02, March 2003). As shown in Table 7.1, real minimum wage levels in Bekasi and Cilegon were virtually the same as Jakarta (225 thousand *rupiahs* as opposed to 226 thousand *rupiahs* for Jakarta) and Tangerang (227 thousand *rupiahs*).

Policy experts as well as businesses had been worried by the imposition of higher than expected minimum wages, especially when Indonesia's economy is still reeling from various crises. Based on neo-classical economic theory, increases in wages, including the minimum wage could have a negative employment effect (Reynolds et al 1995). The effect would not bode well for the government's development strategy of employment creation. Some studies, notably by *SMERU* (2001) and Bird and Manning (2003)², showed inverse effects of minimum wage increases on the formal and informal sector.

The field study found that businesses were concerned about the significant minimum wage increases during the period. All of the managers interviewed stressed that they did not object to paying their workers higher wages so long as the firm's business conditions remain conducive. Firms, especially in the textile, garment and footwear sector, argued that the crises had weakened demand for their products and that they had difficulties just paying the current wage, let alone paying additional increases due to increases in the minimum wage. They had to find other cost saving means to avoid bankruptcy. Firms specifically blamed the increases of the minimum wage in 2002 where nominal minimum wages increased by more than 35 percent in some districts.

² The *SMERU* report showed that increases in the minimum wage decreases employment in the urban formal sector in the Jabotabek areas, using BPS's Labor Force Survey data. Whereas the Bird and Manning study concluded that increases in the minimum wage could lead to bunching up of workers in the informal sector and also depressed real wages in the informal sector.

This concern was raised during the wage council discussion on the 2003 minimum wage setting in Jakarta, as well as the deteriorating economic conditions in Indonesia. All parties agreed that the minimum wage should not be increased too much lest it would make things worse (Interview G04, March 2003; Interview S02, February 2003). Eventually, unlike in 2002 where regional growth was used to determine the minimum wage increases, minimum wages in 2003 were determined by the inflation rate of 2002. In fact, the city of Bogor did not increase the nominal minimum wage at all in 2003³.

There were also signs that subsequent minimum wage levels would not be increased significantly. For instance, in Jakarta the 2004 minimum wage level increased from 631500 rupiahs to 671550 rupiahs, a nominal increase of only 6.34 per cent. Furthermore, there were reports that the planned minimum wage level for 2005 was set at 711843 rupiahs, an increase of only 6 per cent (*Detikcom*, 2004a). Trade unions rejected the planned increase and, those that were involved in setting the new minimum wage, did not sign the tripartite agreement, arguing that it was below the current minimum subsistence need level (approximately 94 per cent). In Central Java, the provincial government has decided to increase the minimum wage by 7.14 per cent (*Detikcom*, 2004b). Nonetheless, it appeared that the government is limiting the minimum wage level to increase approximately the same as inflation rate in each region. Thus, it can be argued that the government's policy was to prevent real wages from falling or from rising too quickly and, eventually, to provide stability in the labour market.

Minimum Wages and Basic Living

As stated earlier, the government has been pursuing a basic needs approach to minimum wage setting since 1973 with the goal of setting the minimum wage on par with minimum physical need (Starr, 1993, p. 99). The government had elevated one of the criteria for setting the minimum wage from the minimum physical needs to the slightly greater value of minimum daily needs. This is perhaps crucial for increasing the quality of life. Increasing the basic living may be related to increasing the HDI (Human

³ Apparently, the market survey revealed that the minimum daily needs value on which the minimum wage is based was lower than in 2002. The council was reluctant to use the lower nominal value as the new minimum wage for 2003 fearing that workers would not accept it (Interview G07, March 2003; Interview G08, March 2003). Eventually, the council decided to use 2002 minimum wage as the 2003 minimum wage.

Development Index), which measures the quality of life of a country (*Kompas*, 2000a). One trade union official also commented: “Increase in minimum wage means increasing the welfare of workers and could mean increasing the quality of life” (Interview S01, February 2003).

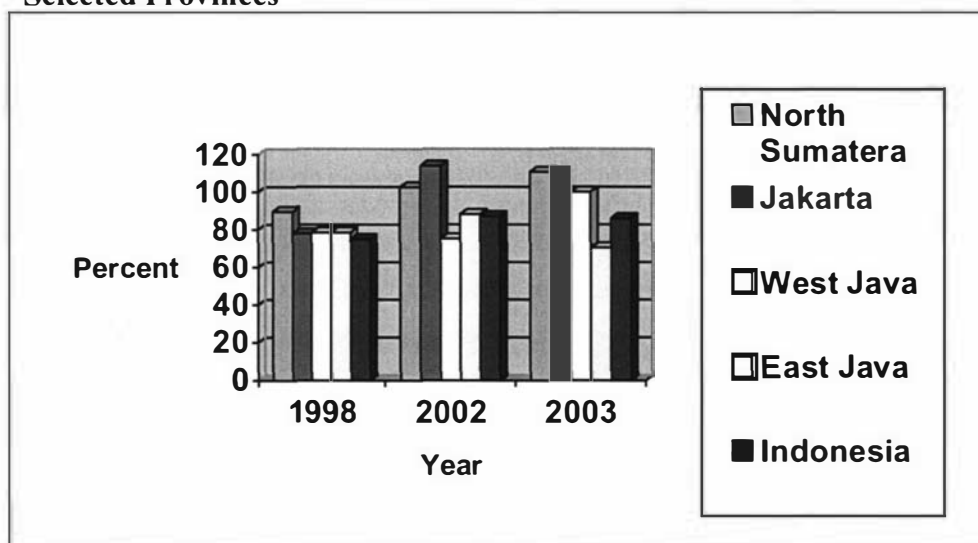
In relation to the minimum wage in Indonesia, basic living could be interpreted as the minimum subsistence need on which the minimum wage level is based. The minimum subsistence need is obtained from a survey on products needed on a daily basis. It consisted of 42 to 43 different items ranging from food and clothing, to transportation costs and housing rent⁴. The goods are also equivalent to 3000 calories per day. Prior to the market survey the council would decide the quality of the items and the type of items to survey. The council then breaks into teams consisting of each of the stakeholders, i.e., one from the government, one from the employers association, and one from the trade union. Each team would survey a market normally frequented by workers and collect prices of goods. Then, all the teams would merge again and decide how best to calculate the minimum subsistence need. Normally they would calculate the average prices of all the teams to obtain the minimum subsistence need value. They then proceed to calculate the minimum wage in which other factors, such as inflation and the state of the economy are taken into account. More importantly, they also must consider the minimum wages of neighboring districts and cities to avoid social jealousy among workers.

Figure 7.1 shows that decentralizing the minimum wage setting has made minimum wages much closer to the minimum daily (subsistence) need. The average ratio of minimum wage to minimum daily need has increased from 75 percent in 1998 (prior to decentralisation and proliferations of unions) to above 85 percent in 2003. In some several provinces, such as North Sumatera, minimum wages even surpassed the minimum subsistence need in 2002 and 2003. Unions, however, are now pursuing a more ambitious level of minimum wage, the minimum decent living. They argued that the current minimum daily need does not reflect the real everyday condition of life in urban areas where factories are located. These needs include the use of electrical

⁴ Normally, the number is 43 different items. However, it also depends on the agreement of members of the wage council in each district or city. In Jakarta for instance, the wage council used 43 different items, whereas in Bandung district the council decided to survey 42 items for the 2003 minimum subsistence need value (Interview G11, March 2003).

appliances such as television and radios. They also argued that the current 43 items in which the minimum subsistence is calculated from no longer suffice. Based on information obtained from several union officials, the minimum decent living includes 55 items instead of 43. During an interview with a trade union official in Jakarta, the writer was told that the union set the minimum decent living in 2003 at approximately one million *rupiahs* per month as compared to the minimum wage of 631 thousand in the same period (Interview S02, February 2003; Interview S08, February 2003).

Figure 7.1 Proportion of Minimum Wages to Minimum Daily Needs in Selected Provinces



Source: Ministry of Manpower and Transmigration, various years

An interview with one of the wage council members revealed that the minimum wage level was intended as a safety net wage. By definition, the safety net wage was designed as some sort of relative poverty line that separates the poor and the non-poor. The idea was that the safety net wage would be used as a flexible wage indicator as a basis for the industrial relations stakeholders to negotiate on. It was not meant to be the lowest wage floor for workers, according to the official. The two sides would negotiate which wage level is sustainable for the continuation of production. This is where the benefit of active union participation came in. By negotiating for wage mark-up, unions theoretically ensure the flexibility of wages and, thus lead to more efficient allocation of labour.

On the other hand, the trade unions interviewed in the field still view minimum wages as a non-negotiable basic labour right that firms must comply with without reservation.

It was the main reason trade unions staged strikes during the New Order regime period. The premature elimination of the minimum wage policy would bring about disastrous results and would be a major set back for the government's stabilisation policies. It would be prudent for the government to promote better industrial relations policies and allow unions to gauge the importance of negotiating a more flexible wage arrangement with firms. The minimum wage level could be used as a standard for these negotiations, instead of just using it as a rigid form of wage determination.

The charge of many workers is that their wage changes can not keep up with the increasing cost of living. It would be ideal if the minimum wage has kept pace with the increasing cost of living to keep real wages from falling. Nonetheless, Figure 7.1 showed that the minimum wage has kept pace with the minimum subsistence need, where it is within 90 to 95 percent of the minimum subsistence need since the start of the decentralisation process. The minimum wage increase in Jakarta for 2003 was based on the inflation rate at the end of 2002 (Interview G04, March 2003). The inflation rate in Jakarta at the time was approximately 6 percent, so that the real wage increase is only about 6 percent instead of 20 percent in 2002. It seemed that an increase in the minimum wage level at the pace of the inflation rate had satisfied all stakeholders. Even though there were grumblings from most of the unions interviewed (Interview S02, February 2003; Interview S08, February 2003), in the end most were satisfied with the final outcome. Perhaps, some unions were more concerned about pursuing a more lucrative sectoral or industrial minimum wage. There was no evidence of dispute during the 2003 minimum wage setting similar to the 2002 round where employers had taken several local government officials to court.

Misconceptions on the Meaning of Minimum Wages

A crucial element of the minimum wage discourse was the very idea of the application of the minimum wage in Indonesia. The fieldwork revealed differing interpretations on what a statutory minimum wage should be, even among government officials⁵. Trade unions interpret differently the concept of the statutory minimum wage. It is clear that

⁵ A government official in Jakarta described the minimum wage as the lowest monthly wage given to a worker whose tenure is less than one year. If a worker has worked for more than one year his or her monthly wage should be more than the minimum wage (Interview G01, February 2003). The minimum wage consists of the base wage plus a fixed benefit. The fixed benefit does not depend on how many days the worker works.

the notion of neo-liberal capitalist development was still the main development path for the country. However, with greater democratization, that path has somewhat shifted more to welfare capitalism which calls for a more dynamic relationship between capital and labour. The imposition of the new labour laws seemed to strengthen that point. The minimum wage could be seen as a basis for negotiations between employer and employees, while keeping the capitalist export-led development on track. Other government officials interviewed commented that the minimum wage was designed not as a minimum wage adopted by firms, but only as a safety net wage (Interview G01, February 2003). It is considered a wage floor for workers where a wage below that level would be considered insufficient to provide subsistence to workers.

The comment was echoed by a national trade union leader of the SPTSK. He said that;

UMP beda dengan negosiasi upah. seharusnya Upah minimum sebagai social safety net di pisahkan dengan bargaining upah. Upah minimum seharusnya dijadikan acuan untuk negosiasi - the district or city minimum wage should be used as a safety net wage and should be distinguished from wage obtained from collective bargaining. The minimum wage should be used as a base for wage negotiations (Interview S01, February 2003).

He reiterated further that the minimum wage, as a safety net wage, should be used as a basis for collective bargaining within the firm and not be used as a fixed wage which the firm has to pay. Once the local minimum wage is set, it is up to the firm level union and management to negotiate a minimum wage within the firm. Whether or not the statutory minimum wage can be paid depends on the outcome of the collective bargaining agreement. Depending on the ability of firm to pay, the minimum wage in a firm could be less if the firm is incapable of paying and more if the firm's wage policy is to pay above the minimum wage level. There is actually an official mechanism for those firms unable to pay minimum wages. Firms could register to delay paying their workers the current statutory minimum wage, provided that they show evidence that they cannot pay.

The researcher found evidence in one garment firm in Jakarta where, contrary to the current regulations, workers and management decided not to impose the 2003 statutory minimum wage. The firm is a supplier to a world famous jeans company. They opted instead for the firm to pay the previous level and delay the current minimum wage until next year. The manager interviewed said that workers agreed to consider the

continuation of production and keeping their jobs rather than opt for an increase of minimum wage and face firm closure (Interview 10, March 2003). It is perhaps a true example of proper industrial relations without any government intervention. The management also recognized the existence of the firm-level union and seemed to have an understanding of the current economic condition. Based on the interview and available document, both sides also recognized the need for increasing the welfare of workers, but noted that the increase of that welfare should not come at the expense of downsizing the workforce. One reason for not increasing the wage was the lack of demand from buyers. The firm did not mind paying workers more if demand was also high. The firm is dependent on global jeans company demand. Even though their perception of the statutory minimum wage seemed similar to the current perception, at least negotiations with workers had occurred more often than before.

This perception is significantly different to the perception of other unions, employer representatives and, for that matter, unions at local and firm level, and ultimately, workers. An interview with a Bekasi chapter of Apindo revealed that they perceived the statutory minimum wage as the minimum starting wage of a firm (Interview A01, February 2003). This perception is likely to stem from the criteria on which the statutory minimum wage is based. They claimed that minimum wages are determined by minimum subsistence need, inflation, the labour market situation, the ability of the firm to pay, and minimum wages of neighboring areas. They also claimed that the present minimum wage determination tended to focus too much on the social welfare side and less on economic and business conditions. They pointed to the rise in crime figures, which are indirectly linked to increased unemployment. They also believed that minimum wage fixing should be conducted every two years, not the current annual fixing. The reason being that firms needed time to consolidate their accounting to adapt to new minimum wages.

Minor trade unions also perceived minimum wages as a non-negotiable basic right in which a firm has to pay. They argued that wages were already negotiated through the minimum wage fixing machinery of the local wage council. Wirahyoso (2002) echoed this view and added the minimum wage should not be linked to the fluctuations in economic condition because the minimum wage is a basic right and a (social) safety net for workers. Therefore, unions argued that firm should not renegotiate the minimum

wage with workers (Interview S05, February 2003; Interview S07, February 2003). They also pointed out that those firms who cannot afford to pay the current minimum wage could be exempted by registering with the local manpower office. However, they must provide evidence of their inability to pay, such as providing the local manpower office with their accounting records. In any case, firms could apply for an exemption if they feel that they cannot afford to pay the minimum wage. Nonetheless, the fieldwork revealed that many workers were unaware that firms could apply for exemption if they are unable to pay. They assumed that if the minimum wage is set there should be no renegotiation of wages. Due to this perception, strikes could occur when firms do not want to pay minimum wages to workers.

Respondents' Views on the Decentralised Minimum Wage Fixing

Despite the misconceptions on the definition of the minimum wage, both firms and workers appeared to accept the decentralized minimum wage fixing. 14 out of 24 firms interviewed strongly accepted the decentralisation of minimum wage fixing to local government. Three firms accepted the new process with reservation. Four out of 24 firms did not agree to the new process and the remainder did not respond. One main reason given was that stakeholders in that local authority would know the local conditions in those regions better than officials from the central government. Those who had reservations argued that it needs coordination between central and local governments to make it doable and that the law governing the minimum wage policy needs to be clearer.

All trade union officials interviewed also strongly accepted the decision to decentralize the minimum wage fixing to local government. It gives trade unions at grass root level greater participation in determining minimum wages in their own locales. Indeed, the fieldwork revealed a more dynamic process of minimum wage fixing process than in the past. However, several trade unions rejected the minimum wage fixing process in West Java where it was delegated by the provincial authority to district/city authority. One trade union in Bandung city even declined to approve the 2002 minimum wage in which it was a member. They argued that the decision violated the Ministerial Decree Number 226, 2000 which stated that the central government only delegates the minimum wage fixing to provincial authority, but not to district/city level (Interview G03, March 2003).

Minimum Wages in 2001 and 2002

The main purpose of assessing the implication of the decentralized minimum wage focused on the minimum wage levels in 2001 and 2002. The increase in both years was so high that many discussed the impact of the minimum wage increase on firm closures as well as decreases in employment. An interview with a government official in Jakarta revealed that the large increases in both years, particularly in 2002 were designed to catch up on the low wages. His comments were:

Tidak ada pertimbangan politik, hanya unsur ekonomi dan social. Dulu UMP naik terseok-seok, jadi sangat jauh dari penyampaian ke tingkat KHM. Dulu penelitian tentang KHM masih kurang valid. Makanya kita benahi secara bersama. Malah kemarin kita lakukan survei bersama. Tidak ada itu unsur politik dalam penentuan UMP. Kalau serikat buruh ditunggangi politik itu bahaya. Kasihan kalau begitu rakyat yang menjadi korban – There was no political reason behind the increase in 2001 and 2002. In the past, the government was dragging its feet in trying to increase minimum wages to an acceptable level. Minimum wage increases annually were slow and far from the level of the minimum subsistence need. Which is why we, the wage commission, have been trying to fix. We now conducted our own market survey, together with employer and trade union representatives. There is no politics in setting the minimum wage levels. If trade unions were used as a political weapon, then it's dangerous. The people are the ones who suffered. (Interview G01, February 2003).

As explained in the preceding chapters, the minimum wage at district and city level is being set by the district and city government, administered by the local manpower and transmigration office. The wage council (in the city it's called a wage commission), under the authority of the district head or mayor, set minimum wage level for the region annually. The council consists of equal number of representatives of the government, trade unions and employers, plus a chairperson from a reputed local university. Trade unions in the wage council are aware of their limitation in forcing their interests. If negotiations with the employer association, often represented by Apindo, break down or a deadlock the government members of the council would be included in the eventual voting procedure to decide on the level of the minimum wage. Government members include officials from various regional government and central government apparatus such as the local industry office and the District Statistics Office that provided data on inflation, GDRP and the labour market situation. Thus, the votes of the government members of the council often became the deciding voice, depending on which

development path the government wished to promote. In 2001 and 2002, the government appeared to be pro-labour as indicated by the significantly high increases in the minimum wage. This is a different from the large increases during the 1990s when the government was forced to do so because of pressures from internal and from abroad to improve labour conditions. However, defeat of the pro-labour government during the 2004 general election means that the pendulum could swing the other direction.

As an example, another official in the Bandung district did not share the view of the Jakarta official that there was no political reason behind the minimum wage fixing. He reiterated the political dimension of the minimum wage provision by pointing to the fact that the governor of West Java has delegated the authority to set minimum wage levels to district and city heads since 2001 (Interview G06, March 2003). The minimum wage in 2002 was particularly controversial. The wage council reached a deadlock because the stakeholders, especially the employers Association (*Apindo*), could not agree on the minimum wage level for 2002. Perhaps due to the fact that the minimum wage level increased quite significantly. The council finally decided to, for lack of a better term, agree to disagree (Interview G06, March 2003; Interview G11, March 2003), and handed the authority to the district head (*Bupati*) to make the decision. The district head finally decided to use the minimum wage of the neighboring Bandung city as the basis for the 2002 minimum wage level for Bandung District. The decision stayed, even though the employers association tried legal means to change the minimum wage level for 2002.

Nonetheless, a nominal increase of 38.7 percent in 2002 was seen as quite high because, in the past the rate of increase in minimum wage levels had never surpassed 15 percent in nominal terms. Indeed, an official said that the 2002 increase was designed to be shock therapy to firms (Interview G01, February 2003). The increase was designed to catch up on falling real wages caused by the economic crisis. In 1998, inflation was more than 77 percent and nominal minimum wage levels were only increased by 15 percent. As a result, real minimum wage actually decreased by more than 30 percent. The current minimum wage setting regime was created to properly stabilize the minimum wage to an acceptable level. He added further that in the future it would be difficult to increase the minimum wage to that level again. The next increase in the minimum wage level would be based on economic factors such as inflation and

economic growth. As a matter of fact, the minimum wage level only increased by about six percent in 2003 and 2004.

However, the fieldwork revealed that the reason for the significant increase was due to the fact that minimum wage fixing at district and city level started in 2001. Previously, the provincial governments determined the level of minimum wage and even then, it had to be approved by the Minister of Manpower. Moreover, the minimum wage calculation was done more properly in 2002 (through market survey) and in several districts the methods used in 2001 were done in haste. In Bogor city, for instance, the KHM for 2003 was found to be significantly lower than in 2002. In the end they decided not to increase the minimum wage for 2003. A member of the Bogor Council reiterated that they contemplated decreasing the minimum wage level, but decided against it for fear of a backlash from trade unions and workers (Interview G07, March 2003; Interview G08, March 2003).

Another reason for the significant increase was the method by which the minimum wage level was calculated. The calculation was based on the average monthly expenditure of 43 daily items, such as food, clothing and other daily expenses. Prior to the decentralisation process, the government did not change the quality of the items that formed part of the monthly minimum. Some items no longer existed in the market and were not replaced. For instance, a lamp that was powered by kerosene was still included when it was not available in the market anymore. This item was replaced with the cost of electricity, which the majority of people now used. Thus, increasing the quality of the items or replacing items that no longer existed in the market meant that the nominal minimum wage level would also increase. The increase in minimum wage levels also increased its potential to affect other variables.

In the end, political considerations appear to be the main factor that determines the level of increase in minimum wage. In 2001 and 2002, the substantial increase in minimum wage levels was brought about by the political euphoria in the previous years. Public consultation on labour policies, the growing political leverage of trade unions, as well as falling real wages ensured that a reasonable increase of minimum wages was necessary to obtain economic and political stability. The 2002 and 2003 modest minimum wage increases also showed that the government has reasserted its political dominance by

changing the rate of increase. Government representation in the wage council ensures that the government has the deciding vote in approving minimum wage levels. The recent minimum wage determination for 2005 showed that the central government also retains considerable authority in the minimum wage provision. The Jakarta governor, who was supposed to have the final authority for the Jakarta minimum wage, felt obliged to re-discuss the 2005 minimum wage with the Minister of Manpower and Transmigration (*Detikcom*, 2004a). Despite the governor's assurance that all parties agreed to the new minimum wage level, objections and threat of massive protests from a trade union alliance would likely drag the problem for some time.

Box 7.1 Minimum Wage Calculation.

Calculation of the minimum wage at district and city level and province is depicted here. Based on the so-called Delphi Method, a panel discussion for the 2003 minimum wage for West Java 2003 minimum wage showed that:

Minimum wage = f (lowest level of subsistence minimum need in the province, inflation, ability of firm to pay, level of unemployment, economic growth, average wage of neighboring areas).

As an example, for West Java the calculation for the provincial minimum wage for 2003 was:

Lowest KHM:	354 371 rupiahs
Inflation rate:	12 %
Ability of firm:	-11 %
Unemployment Rate:	- 8 %
Economic growth:	3.5 %
Average wage of neighboring periphery region:	36 188 rupiahs (Dinas Tenaga Kerja dan Transmigrasi Propinsi Jawa Barat, 2002).

Thus, the minimum wage for West Java in 2003 was 320 000 rupiahs. An increase of approximately 13 percent compared to 2002.

However, even though the district and city minimum wage used the same formula, in practice it is more difficult to achieve due to the conflicting nature of the setting process. The provincial minimum wage is, for practical purposes, academic because both workers and trade unions are more concerned with the district and city minimum wage, which is substantially higher than the provincial minimum wage for industrial areas such as the Botabek and Bandung.

A paradox of the minimum wage level occurred between the Bandung City and Bandung District. The wage council, based on the event that resulted in the setting of the 2002 minimum wage level, was more cautious in determining the 2003 minimum wage. After the initial market survey to determine the 2003 minimum subsistence need, the council went through the usual lengthy process of deciding the 2003 minimum wage. At the end of the process there was the usual disagreement between members from the trade unions and members from the employers association. The employers association did not want to use the minimum subsistence need value as the 2003 minimum wage because it was too high. They emphasized that economic conditions were not conducive and many firms also could not afford to pay the rate of increase in the minimum wage. They finally decided to consider minimum wages from neighboring districts. However, neighboring districts such as Bandung city had not decided on the minimum wage, because they were also waiting for other neighboring districts to set their minimum wage. Finally, they decided to use the minimum wage of the Cimahi District which appeared to have set their minimum wage. Apparently, Bandung City also decided to use the minimum wage set by the Bandung District. In the end, the 2003 minimum wage of Bandung District became higher than its minimum subsistence need value. On the other hand, the minimum wage in Bandung City was lower than its own minimum subsistence needs value for 2003.

The Impact of Minimum Wages

The effect of the increased minimum wage varies across sectors and regions but could suggest a complementary effect rather than the main effect. Based on the interviews with firms, labour issues including minimum wage increases were the third biggest cause of economic deterioration. High minimum wage increases may speed up the deterioration of businesses affected by the global economic slowdown (BharaTextile.com, 2002). The effect is also dependent on the level of compliance among manufacturing firms. Since the government has vigorously implemented the minimum wage setting in the 1990s, compliance is considered high among large and medium manufacturing firms. Data from Statistics Indonesia (Badan Pusat Statistik, 2002) suggested a compliance level as high as 74 percent.

Minimum wage compliance was different across sectors. In the high tech electronic sectors, it was found that all of the establishments visited by the researcher had paid wages above the prevailing minimum wage. However, findings in the field and from interviews with labor unions suggest that some establishments, notably electronic component manufacturers, had not paid workers at the prevailing minimum wage level. The researcher could not extract more information, but contends that electronic component workers may be less skilled than their counterpart in the electronic establishments that manufacture finished products.

Figures in Table 7.2 showed that the increase in minimum wage had affected some firms with regards to employment. 12 respondents (50 %) contended that the increase in wages caused firm to lay-off workers. The majority of respondents who claimed that the increase had made them lay-off workers were in the TGF (textile, garment and footwear) sectors (10 of 16 or over 60 percent). The number of workers for these firms generally decreased in 2002. Only two metal products and electronics firms said that an increase in wages affected their policy to lay-off workers. The majority of firms not affected significantly by the increase of the minimum wage were from the metal products and electronics sectors. These firms tended to be capital intensive and had some degree of foreign investment.

Table 7.2 Effect of the Increase in Minimum Wages on Employment Lay-offs

Sub-sector	Medium		Large	
	Affected	Not Affected	Affected	Not Affected
TGF (Textile, Garment and Footwear)	3	2	7	4
Metal Products and electronics and automotive parts	1	2	1	4
Total	4	4	8	8

Source: Fieldwork, 2003.

The increase in the minimum wage also affected the future ability some firms to hire more workers, thus jeopardizing employment opportunities for new entrants to the labour force. Table 7.3 shows that, of the 24 manufacturing firms, the majority (16 of 24 or 67 per cent) contended that the minimum wage in 2001 and 2002 affected their

ability to hire more workers in the future. The majority of these firms were TGF firms (11 of 16 or 69 per cent). Moreover, metal products and electronics firm were also affected by the increase of minimum wages. From the eight firms in the sample, five (60 percent) believed that the minimum wage increase had affected their future ability to hire more workers.

Table 7.3 Effect of Minimum Wage Increases on Future Ability of Firms to hire more Workers

Sub-sector	Medium		Large	
	Affected	Not Affected	Affected	Not Affected
TGF (Textile, Garment and Footwear)	4	1	7	4
Metal Products, Electronics and Automotive Parts	2	1	3	2
Total	6	2	10	6

Source: Fieldwork, 2003.

Nonetheless, the impact of the increase in minimum wages was not the sole reason for many employment lay-offs. Changes in overseas as well as domestic demand for their products were the main cause of employee lay-offs. 16 of 24 (67 percent) respondents admitted that the main reasons from the mass lay-offs were decreasing demand, as well as increase in fuel and electricity prices, and political uncertainty were. Consequently, these firms had to decrease their operational costs by, for example, eliminating overtime work and were unable to hire new workers. A garment firm official which supplied jeans to overseas buyers said that they were unable to pay their workers minimum wages because of a lack of demand overseas. Another garment manufacturer commented:

Jelas UMK mempengaruhi perusahaan untuk mengurangi pegawai, apalagi dengan naiknya bahan baku, bahan bakar lain seperti listrik dan bensin, sedangkan nilai jual kain tetap tidak ada perubahan. Maka perusahaan tidak akan mendapat untung, justru kemungkinan rugi – Of course, increases in the minimum wage will make the firm lay-off workers, especially since prices of other inputs such as raw materials, electricity and fuel are also simultaneously increasing, for the price of garment (overseas) did not change. The firm will not profit, but instead it could be at a loss (Interview 10, March 2003).

They maintained that they had difficulties just paying the current wages, let alone increasing wages for their workers. The results were confirmed by all of the relevant government officials who were interviewed. They appeared to be worried that high increases in the minimum wage could create more unemployment. It was also true that the increase in minimum wage levels during the 1999-2002 period coincided with the government's decision to decrease or eliminate subsidies for electricity and fuel in 2002. It is likely that the continuing economic crisis and subsequent planned increases of fuel and electricity prices were the real triggers of the alleged mass employment lay-offs. The increase in the minimum wage might have accelerated the process, rather than being the main factor causing the lay-offs. When questioned further, in addition to increases in minimum wages most of the managers also complained of exorbitant taxes and illegal levies, which also affected their decision to lay-offs workers. They argued that they could not minimize these costs and urged the government to intervene in eliminating these so-called illegal levies. As a result, workers' wages is the only cost structure which employers can try to manipulate.

In contrast to Tables 7.2 and 7.3, in another question, only three of the 24 respondents (12.5 percent) said that the increase in the minimum wage was the reason for the previous year (2002) employee lay-offs. The majority (14 of 24 or 58.3 per cent) claimed that decrease in demand due to difficult economic times was the main reason for employment lay-offs. Only one respondent chose trade union activity as the main culprit for employee lay-offs. It could be concluded that a combination of many factors, decrease in product demand, increase in levies from local government, corruption and labour problems, including the minimum wage policy were the cause of increased unemployment.

The writer could not find conclusive evidence that employment in these firms decreased from 2000 to 2002. Several firms did not answer the questions on the number of workers in these years. However, the interviews with managers, particularly from garment firms, revealed that the number of employees decreased by an average of approximately five per cent in 2002. The number of employees in the electronics and automotive parts sector appeared to increase, implying that minimum wage increases did not have a negative impact on employment. Again, the results overall were inconclusive because of lack of data. Most of the estimates came from interviews with

managers. Nonetheless, the employment impact is addressed in following chapter (Chapter VIII).

Most of the managers interviewed did complain about the increases in 2001 and 2002, saying they were too high. Indeed, in some districts increases in real minimum wages exceeded more than 40 percent in 2001 and more than 20 percent in 2002. However, when asked about the mere five percent increase in nominal terms in 2003 none of the respondents had much complaint. It is likely that a slight increase in the minimum wage would not put pressure on firms to lay-off workers or affect their future ability to hire more workers and, at the same time, satisfy the workers' need of covering increases in the cost of living.

The idea of using inflation as a basis for increasing the yearly minimum wage was proposed at the Jakarta wage commission or council. An interview with one of the government members of the commission revealed that from 2003 onwards inflation could be used as the basis for increases in the nominal minimum wage. Early indication of the 2004 minimum wage also confirmed the use of inflation to increase the nominal minimum wage. This meant that in real terms the minimum wage would stay more or less the same. The official also stated that the Jakarta minimum wage fixing machinery is also used as the basis of other regional wage councils, especially in regions close to Jakarta. The researcher did not find any indications that wage councils in Bekasi, Bandung and Bogor were going to use inflation as a base to increase the nominal minimum wage because they went through the process of minimum wage fixing thoroughly. However, they explained that in the end, the minimum wages of the neighboring districts or cities are crucial in determining the final value of the minimum wage and they, particularly Bekasi and Bogor, frequently look to Jakarta to initiate the process. On that basis alone, the minimum wage changes would be highly dependent on inflation. In any case, the KHM value also includes increases in the prices of goods. The move was meant to stimulate regional economic development and satisfy workers' perception that the government needs to pay more attention to workers. Trade unions represented in the council did not wholly agree to the meager increase, but were willing to accept the decision.

The writer did not find any indication that political interference occurred during the minimum wage setting process in districts and cities in West Java. However, there were indications of political interference occurring after minimum wage levels were set by the wage councils, especially in Jakarta. Despite repeated denials of Manpower officials interviewed by the researcher, there were examples where the nominating officials changed the minimum wage level set by the wage council. More recently in Jakarta, the Manpower minister felt the need to “discuss” the 2005 minimum wage with the Jakarta governor (*Detikcom*, 2004a). As a result, the minimum wage level was significantly lower than the KHM.

The study also contended that the negative employment impact of increased minimum wages was insignificant in the high technology sector. As previously mentioned, one reason was because the majority of establishments in this sector pay efficiency wage to their workers. An efficiency wage refers to wages paid by firms to workers based on the workers basic needs to increase productivity and not on the market-clearing wage. This meant that workers in this sector enjoyed higher than average wages compared with wages from their counterparts in the garment sector. Interviews with managers in this sector did not give any indication that these firms have been affected by the minimum wage increase. The real difficulties, especially when negotiating with the unions, were the amount of pay increases for wages above the minimum wage levels. Subsequent increases in wages above the minimum wage did not close the gap between the lowest paid workers and the highest paid workers as the minimum wage was intended to do.

Firms in the electronic sector stressed the minimum wage increase and other labor issues had not significantly affected their production. In fact, the field study found that wages and other working conditions were much better in this sector than other more labor-intensive sectors, such as the garment sector. The high technology sector, such as the electronics, rely on new technology and products and international competition to increase production and sales as well as capturing other niche market, rather than relying on cheap labor.

Another valid reason for the lack of employment losses was the reluctance of firms to lay-off workers due to the high cost of lay-off. Ministerial decree number 150, 2001 had created a lot opposition because firms would pay a higher cost of compensation than

before. One of the rules in the decree stated that workers who are being laid off must be fairly compensated, even if he or she committed a crime within the company, such as graft and theft. In addition, the amount of compensation was also increased significantly⁶. On top of that, the firm must apply for lay-offs to the local employment authority. Corruption such as illegal levies made sure that the application for laying off workers would also be costly.

The fieldwork found positive indications, however, that electronic firms were also finding ways to decrease labor cost. Two electronic firms and two trade unions interviewed confirmed that firms do look for alternatively cheaper labor by employing contract workers and outsourcing some of their work⁷. The application of contract workers is quite significant. One firm interviewed estimated that the number of contract workers were more than one third of the entire workforce (Interview 24, April 2003). Some firms also outsourced some of their work, including workers for their production line. In one case, a firm even replaced their entire production workers with outsourced workers because regular workers staged a strike⁸. The researcher did not find similar conclusion in the TGF sectors. In addition, non-compliance with the minimum wage seemed likely to occur in this sector.

It would seem that those who do not pay minimum wages tended to be locally-owned and medium in size. The researcher also noticed that these firms tended to be outside the Jakarta proper. Though, on one occasion the researcher encountered a large, export-oriented firm in East Jakarta that did not pay their workers minimum wages (Interview 10, March 2003). However, as explained later on in this chapter, the firm struck a deal with their workers not to pay minimum wages due to difficult economic times. In Bandung, specifically in the Majalaya and Paseh sub-districts, the researcher visited four garment firms that do not pay minimum wages. An official, a member of the district wage council, of the Bandung district confirmed the condition in the Majalaya

⁶ Compensation depends on the number of years services rendered by the worker. For instance, if a worker had worked for two years, then the compensation would be two times the monthly wage or salary.

⁷ The researcher was able to interview both the management and firm-level trade unions of two firms. Both firms appeared to have good industrial relations because the management did not object to the interviews of both parties.

⁸ Obtained from Interview S13, but the trade unions referred the condition of their colleagues in another firm that produced motorcycles. They said that because most of the workers staged a strike, the firm decided to temporarily replace the entire workforce with workers from their subsidiary firms.

area, even though the writer did not specifically ask that type of question. During the 2003 minimum wage determination process, four firms applied for the exemptions, and the wage council was obliged to visit these firms to ascertain whether the delay in paying minimum wages was warranted. During these visits, the official saw a lot more firms, mostly garment firms, in the Majalaya area that did not pay minimum wages. However, he did not have the necessary information to determine the exact number of firms that did not pay minimum wages. He surmised that workers simply accepted the fact that the firm they are working for could not pay the minimum wage. In fact, these firms have never paid minimum wages during previous years.

Similar to the footwear sector, many garment firms had also suffered losses due to lack of overseas demand. For many of them the profit margin is so dependent on orders from abroad that they have difficulties paying previous wages when there are no orders, let alone wages that increased due to a minimum wage increase. The interviews results showed that most the garment establishments in the greater Jakarta area have had no problem in paying an increased minimum wage as long as there are continuing profit-making activities. The researcher found three firms, two garment firms in the Bandung district and only one in Jakarta (12.5 percent of the whole sample), still pay wages below the minimum wage and, thus, negotiated with their workers not to pay or at least delay paying the current minimum wage. The researcher also suspected that most of the textile, garment and footwear establishments who declined the interviews did not pay minimum wages or were experiencing a difficult time and did not want to be disturbed. However, due to lack of evidence the researcher could not make any conclusions. Data from the special ADB/World Bank survey may shed some light because the nature of the questions may reveal whether or not these firms pay minimum wages.

Information collected from the field showed that labor issues, such as minimum wages and increased activities of labor unions did not have as great an impact when compared to the deteriorating macroeconomic conditions. Lack of demand, especially in the garment and footwear sectors, was the main reasons for many closures. Issues such as an increase in the minimum wage were overcome by firms negotiating with workers to delay wage increases for the time being, or decline paying minimum wage at all. Many textile and garment firms in Bandung area, especially the Majalaya sub-district where the majority of these establishments are located, pay their mainstay workers below the

local minimum wage. The local Manpower office reported that 160 of the 220 textile and garment factories in Majalaya failed to pay their workers minimum wages (Kompas, 2003d). This condition is unlawful but many workers were forced to accept the terms and live below subsistence levels rather than being unemployed. Remarkably, because of agreement between workers and management not to pay minimum wages, none of the firms visited by the writer in Majalaya experience any significant lay-offs⁹. In fact, from 2001 to 2002 there was a slight increase in the number of workers. The majority of the interviewees, including labor union officials, admitted that even though labour issues such as an increase in the minimum wage were a concern, employee dismissals mostly resulted from the economic downturn, rather than from labor issues.

Spill-over Effects of the Minimum Wage Increase

The increase of the minimum wage also created a spillover effect which ultimately increased the total cost of production. An increase of minimum wages had the effect of increasing the wages of other workers, as well as other benefits to workers. It is understandable for other workers to demand for an increase in wages if the wages of the lowest paid workers are increased. The intention of the government was actually to provide social protection to new workers, workers with low educational attainment and/or lack of experience, workers with less than one year of tenure, and unmarried workers (Wirahyoso, 2002, p. 78). In addition, it intended to protect workers from undesirable employers.

In some companies interviewed, the increase is the by the same margin across the board, thus rendering the hypothesis void that the minimum wage could decrease the wage gap between the highest paid and the lowest paid. These spillover effects, however, differed in terms of magnitude. In one firm the increase of other wages was the same in terms of nominal value. In another firm, the increases of other wages were progressive; meaning the increase in percentage terms was the same. In another firm, the increase only took effect for wages below the supervisor levels, whereas other wages did not increase, or only increased slightly.

⁹ The first firm even had an increase from 146 in 2000 and 2001 to 156 in 2002 (Interview, 2003). The second firm had a decrease in 2001 (from 55 to 47) but the number steadied in 2002. In both cases, the percentage of women workers appeared to increase slightly. No explanation was given, but a local trade union official said that there was a new phenomenon of firms who would rather hire female workers due to their perceived docility when it comes to trade union activity.

Furthermore, the Apindo official added that the minimum wage increase would also increase the price of local inputs, such as raw materials, and thus further increase production costs. They claimed that firms which provided raw materials must increase the price of their products because their labour cost also increased as a result of the minimum wage increase. The Bekasi chapter of Apindo stated this quite clearly (Interview A01, February 2003). They claimed that the effect of a minimum wage increase certainly affected the amount of contribution the firm had to make to Jamsostek¹⁰. Even though the workers mostly contribute to their own Jamsostek funds, some employers also pay part of, if not all, the funds.

Nonetheless, the views of officials in the employer association, most of whom were human resources managers, were based on a rigid neo-classical approach to minimum wages. This theory contends that under a fully competitive labour market, a significant increase in minimum wage levels would certainly cause a decline in the demand for workers. Observers generally maintained that the Indonesian labour market tends to be a competitive labour market (Suryahadi et al., 2003, p. 30). It seemed that there is also a perception among the members of the employers association, and also among human resource managers, that the Indonesian labour market was assumed to follow this neo-classical view. The officials in Bekasi, for instance, argued that an increase in the minimum wage would certainly create more unemployment. A Bekasi employer association official from the interview said:

Don't blame us if the increase in minimum wages causes more unemployment...now there are already an increase in crime in Bekasi. Even the so-called secure housing area could not avoid being robbed. Now, there are already a lot of unemployed people. This could mean that there will be an increase in crime. The government should think more about creating more jobs instead of losing them by imposing considerably higher minimum wage (Interview A01, February 2003).

The officials referred to the high increase in the minimum wage in 2002. They pointed to the fact that rising crime rates were attributed to the unemployed who had to fend for themselves and their families. Accordingly, they stated this view during the 2003

¹⁰ Jamsostek or the employment insurance is based on a percentage paid jointly by employers and workers. Some high tech companies paid the whole amount to the Jamsostek.

minimum wage setting in their district. They are of the opinion that the government should provide more jobs, rather than increase the minimum wage levels. Their argument appeared to have an effect on the Bekasi District wage council, as the increase in the nominal minimum wage was trivial compared to 2002.

When asked about the small impact of an increase in minimum wages to overall production cost, they argued that an increase in wages also has a spill-over effect on other labour costs, such as social security or Jamsostek funds. The contribution of employers to the fund is calculated based on a percentage of the employees wage (McLeod, 1993). In addition, they argued that the increase in wages also affected wages of employees from suppliers, which in turn would increase the price of raw materials. Eventually, all the changes in prices could affect the overall production cost of the firm.

Minimum Wages and Firm Closures

Even though in Chapter V many manufacturing firms were reported closed especially after the 1998 financial crisis, there was no indication that these closures were the result of increases in the minimum wage during the 1999-2002 periods. Unlike the impact of the minimum wage increases on current and future employment where respondents gave conflicting conclusions, all respondents agreed that increases in minimum wage did not directly cause firm closures. The researcher based this conclusion from opinions obtained from the interviews of government officials, trade unions and employers association. They all agreed that the crisis and other factors such as rises in fuel and electricity prices, as well as increased activity by trade unions were to blame for firm closures. Their view on the impact of minimum wage increases was mostly concerned with lay-offs, profitability of firms/increased cost, or relocation.

The researcher also visited two firms in the Jabotabek area which closed down prior to his visit. In both of these firms trade union activity was very strong and there were indications that union militancy was partly to blame for their demise. Another, perhaps more compelling reason, was the fact the demand for these firms' products decreased. Thus, decreasing demand, coupled by increased union militancy prompted the firms to close. A more detailed explanation of the closures is in Chapter IX of the thesis.

Minimum Wages and Labour Productivity

It would seem that there was difficulty in measuring the impact of minimum wage increases on labour productivity due to lack of data. A study by Timmer and Szirmai (1999) reported that from 1960 to 1993, labour productivity remained relatively low compared to countries such as South Korea and Taiwan. During the fieldwork the writer could not obtain any relevant data on the impact of minimum wage increases on productivity. However, the writer was able to obtain some indication from the interviews with managers and trade union officials.

The majority of the managers insisted that they would expect productivity to increase because minimum wages increased. However, other managers also contended that production does not depend on labour productivity, but rather on demand and the level of technology. This is true for the TGF industries because the amount of goods produced are based on the demand from overseas. If demand increased then firms would hire temporary workers to fill the gap in production and then they would shed these workers, if demand were low.

Nevertheless, Table 7.4 shows that the majority of respondents (15 of 24 or 62.5 percent) agreed that the increase in the minimum wage consequently increased labour productivity. Even in the TGF sector where productivity tended to be low, the majority of respondents said that increasing wages could increase productivity. The managers contended that complying with the minimum wage provision allowed workers to concentrate on working rather than striking. They expected workers to be more productive after receiving higher wage. The workers also tended to be more enthusiastic in working and resulting in less absenteeism at work.

Table 7.4 Effect of Minimum Wage Increase on Labour Productivity

Sub-sector	Medium		Large	
	Affected	Not Affected	Affected	Not Affected
TGF (Textile, Garment and Footwear)	3	2	8	3
Electronics and automotive parts	2	1	2	3
Total	5	3	10	6

Source: Fieldwork (2003)

Interviews from trade union officials revealed similar answers and also other opinions. Some Trade union officials said that the minimum wage is non-negotiable and should not be linked to labour productivity (Interview S12, April 2003). Workers are not under obligation to work harder and produce more goods if the minimum wage was increased. Other union officials contradicted this notion by saying that minimum wage compliance by firms could decrease absenteeism and would increase the workers' enthusiasm to work for the company (Interview S09, February 2003). In addition, the workers' sense of belonging in the firm would improve and they would be 'friendlier' towards management. This is important in terms of industrial relations and industrial peace. Workers would even be willing to work overtime to help firms meet production quota. The researcher found these relatively friendly relations in two of the five firms-level trade unions interviewed.

There was also evidence that some firms were planning to resort to new technologies to be more productive. Eight out of 16 large establishments (33 percent of total sample) were either planning to or already have new technologies in place to boost their output. All eight firms are either electronics or automotive parts firms. None of them admitted that the minimum wage increases caused them to switch to new technologies. Rather, they wanted to increase production in anticipation of increased overseas demand. However, one manager from an electronics firm insisted that they pursued new technologies to avoid antagonizing their workers (Interview 24, April 2003). The manager also added that they were training their workers for the required skills to use the new technology. The writer surmised that, based on the interview, they had to increase the minimum wage, but would want to increase productivity through new technologies. The fact that they were also training their existing workers in new skills

for the new technologies gives an indication the firm felt that increase in labour productivity can be achieved through technology and not an increase in the minimum wage.

There was also a charge from trade union officials that some employers are gradually replacing regular workers with irregular workers, i.e., outsourcing or fixed-term contract workers, even though regulations restricted the use of irregular workers. More than 70 per cent of the firms interviewed said that they use irregular workers. The writer found that most of the irregular workers were fixed-term contract workers in both the TGF and electronics and automotive sectors. Four firms in the Bandung district use casual workers who were paid on the daily basis. In addition, use of both fixed-term contracts and outsourced workers appeared to be on the increase. One worker (who was present when trade union officials were interviewed) explained that fixed-term contract workers have increased in the past year from 33 percent to 40 percent (Interview S13, April 2003). Indeed, irregular workers make up at least 30 percent of the workforce in the firms. However, the main reason for the increase of irregular workers has more to do with the activities of trade unions rather than increases in minimum wage levels (See Chapter IX). There was little evidence that the main reason for employing irregular workers was that they have higher productivity than regular workers.

Sectoral or Industrial Minimum Wages

One important finding during the field visit to West Java and, to a lesser extent Banten province, revealed the eagerness of trade unions to pursue sectoral or industrial minimum wages within manufacturing and within the province. It appeared that sectoral minimum wages have been pursued more in provinces that do not delegate district or city minimum wage fixing to the respective authorities. In North Sumatera, for instance, the governor approved the provincial and district/city minimum wage as well as the sectoral minimum wage, annually. Nonetheless, the sectoral or industrial minimum wage was applied mostly to sectors outside the manufacturing sector, such as construction and services. The sectoral minimum wage in Jakarta was thoroughly discussed in the wage commission, but was not applied in 2003. The issue of sectoral minimum wage in West Java, in particular Bekasi district, also appears to have been pursued in earnest by trade unions recently. The trade unions in Bekasi district

succeeded in convincing the wage council to apply the sectoral minimum wage to several sub sectors within manufacturing.

The issue of the sectoral district minimum wage in Jakarta and West Java was brought up by several trade unions, notably the SPLEM (Interview S02, February 2003) and SPMI (Interviews S12 & S13, April 2003). West Java, in particular, did not have sectoral minimum wages in 2001 and 2002, but were successful in forcing the sectoral minimum wage in sector 38, which includes metal products, electronics and automotive parts. They argued that workers in these sectors were more productive and more skilled. Therefore, they should receive a higher minimum wage level than their counterparts in the TGF sub-sectors. In any case, their wages were already higher than the mandated minimum wage and any implementation of the sectoral minimum wage should not upset firms. Indeed, increases in minimum wage levels did not appear to have had any significant negative impact, despite Apindo's argument that they did. In Bekasi district, trade unions were able to argue their case at the wage council and were accepted. The sectoral minimum wage in 2003 was set at five percent higher than the mandated minimum wage of that year. However, this decision was not without controversy in itself. The five percent difference only applied to firms which produce final products, such as television sets or audio sets. The five percent difference was not given to electronic firms which only produce intermediate products.

In the field, the writer visited one electronic firm which consisted of two plants (Interview S13, April 2003; Interview 24, April 2003). The two plants were actually under different company names, different management and different accounting systems. However, both produced products under the same license, a famous Japanese electronic giant. One plant, Plant A, was producing final product in the form of television sets. The other plant, Plant B, which was separated by a gate from Plant A, produced electronic components for the televisions. The latter supplied the components for the first firm, which then assembled the television sets. The trade union members of Plant A were interviewed collectively by the researcher. They explained that their neighboring trade unions in Plant B had received their wages at the current minimum wage level. However, workers in plant A received wages five percent higher than their counterparts in Plant B. This difference caused a lot of grumbling and dissatisfaction among workers in Plant B. Even though no strikes were observed and was not reported

by workers in Plant A, the interviewees did mention the grievance of workers in Plant B over the different minimum wage level.

Summary

Preliminary results show the negative impact of the minimum wage increases of 2001 and 2002 on employment. Nonetheless, the minimum wage increase cannot be blamed solely for the deteriorating business condition in Indonesia. Other factors, such as weakening international demand as well as domestic demand appeared to be the chief cause of employment lay-offs and the potential negative impact on the ability of firms to hire more workers in the future. In addition to the substantial increase in minimum wages in 2001 and 2002, there were also simultaneous increases in electricity and fuel prices resulting from the central government decision to decrease fuel and electricity subsidies, as well as additional levies from local government due to increased local autonomy. It is likely that the minimum wage policy, especially those related to the new decentralized minimum wage fixing in 2001 and 2002, did not significantly reduce overall employment. However, the minimum wage increase appeared to adversely affect future employment opportunities, especially in the TGF sector.

It also appeared that the amount of increases in regional minimum wages in 2001 and 2002 had worried businesses and the local government. Although it was claimed that wages in Indonesia was still competitive in the Southeast Asian region, even compared with Vietnam (*Kompas*, 2001d). Evidence showed that large increases during that period were designed to make up for falling real wages brought about by the crisis. The increase was also meant to bring minimum wages on par with the minimum subsistence need. Once the minimum wage levels are comparable to the minimum subsistence need, the government would be reluctant to approve such large increases. Subsequent nominal increases in 2003 and 2004 showed that the government is unlikely to repeat such increases and it will concentrate on preventing real wages falling. It also showed that the political dimension of the minimum wage policy played a crucial role in determining the level of increase and often overrode economic or social reasoning.

While the main reason for lay-offs in many firms, especially garment and footwear, was lack of orders, increases in minimum wage might have sped up the process.

Nevertheless, it is important to assure that minimum wages meet the minimum needs of workers, but at the same time they should not be set too high so as to depress businesses. Preventing the minimum wage level from falling would promote better industrial peace. Setting unsustainably high minimum wages would not only cause businesses to fail, but also be unfavorable for workers in the end. Failed businesses translate into mass lay-offs. The wage council, if it works properly and objectively as a tripartite institution, can avoid excessive increases in minimum wage levels in the future. There is also hope that improved tripartite and bipartite relations in wage setting, whether it is regarding minimum wages or firm wages, can be a catalyst for other negotiations, especially with the proposed industrial relations bill already passed as law in early 2004¹¹.

Some analysts proposed a flexible wage system to solve the problem of unemployment (*The Jakarta Post*, 2002). They argued that the current minimum wage system is so rigid that investors have been reluctant to commit new investments to Indonesia, which consequently prevented the creation of new jobs. Current employers are also reluctant to hire more workers due to the minimum wage increases. Furthermore, new investments that do come to Indonesia are more capital-intensive, such as the higher paid electronics components and IT sector that require semi-skilled to high-skilled workers. In contrast, most Indonesian workers are still unskilled. Nonetheless, leaving wage determination entirely to the market or regional market might decrease the quality of jobs provided, and thus might harm existing workers and potential workers. I argue that the minimum wage could still be used in the realm of flexible wage policy. If the minimum wage fixing machinery can be applied as some had intended to be, i.e., a safety net wage. To quote one of the trade union leader: “UMP dipakai sebagai acuan untuk negosiasi - the regional minimum wage could be used as a base for negotiation at firm level” (Interview S01, February 2003). Collective bargaining could then be properly applied to negotiate wages at firm level, and thus apply the flexible wage policy indirectly.

In addition, the minimum wage provision could actually be a blessing in disguise for other provinces. The fieldwork and other sources of information show that while firms were still considering relocation, some have eyed other provinces, such as Central Java

¹¹ However, it appears that the new government has delayed the implementation of the law until 2006.

or South Sumatera as possible new locations. Firms who felt that increases in the minimum wage are too high in West Java and Jakarta might choose to relocate to other provinces with lower wage levels. Provinces struggling with generating their own income could find ways to entice firms to come to their provinces with incentives such as tax breaks or easier permits. In addition, labour mobility could also be improved and decentralized to avoid urbanization in certain areas. Local governments could also ensure better industrial relations by imposing better labour conditions to avoid costly labour disputes. If other provinces could learn from the decentralisation of minimum wage fixing, then they could also learn from the mistakes in labour policy experienced by West Java and Jakarta.

A favorable outcome of the minimum wage fixing mechanism at the local level in West Java may have implications on minimum wage fixing elsewhere in the archipelago. Already other provinces, such as Central Java and East Java are already considering joining West Java in using localized minimum wage fixing at district and city level. These provinces have effectively eliminated the use of provincial minimum wage and concentrate on district/city minimum wage¹². Banten, a new province, had already done so due to its pre-inclusion to the West Java province prior to decentralisation. The successful process of the West Java minimum wage fixing machinery could have an impact on union activities and minimum wage fixing in other locales throughout the archipelago.

Unfortunately, the nature of the antagonistic relationship between labour and employer, as well as the government, created differences in opinions on the impact of decentralized minimum wage fixing. On one hand, employers were convinced that increases in the minimum wage, especially during the 2001-2002 period, were not good for businesses. Although, they also explained that other factors also affected their decisions to sack workers. On the other hand, trade unions claimed that wages are only a fraction of the production cost of the firms. Thus, increasing the minimum wage significantly would not damage the firms' profitability. The government was diplomatic

¹² The provincial minimum wage, obtained from the lowest minimum wage level among the districts is still being officially recorded. However, it is practically useless in terms of minimum wage levels in the districts/city.

in their argument, saying that everything should be negotiated properly. It would seem that the government was trying to balance the needs of both sides.

Eventually, objective assessment is needed to support the opinions various parties. The interviews and questionnaires did not provide clear objective quantitative results on the minimum wage impact. The data obtained from the interviews and questionnaires did provide sufficient data to make an assessment on the employment impact of minimum wage increases in 2001 and 2002. The researcher felt the need to provide further analysis to support the results of the fieldwork, as well as answer the second objective of the thesis. The next chapter measures the impact of minimum wage increases using data obtained from establishment surveys.

Chapter VIII

Analysis of the Employment Impact of The Minimum Wage Policy Based on Secondary Data Sources

Introduction

The central contention of the minimum wage policy debate is its impact on employment. The neo-classical economic theory argues that an increase in minimum wages has a negative impact on employment. Chapter III already explained the argument, as well as the empirical studies which support and challenge the neo-classical view. Chapter III also argued that most empirical studies concerning developing countries appear to support the neo-classical view, due to the argument that developing countries have an oversupply of cheap labour. This chapter brings the argument again into focus as it aims to assess the employment impact of the minimum wage increases of 2001 and 2002 in Indonesia. Basically, the objective is to find out whether increases in wages, during the start of the decentralization process, have had a negative impact on employment.

As explained in Chapter V, empirical studies on the employment effects of the minimum wage policy in Indonesia had mostly been conducted before the decentralization process, and thus used pre-2000 data. Studies by Rama (1996 and 2001) used panel data evidence from the Annual Manufacturing Survey during the early 1990s. Another study by Alatas and Cameron (2002) employed the difference-in-difference method using 1990 and 1996 data from the Large and Medium Manufacturing Survey. SMERU (2001) and Suryahadi et al. (2003) also used panel data evidence using pre-2000 data from the Annual Manpower Survey. Previous studies only took into account inter-province effects of the minimum wage policy. As explained in Chapter V, the minimum wage fixing has been complicated by the decentralization process, where minimum wage fixing was delegated to district/city level. Thus, it would be appropriate to conduct inter-district/city analysis. For the purpose of this thesis, only the short-term impact of minimum wage increases on employment can be measured. The reason for not using panel data evidence was due to the limited data available.

Effectively, the writer only had 2000-2002 data available for the analysis. Data for 2003 onwards is either not yet available or incomplete.

There are three major reasons why choosing 2001 and 2002, as the analysis years, is important: Firstly, the minimum wage increases were quite large in 2001 and 2002, compared to previous and subsequent years (See Chapter V). Secondly, the decentralization of government functions to local authority started in 2000, after Law Number 22 1999 was approved by the House of Representatives. The minimum wage setting, which was delegated to provincial authorities, started in 2001. However, in West Java's context, the governor further delegated the authority to set minimum wages to district/city authorities in 2002. Thirdly, trade unions, through the ratification of ILO Convention Number 87 on Freedom of Association, were allowed greater participation in minimum wage setting at local level.

Unlike the qualitative analysis, the quantitative analysis of secondary data is limited to estimating the employment impact of the minimum wage policy. In Chapter VII, it was explained that the main reason for increasing minimum wages significantly in 2001 and 2002 was to bring the minimum wage level at par with the minimum subsistence need, which was supposed to start in 1997 (Simanjuntak, 1995). The Asian economic crisis, which started in 1997 and affected Indonesia in 1998, caused real wages to fall significantly in 1998 and the government felt obliged to adjust wages to workers' basic needs (Interview G01, February 2003).

The analysis in this chapter employs several methods. The first used is the regression model employed by Card and Krueger (1995). The regression model was applied to the Investment and Productivity Survey (2003) data¹. The strength of the data set is the existence of trade union and minimum wage compliance variables, as control variables for use in the regression model. Trade unions are known as strong supporters of the minimum wage policy and often monitor compliance. Their presence could increase the employment effects of the minimum wage changes. The second method used is the two-stage least squares regression method (2SLS). The data used in the estimation is the

¹ The survey is a World Bank (2003) and Asian Development Bank funded survey conducted by Statistics Indonesia. The writer was able to participate in the pilot survey and obtain permission to use the raw data.

2000-2002 Annual Large and Medium Manufacturing data. The third method used is the so-called BGDC method, based on the quasi-elasticity concept, where birth and death of firms affect employment in general². With respect to the BGDC method, data was obtained from the manufacturing directory. In addition to these methods, analysis using tabular format, based on the Productivity and Investment Survey (2003), is also presented.

Data Sources

The data used in the analysis are comprised of several types of secondary data from Statistics Indonesia, but they originated from the same sampling frame. The data included in the analysis consist of:

1. *The Productivity and Investment Climate Survey* – This was a one-off survey conducted by Statistics Indonesia and funded by the Asian Development Bank and the World Bank. The sample was randomly selected from the Directory of Large and Medium Manufacturing firms in 10 provinces. The survey collected data for years 2000 to 2003. Some information from the survey is used in this analysis, including minimum wage compliance and trade union density. The survey focused on the problems which hinder investment growth in Indonesia and included problems associated with labour issues and policies. However, the writer was mainly concerned with the manpower section of the survey, especially that concerning wages and trade union activity. The writer found the data in this survey were important as they included trade union and minimum wage compliance data which were used in this analysis as control variables. These variables are not available from other data sets and they were not included in previous studies. The data from the survey were used for the first regression model and they are also presented descriptively.
2. *The Large and Medium Manufacturing Firm Directory* – This is a continually updated data set of all large and medium manufacturing establishments in Indonesia. This directory is used as a frame for the Annual Large and Medium Manufacturing survey, stated in number three below. It

² BGDC, as explained in Chapter VI, refers to birth, growth, death and contraction of manufacturing firm size of employment.

also lists establishments that are temporarily non-active and establishments that have downsized from medium or large to small. This data is used in the analysis using the BGDC calculation. Although the directory is the most up to date and complete, in terms of the number of firms, it is also the weakest in terms of reliability and consistency of data because it was designed as a sampling frame and not for analysis and publication. Thus, the data did not experience rigorous editing like those of the annual survey. At best, the data are only sufficient as an indicator of changes in the number of establishments and workers.

3. *The Large and Medium Manufacturing Data* – These data were obtained from the Annual Large and Medium Survey. This survey is a census of all active large and medium manufacturing firms listed in the Directory. The data is available from 1975 (currently stands around 20,000 firms in 2003). This data set is the most reliable because it collects data from all large and medium manufacturing firms in Indonesia. However, the data have a lag of two years in terms of publication. Thus, the most recent available data are for 2002. The data were used for the regression analysis.
4. *The Quarterly Wage Survey* – A period survey collecting data of manufacturing, hotel and mining firms, on wages below supervisor level only. The limited sample for the manufacturing firms is randomly drawn from the Directory of Large and Medium Manufacturing. The data are available up to 2003. In this Chapter, the wage data were used as instrumental variables in the 2SLS regression.
5. *Minimum wage data* – Minimum wage data were obtained from the Ministry of Manpower and Transmigration, and the local Manpower Office documents. Some data were available from the Ministry website and some had to be obtained through photocopying documents at the main office. Minimum wages at district/city level were used as instrumental variables in the 2SLS estimates.

For the purpose of this thesis only, establishments in manufacturing firms in West Java and Jakarta were used in the analysis. The data on these establishments contains average wages of production worker below the rank of supervisor, a good approximation of low

wage employment. The writer hoped to corroborate the results of the data analysis with the fieldwork results obtained in Chapter VII.

Characteristics of the Productivity and Investment Survey Data

The Productivity and Investment Climate Survey (2003) was conducted during the same time that the fieldwork was conducted. However, the survey continued up to the end of 2003, while the researcher completed the fieldwork in June 2003. The researcher was fortunate to be involved with the questionnaire design and the pilot study of this survey. The full dataset, in which the response rate was more than 70 percent, as obtained in October 2004. Late responses, which delayed data processing, were the main cause of the delay in delivery of data that was expected to be available in early 2004. The writer was able to pilot test the questionnaire in a textile firm in Bandung. Although the survey was independent of the fieldwork, it helped to corroborate its results.

The response rate of the survey was 71.3 percent (713 respondents out of 1000 targeted). Of the 1000 establishments in the sample, 713 establishments returned part 1 and part 2 of the questionnaire. Distribution of respondents is shown in Table 8.1. The majority of the respondents were located in the industrial areas of Java, notably the Jabotabek region, comprising Jakarta and its periphery districts of West Java and Banten. As explained in the previous chapters, West Java and Banten border Jakarta in the South and several districts within the provinces, such as Tangerang, Bekasi and Bogor, are located just outside Jakarta, where most manufacturing industries are concentrated. The analysis included the rest of the provinces in the survey, but the focus was on the three main provinces. In addition, Banten was included in the West Java analysis because that province was part of West Java, prior to 2001, and much of its industrial relations legal processes were still conducted in Bandung, the capital of West Java.

Table 8.1 Distribution of Respondents by Province, ISIC and Firm Size

Province\ISIC	31		32		33		34		35		37		38		Total
	M	L	M	L	M	L	M	L	M	L	M	L	M	L	
North Sumatera	6	10	1	0	3	3	2	1	4	4	0	1	0	1	36
Riau	0	0	0	0	0	0	0	0	0	0	0	0	2	21	23
Jakarta	11	6	36	37	3	1	6	1	10	11	1	0	4	8	135
West Java	15	7	61	90	1	1	1	1	8	2	0	0	7	8	202
Central Java	7	3	3	13	1	1	1	1	3	1	0	0	0	0	34
Jogyakarta	4	2	1	1	1	0	0	0	0	0	0	0	0	0	9
East java	27	18	27	11	5	10	2	3	9	10	1	0	4	5	132
Banten	6	5	12	33	2	3	3	3	11	4	0	0	5	4	91
Bali	1	1	10	2	2	0	0	0	0	0	0	0	1	0	17
East Kalimantan	4	2	0	0	1	4	0	0	0	1	0	0	2	1	15
South Sulawesi	5	2	1	0	3	2	0	0	0	0	0	0	0	0	13
Total	86	56	152	187	22	25	15	10	45	33	2	1	26	47	713

Source: Statistics Indonesia, the Productivity and Investment Climate Survey (2003)

Notes: M – Medium firms

L – Large firms³

Number of respondents based on questionnaire part II

ISIC Description: 31 – Food, beverages and tobacco

32 – Textile, Garment, Footwear and Leather products

33 – Wood, plywood and wood products

34 – Printing

35 – Chemicals and chemical products

37 – Basic steel

38 – Metal products, automotive and electronic components⁴.

The main concern arising from the survey response rate is that those firms, which did not respond, might be the firms that did not comply with the minimum wage law or those that did not allow the presence of unions. Nonetheless, the data might be sufficient to describe the development of labour unions and the minimum wage compliance across regions and sectors due to the relatively high response rate.

³ Size of firms, under the Statistics Indonesia definition, is determined by the number of employees. Large firms are defined as firms having 100 or more persons engaged in production. Medium firms are defined as firms having between 20 to 99 persons engaged in production. In other government institutions, large and medium firms are defined as firms having start-up capital of more than five billion rupiahs. Thus, under this definition, some medium or even large firms under the Statistics Indonesia definition may be considered small under the start-up capital definition. The researcher found evidence in the field of 'small' firms, but with more than 50 workers working in different shifts.

⁴ ISIC code refers to the International Standard Industrial Classification version 2, a classification of economic sectors in which codes beginning with three mean manufacturing industries. The latest version, version 3, mixed the codes according to raw materials. Thus, for the purpose of this thesis, version 2 of the ISIC was used to allow for better description.

Minimum Wage Compliance and Trade Union Density

Based on the survey, there was a high degree of minimum wage compliance in general. Table 8.2 shows that minimum wage compliance was quite high across all sectors. In Sectors 32 and 38, which the analysis is focusing on, there appears to have been a sufficiently high level of compliance - between 88 to 100 percent, respectively. It is not difficult to understand since firms in sector 38 are mostly large, capital intensive and FDI firms which are able to pay high wages. This was also confirmed by fieldwork in three electronics and two automotive parts firms in the Bekasi and Tangerang areas. However, between these two sub-sectors, sector 32 had the lowest compliance, due to the characteristics of firms within that sector. This sector includes the TGF labour intensive industries. Nevertheless, the relatively high compliance could mean that the minimum wage policy was being enforced during the survey period.

On the other hand, trade union acceptance by manufacturing firms appeared to be lower than minimum wage acceptance. Table 8.2 shows that firms were almost evenly split concerning the acceptance of trade unions with only 53.58 percent of the sample having trade unions in their companies. The fieldwork revealed that employers who could afford to pay high wages preferred complying to the minimum wage provision, but were less inclined to accept the presence of independent trade unions for fear of escalating industrial conflicts. One human resource manager pointed out that industrial conflict is more costly than compliance with the minimum wage (Interview 07, March 2003). Indeed, experience in Indonesia shows that many production hours have been lost as a result of strikes (see Table 4.9 in Chapter IV). Data on union density suggest that trade unionism is still developing and that trade unions could still recruit new members. A trade union official estimated that only about 25 percent of businesses in Indonesia have firm-level trade unions (Interview S09, February 2003). The resistance of firms to accepting any trade union might also be a factor in hampering the progress of trade union expansion.

Table 8.2 Percentage of Minimum Wage Compliance, Union Density in West Java And Jakarta, by 2 Digit ISIC in 2002

2 Digit ISIC	Total	West Java (Banten included)	Jakarta
Minimum Wage Compliance			
32	89.9	88.7	95.7
38	98.6	95.8	100.0
Total	91.9	90.4	94.0
Union Density by Sector			
32	54.7	66.0	45.7
38	64.9	64.0	63.6
Total	53.6	60.3	43.9
Union Density Per firm			
32	84.0		
38	54.7		
Total	77.6		

Source: The Productivity and Investment Climate Survey (2003)

Notes: - Union density by sector is defined as the percentage of firms where trade unions existed within the sub-sector.

- Union density per firm is defined as the percentage of workers belonging to trade unions per firm.

Union density per firm appeared to show the resistance of employers/managers in some sectors of accepting trade unions. Table 8.2 shows that in sector 38 union density per firm was much lower than industry average, 54.7 percent compared to 77.6 percent for all samples. The reason could not be explained from the secondary data. However, the fieldwork revealed that electronic firms (included those in sector 38) often employ outsourced workers or fixed-contract workers. In one electronic firm, more than one third of production workers were fixed-contract workers (Interview S13, April 2003). As these workers are normally not members of trade unions, it made sense why union density in sector 38 was quite low, compared with the national average and sector 32. It also made sense that the relatively high union density in sector 32 meant a strong support for the minimum wage provision. As also noted in the next chapter, some managers out-rightly rejected the existence of trade unions for fear of labour unrest. Some managers preferred non-trade union employee associations (mostly for social purposes and not collective bargaining), firm-level trade unions with no outside

affiliation, or SPSI affiliated trade unions which were considered friendlier towards management than independent trade unions.

One anomalous result obtained from the data resulted from a question concerning a firm's exemption if they were unable to pay the minimum wage. Less than one percent of the respondents had exemptions, despite the fact that many firms expressed their concern over the minimum wage increases. The result was corroborated by an interview with a government official in Bandung District (Interview G06, March 2003). He said that only four firms, out of several hundred firms within the district, even asked for an exemption in 2002. Even more surprising was that he also said that no firms had asked for exemptions in 2001. A likely explanation, according to the official, was that the system of decentralized minimum wage fixing was not properly in place and firms were not yet aware of the option to apply for exemptions. Nevertheless, it did not explain why only four firms applied in 2002, when the official also stressed that many firms in Bandung were known to pay workers less than the minimum wage.

Labour Demand

Table 8.3 shows the number of vacancies for skilled and unskilled workers in manufacturing firms in 2001 and 2002. Vacancies are used as an indicator of labour demand in large and medium manufacturing firms in Indonesia. The vacancy rates for unskilled workers had declined between 2001 and 2002. Vacancies in sector 32 and 38, where the bulk of manufacturing workers were employed, had significantly declined by 20.2 and 40.6 per cent, respectively. If this condition was similar in 2000, then unskilled workers have been the ones suffering as a result of any detrimental effects of labour policies, such as the minimum wage provisions. In addition, the increasing activity of trade unions may also have prompted firms to shed unskilled permanent workers and hire more flexible workers, such as fixed-term contract workers and temporary workers, as well as using outsourced workers.

Table 8.3 Number of Vacancies by type of Permanent Workers and 2-digit ISIC

2 Digit ISIC	Skilled			Unskilled		
	2001	2002	Change (%)	2001	2002	Change (%)
31	170	180	5.9	836	746	-10.8
32	4849	4801	-1.0	3304	2750	-16.8
33	12	17	41.7	70	130	85.8
34	10	3	-70.0	182	83	-54.4
35	35	55	57.1	467	424	-9.2
38	2140	2559	19.6	894	636	-28.9
Total	7216	7615	5.5	5753	4769	-17.1

Source: The Productivity and Investment Survey (2003)

Notes: - Skilled workers, in the context of the survey, refer to workers in manufacturing firms who had undergone more than three months of training.
 - Unskilled workers are those who had 3 months or less training.

Skilled workers did not experience the same decline in vacancies as unskilled workers. Table 8.3 shows that, overall, there was even a slight increase of vacancies (5.5 per cent) from 2001 to 2002. Even better, sector 38 showed a more significant increase of 19.6 percent. It may indicate that sector 38 (which includes electronic and automotive assembling), is shifting to much more capital-intensive electronics manufacturing, rather than simply assembling⁵. This view was supported by the fact that a large Japanese electronic company (Matsushita) was planning to make Indonesia the centre of its electronic manufacturing venture (Interview S12, April 2003).

In addition, non-regular workers, or temporary time workers, experienced a large increase in employment during 2000 and 2002⁶. Table 8.4 shows that overall the number of non-regular employees had significantly increased from 2000 to 2002, especially from 2001 to 2002. Sector 32 (TGF) shows steady increases from 2000 to 2001 and from 2001 to 2002, showing the tendency for more usage of flexible labour. The bulk of the increase, especially in 2002, was female workers who worked in the

⁵ This is called the *capital-skilled labour complementarity* described by Griliches (1969). He found that the degree of substitution between capital and skilled labour is lower than between capital and unskilled labour, meaning that where capital is needed, skilled labour is also needed.

⁶ Based on the definition used in the Productivity and Investment Climate Survey, temporary or non-permanent worker refers to workers employed by manufacturing firms for 1 year or less with no guarantee of renewal of contract. Many temporary workers were fixed contract workers or outsourced workers belonging to vendors of employment providers. Prior to the New Employment Law Number 13, firms could outsource even their core production workers. The new law prohibits outsourcing of core employees. Nevertheless, some unions were still concerned that regardless of the new law, firms would still outsource their core workers.

textile and garment industries. In contrast, the number of non-regular workers in sector 38 declined in 2001, but had a slight decrease in 2002. The number of non-regular female workers declined in both 2001 and 2002. Additional workers seemed to be male workers, contrary to claims by trade unions that firms tended to hire more female workers rather than male workers, due to their perceived docility towards labour militancy (Interview S09, February 2003).

The significant increase of non-permanent workers provides an indication of the predicament faced by unskilled workers. Non-permanent workers are also non-unionized and are not covered by collective agreements, and receive less benefits than permanent workers. Skilled workers normally have no problem because their services are in demand, their wages tend to be higher than the minimum wage level, and they can be persuaded with higher pay not to join the union. Could this mean that there is a tendency for firms to move towards flexibility of labour as many pundits of anti-globalisation have claimed?

Table 8.4 Number of Temporary Workers by 2-digit ISIC, 2000-2002

2 Digit ISIC Description	Year			Difference	
	2000	2001	2002	2001-2000	2002-2001
Total employment					
31	5861	6272	6076	411	-196
32	5320	6322	7692	1002	1370
33	392	521	468	129	-53
34	230	437	792	207	355
35	3897	4654	4528	757	-126
37	0	0	0	0	0
38	6963	5075	5822	-1888	747
Total	22663	23281	25378	618	2097
Number of Female Employees					
31	3453	3582	3646	129	64
32	4244	4839	6029	595	1190
33	75	94	95	19	1
34	85	155	229	70	74
35	1321	2206	2230	885	24
37	0	0	0	0	0
38	4285	3313	2999	-972	-314
Total	13463	14189	15228	726	1039

Source: The Productivity and Investment Climate Survey (2003)

Table 8.5 shows that the percentage employment change from 2001 to 2002 was large in West Java, particularly for sector 32 and for unskilled workers, compared to Indonesia. It is important to note that the adverse employment change was more prominent for unskilled workers. With the exception of sector 38, unskilled workers experienced a marked decrease from 2001 to 2002. The biggest decrease of approximately 12 percent was in sector 32. The figures clearly show that, during the period of significant increases in minimum wages, there were employment losses in many firms, notably in the TGF sectors. Although it cannot be ascertained whether the increase in the minimum wage was a major factor in employment losses, observers said that minimum wage increases and other labour problems accelerated the decline of businesses in these sectors (*Bharatextile*, 2001).

Table 8.5 Permanent Employment Change from 2001 to 2002 by Level of Occupation and Area (in percent)

Region and category	Level of Occupation			
	Management	Professional	Skilled Production	Unskilled Production
All Provinces	1.6	7.7	1.0	-5.0
All Provinces (Minimum wage compliance)	1.6	7.7	0.9	-5.0
West Java	-4.6	4.5	-8.3	-10.9
West Java (Minimum Wage Compliance)	-4.7	4.5	-8.5	-11.0
West Java – Sector 32	-6.0	4.4	-10.2	-11.9
West Java – Sector 38	7.9	5.0	-6.1	1.4
West Java – Sector 32 (Minimum wage compliance)	-6.0	4.4	-10.3	-12.0
West Java – Sector 38 (Minimum wage compliance)	7.9	5.0	-6.1	1.4

Source: Productivity and Investment Survey (2003)

Notes: Minimum wage compliance - those firms who complied with the minimum wage regulations.

Sector 32 – ISIC code for manufacturing sector consisting of textiles, garment, leather and footwear firms.

Sector 38 – ISIC code consisting of metal products, electronics and automotive components.

Unskilled workers in West Java, mainly in sector 32, seemed to bear the brunt of the decrease in employment. In West Java as a whole there was approximately an 11 percent drop of unskilled employment from 2001 to 2002. Most of the decrease came from sector 32. Skilled workers in this sector also declined by more than 10 percent during the same periods. It may indicate that all full time workers were under threat of lay-offs for some reason. Sector 38 also experienced a drop in skilled workers, but not unskilled workers. The main reason for this is that the majority of workers (about 80 percent) in this sector consisted of skilled and semi-skilled workers rather than unskilled workers.

The figures were not significantly different when differentiated between those firms that complied with the minimum wage regulation and the total. This could mean that employment changes from 2001 to 2002 have not been significantly affected by the rise of minimum wages, but rather they have been affected by other employment issues such

as the rise of union activity. This view was supported by the fieldwork. The majority of the employers/managers interviewed expressed concern about both increases in minimum wages and the threat of increases in union activity. However, the researcher received the impression that firms would rather pay minimum wages than face the union threat. There were several indicators that led the researcher to this conclusion. The first was that firms which could pay high wages tended to pay workers the agreed minimum wages or even above it. However, receiving this high wage came at the expense of workers not being allowed to join or set up their own labour union. Some firms even encouraged workers to choose between higher wages or joining a union. Firms who did accept the establishment of unions preferred the old system of unions where only the SPSI was present. They were wary of independent unions mainly because they were perceived to be militant. Evidence from the interviews, and further substantiated by news reports, showed that there were instances where the entire leadership of a firm-level trade union was fired.

OLS Estimates of Labour Demand using the Productivity and Investment Survey Data

The writer also used Ordinary Least Squares regression (OLS) to estimate the effect of minimum wage level increases during the 2001-2002 period. The model is as follows:

$$\Delta \log E_{it} = a + b \Delta \log W_{it} + WJ_{it} + D + v_{it}, \quad (8.1)$$

where $\log \Delta E_{it}$ refers to the log of employment (permanent or temporary) change in West Java and Jakarta for firm i between year $t-1$ and t (or between $t-2$ and t), $\log \Delta W_{it}$ refers to the log of change in real wages in West Java for firm i between year $t-1$ and t , WJ_{it} refers to the West Java dummy, D is a set of dummy variables, and v_{it} is an error term to account for industry, year specific and other unaccounted shocks. Dummy variables included in the estimates were, union presence (Union, ISIC 32 (ISIC32), ISIC 38 (ISIC38), foreign ownership (Foreign), export orientation (Export), and size of plant (Size). Trade unions are said to be the staunchest supporters of the minimum wage policy. Their presence is hypothesized to increase wages. Employment is divided into

full-time employment and temporary employment⁷. The minimum wage and union dummies represent labour standards. The use of the West Java dummy is because it is the only province in which minimum wage setting was decentralized to district/city level in 2002⁸. ISIC32 and ISIC38 dummies represent labour-intensive and capital-intensive sectors. Foreign and export dummies represent global economic integration and size dummy represents size of establishment. Smaller firms are less likely to pay minimum wages than large firms (Kim and Taylor, 1995). The consumer price index (CPI) of West Java, with 1996 as base year, was used as a deflator for real wages.

Diagnostics

The main problem with the estimates was that the data suffers from outlying observations or outliers that render the estimates insignificant. It was decided to investigate the outliers and omit them from the calculation if they could not be edited. Influence diagnostics which utilizes the studentized residuals method was used to detect and delete these outliers (Kennedy, 2003, p. 379). For full-time employees, there were three outliers for 2000-2001, two outliers for 2000-2002 and one outlier for 2001-2002. For the temporary employees there were one outlier from the 2000-2001, one outlier for 2001-2002, and two outliers for 2000-2002.

Other diagnostics tests were also performed on the regression estimates. The Chow test was used to test the significance of the dummy variables in affecting employment (SAS, 1990a, p. 80). It revealed that foreign ownership and union presence dummies had significant effects on full-time employment for the 2000-2001 estimates. However, none of the dummies in the part-time employment regression were statistically significant, except for the 2000-2001 period where the ISIC 32 dummy did have a significant effect. The White test was used to test whether the homoskedastic (constant variance) assumption was violated by the model, in which case there is a problem of heteroskedasticity (SAS, 1990a, p. 62). The test revealed that heteroskedasticity did not appear to be a problem in any of the regressions.

⁷ Temporary or part time workers, based on the Productivity and Investment Survey concept, refers to a person working for less than a year with no guarantee of contract renewal (World Bank, 2003).

⁸ The new province, Banten, also followed this method in 2002. However, for the purpose of the analysis, the writer assumed the province was part of West Java because its industrial relations dispute resolution was still integrated with that of West Java. Moreover, Banten was still part of West Java in 2001 (and included in the calculation for 2002 as part of West Java).

Results of the Regression

The model predicts a negative elasticity of wage on permanent employment, consistent with the standard model of labour demand, for both the 2000-2001 and 2001-2002 periods. Table 8.6 shows that for full-time employment the wage elasticity in 2000-2001 was almost -0.44, meaning that a 10 percent increase in real wages would result in a four percent drop in employment. The West Java dummy for 2001 shows a small negative coefficient, meaning that changes in the wage level affected employment in West Java more than that of Jakarta. The positive coefficient for foreign ownership means, that in 2001, foreign owned-firms were correlated with an increase in employment.

Likewise, the estimate of full time employment for 2001-2002 shows a small negative employment effect. Table 8.6 shows that the coefficient for the 2001-2002 period was -0.04, meaning that a ten percent increase in real wages caused a 0.4 percent fall in employment. The elasticity is much smaller than that of the 2000-2001 period. The small negative coefficient is puzzling because minimum wage increases were higher in 2001-2002 than in 2000-2001. Even when the period was extended to 2000-2002, the coefficient did not change significantly. Moreover, table 8.6 shows that the estimate for 2001-2002 had a much lower R^2 than that of 2000-2001. For the 2000-2001 estimates, the R^2 is almost 50 percent meaning that 50 percent of the variation of $\Delta \log E_{it}$ is explained by the model, whereas the 2001-2002 estimate was only 5 per cent.

It could be that the delay in implementing the 2002 minimum wages in West Java caused by court action made it unlikely that the effect occurred in 2002. The results of the interviews shown in Chapter VII reflected this view. Employer association officials in Bekasi District, West Java, were concerned about the 2002 minimum wage increase affecting employment in 2003 (Interview A01, February 2003). Based on these arguments, minimum wage compliance did not appear to be a significant variable in affecting employment in the short term. A similar regression, using 2002-2003 data, might reveal the true extent of the minimum wage increase. Thus, based on the results, and the unavailability of 2003 data, the writer could not conclude that minimum wage increases were affecting employment.

On the other hand, Table 8.6 shows significantly positive coefficients of the effect of wages on part-time employment in both the 2000-2001 and 2001-2002 periods. This means, increases in average wages appear to have increased part-time employment significantly. The coefficient values show an opposite effect compared to full-time employment. Sector 32 appears to have a negative effect on temporary employment in the 2000-2001 periods, leading the writer to conclude that sector 32 (the bulk of it being the TGF sector) were the losers of any large minimum wage increases. However, not one of the dummy variables had any significant effect in the 2001-2002 periods. The writer surmises that there is a substitution effect of temporary employment or full-time employment, particularly in sector 38 in 2001, when minimum wages were increased significantly. Although the dummy variable for foreign-owned firms shows no significant effect, sector 38 tends to have many foreign-owned firms, especially in the electronics and automotive sectors. The reason for the positive elasticity for part-time employment, might have to do with more than just wages. The fieldwork revealed that foreign-owned firms, especially those engaged in electronics and automotive products, have been substituting temporary workers for full time or permanent workers. Flexible work, arguably a product of increasing global competition, appears to be becoming more and more common in manufacturing firms in developing countries such as Indonesia. Flexible workers are known to receive fewer benefits than full-time workers, and are normally not members of trade unions.

Table 8.6 OLS Estimates of Change in Full-time and Part-time Employment: dependent variable $\Delta \log E_{it}$

Description	Specification					
	Full Time Employment			Part Time Employment		
	2000-2001	2001-2002	2000-2002	2000-2001	2001-2002	2000-2002
	(1)	(2)	(3)	(4)	(5)	(6)
Intercept	0.12 (0.03)	0.04 (0.02)	0.14 (0.04)	0.10 (0.06)	0.07 (0.07)	-0.02 (0.09)
Wage	-0.44 (0.04)	-0.04 (0.02)	-0.16 (0.04)	0.28 (0.09)	0.12 (0.12)	0.24 (0.12)
Minimum wage (Dummy)	No	No	No	No	No	No
Union (Dummy)	0.06 (0.02)	No	No	No	No	No
ISIC32 (Dummy)	No	-0.05 (0.02)	-0.08 (0.04)	-0.16 (0.09)	No	No
West Java (Dummy)	-0.06 (0.02)	No	-0.06 (0.03)	No	No	No
Foreign (Dummy)	0.10 (0.03)	No	0.01 (0.05)	No	No	No
R ²	0.48	0.05	0.13	0.29	0.02	0.09
N	204	229	207	43	50	43

Notes: Standard errors are in parentheses. All estimates are at 5 percent level of significance (two-sided test). Differences in N (number of observations) reflect matching observations for each period and omitted outliers. Some firms which existed in the 2001-2002 period might not yet have existed in the 2000-2001 period. The minimum wage variable as a control variable is included in the calculation, but turned out to be statistically insignificant for all estimates. Estimates for 2000-2001 for both full-time and part time employment are stronger as explained by the much higher R² than the other estimates. Other dummies (Export orientation, Sector 38 and firm size) were also included in the estimates, but were found to be statistically insignificant.

The writer also attempted to use lagged wages (t-1) to calculate the effects on employment at time t. The 2001-2002 employment change (Full time employment) was regressed on 2000-2001 wages. The notion was that the effect of the 2001 minimum wage increases was felt in 2002. However, the result was not statistically significant and it even showed a positive elasticity of 0.105 (with standard error of 0.037). A more convincing result might have been obtained for the 2002 minimum wage increase if data for 2003 had been made available. Thus, the issue was not pursued further and the estimates are not presented in the table.

Therefore, the results in Table 8.6 mean that it is likely that increases in minimum wages could make the situation worse for trade unions, who are trying to increase membership and establish better firm level bargaining. Decline in full-time employment and an increase in flexible employment meant that trade unions could lose members and potential members to flexible workers who are likely to be non-members, due to the nature of their work arrangements. As an example, an interview with an electronics company in Bekasi, West Java revealed an increasing number of non-union flexible workers (part-time, fixed-contract or outsourced workers) working alongside full-time workers (Interview S13, April 2003). Even with the government re-regulating the use of flexible employment and minimum wage fixing, through new labour legislation⁹, it appears that trade unions could be losing ground, just as their predecessors in developed countries such as the United States, did (Martin and Schumann, 1997; Clawson and Clawson, 1999).

To sum up, the OLS estimates provide empirical support for the view that increases in wages were responsible for the decreases in full-time employment, even though it is unclear, based on the empirical evidence, whether the increases in minimum wage levels was a major factor in average wage increases. Except for the 2000-2001 period, West Java did not appear to be significantly worse affected than Jakarta. However, the opposite occurred in estimates for part-time employment. Increases in wages appear to have slightly increased part-time employment. Despite the statistically significant

⁹ The regulations are part of the newly approved Law Number 13, 2003 on Employment. The legislation limits the use of flexible workers, such as fixed-term contract workers and outsourcing. Another piece of legislation, Law Number 2, 2004 on Industrial Relations Dispute Resolution, re-regulates legal procedures for dispute resolutions. See Chapter IX for more details on this legislation.

results, the OLS estimates were questionable because they tend to be inconsistent and do not take into account simultaneity bias. Simultaneity refers to lack of identification of an equation. This arises when one or more explanatory variables are jointly determined with the dependent variable, typically through an equilibrium mechanism (Wooldridge, 2000, p. 501). The labour market is determined by an equilibrium of labour supply and demand. To estimate a simultaneous equation model there is a need to use regression methods other than OLS, such as using Two-stage Least Squares (2SLS) method with instrumental variables to account for the problem. The Productivity and Investment Climate (2003) data set was deemed insufficient for this purpose, due to limited observations, sub-sectors, and districts/cities. A more complete data set, i.e., data from the Annual Manufacturing Survey, is more appropriate because it is a complete survey. Thus, the next model used the two-stage least squares estimation method which takes into account simultaneity problems.

Two-Stage Least Squares (2SLS) Estimation of Relative Inter-district/city Employment Change

The analysis using 2 SLS method with instrumental variables was used to solve the simultaneity problem inherent in the OLS estimates. Instrumental variables were used in the estimation to estimate the endogenous variables in the model, in this case, wages. The 2SLS estimates were in the model that estimated the effect of average wages on district/city employment in West Java. Since the local authorities had started setting minimum wages in their own regions, it was appropriate to estimate the employment effect by district/city. The main data used in the estimation are from the Annual Large and Medium Manufacturing Survey 2000-2002.

The writer adopted the method of 2SLS estimation, employed by Kim and Taylor (1995). Using what they termed a 'structural demand equation', the regression used the relative change of employment in a given manufacturing sub-sector in West Java as the dependent variable. The equation was derived from the textbook labour-market model, where wages and employment are jointly determined by supply and demand (Kim and Taylor, 1995, p. 177).

In the analysis, instrumental variables to estimate the inter-district/city employment effect of minimum wage increases on employment were used. There were 28 second-

level local governments in West Java in 2000, consisting of districts and cities. That number of districts/cities will increase as part of the decentralization process. Moreover, several districts and cities had also joined the newly promoted Banten province. However, for the purpose of the model, all 28 were included in the analysis.

The model is derived from labour demand function explained in Hammermesh (1993)¹⁰. The model below follows the specification stated above (Kim and Taylor, 1995, p. 181). Thus, the model is as follows:

$$\Delta \log e_i = a + b_1 \Delta \log W_i + b_2 \Delta \log y_i + u_i, \quad (8.3)$$

Where,

$\Delta \log e_i$ is the log change in the district/city i's large and medium manufacturing employment between year t and t-1,

$\Delta \log W_i$ is the log change in real employment cost in district/city i between year t and t-1,

$\Delta \log y_i$ is the log change in real gross value added in district/city i between year t and t-1.

u_i is the normally distributed error term.

Gross value added is used as a substitute for capital services because the fixed capital formation data, from statistics Indonesia, were too unreliable to be used for the purpose of this analysis. Likewise, just like the first regression model, employment cost was used as a substitute for true wages. Wage cost data was only available for 1999. By 2000 the Annual Manufacturing Survey ceased collecting wage costs and now only collects total employment cost, which includes wage costs and other labour costs.

¹⁰ See Chapter VI: Methodology for more explanation.

The 2SLS estimates were divided into three; each using different sets of instrument variables. The first instruments used were 'log change of average employment size' in district/city between year t-1 and t-2 and 'log change real employment cost' in district/city between t-1 and t-2. It was assumed that firms had lower wages at year t-2 because large increases in minimum wage levels occurred in 2001 and 2002. The second IV model used just one instrument, 'log change of real employment cost' of district/city i between year t-1 and t-2. The third IV model used 'log change of real employment cost' of district/city i between year t-1 and t-2 and 'log change in minimum wages' in the district/city i between year t-1 and t-2. The IV variables were correlated with the independent variable real wages. OLS estimates were also calculated and used as comparison.

The results show that the estimates turned out to be significant after outliers were omitted from the calculation. Four outliers were omitted from the 2000-2001 and four outliers from 2001-2002 data, using the studentized residuals method explained earlier. Three of the outliers turned out to be the same observations for both periods¹¹. Table 8.7 shows that only the OLS estimates for 2000-2001 appear to be significant. Only coefficients for value added growth were significant. The same result also occurred for 2001-2002, even though there were negative coefficients for wages. The use of IV variables was not statistically significant and did not improve the coefficient estimates. The delay of the imposition of the 2002 minimum wages might be the reason for the insignificant result because, during the first half of 2002, firms were reported paying the 2001 wages, while waiting for the court verdict on the 2002 minimum wages (see Chapter VII). Thus, the employment impact might have been delayed until 2003, or even 2004. The lack of consistency could also be due to the fact that most industries in West Java are concentrated in a few districts, around the Bogor, Tangerang and Bekasi areas. Other districts in West Java actually have much lower wages than areas with a high concentration of industries.

Diagnostic tests revealed that the use of instruments might not lead to better estimates compared with OLS for the 2000-2001 periods. Using the Hausmann test of endogeneity, estimates showed that all three IV estimates were not significantly

¹¹ The outliers were the districts of Depok, Pandeglang, and Karawang that turned out to be districts with low industry concentration.

different from the OLS estimate (Wooldridge, 2000, p.483). This means that the OLS estimates for 2000-2001 should not be dismissed in favour of the IV estimation. Table 8.7 shows that using IV estimates only managed to increase the standard error and decrease the R^2 s, while the OLS estimates for both independent variables produced statistically significant results. The reason is that the instruments used in the 2SLS were not sufficiently strong to improve the coefficient estimates. The Basmann test of over-identifying restrictions shows that at least some of the IVs were not exogenous (SAS, 1990b, Chapter 17). Standard correlation coefficients show that only lagged employment cost has a strong correlation with employment cost.

Table 8.7 Regression Results of Relative Employment Change in West Java
Using OLS and alternative 2SLS Estimates – dependent variable employment $\Delta \log e_i$.

	2000-2001				2001-2002			
	OLS	IV	IV	IV	OLS	IV	IV	IV
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Intercept	0.10²⁾ (0.04)	0.13²⁾ (0.05)	0.13²⁾ (0.05)	0.13²⁾ (0.05)	-0.00 (0.02)	-0.03 (0.03)	-0.02 (0.03)	-0.02 (0.03)
Coefficient on $\Delta \log W_i$	0.18²⁾ (0.08)	0.12²⁾ (0.09)	0.12²⁾ (0.09)	0.12²⁾ (0.09)	-0.06 (0.05)	-0.16¹⁾ (0.08)	-0.15¹⁾ (0.08)	-0.14¹⁾ (0.08)
Coefficient on $\Delta \log y_i$	0.11²⁾ (0.04)	0.13²⁾ (0.04)	0.13²⁾ (0.04)	0.13²⁾ (0.04)	0.11¹⁾ (0.06)	0.11¹⁾ (0.06)	0.11¹⁾ (0.06)	0.11¹⁾ (0.06)
N	24	24	24	24	24	24	24	24
R²	0.42	0.41	0.41	0.41	0.20	0.24	0.24	0.23

Notes: Standard errors are shown in parentheses.¹⁾ indicates significance at 10 percent level, two-tail test. ²⁾ indicates significance at 5 percent level, two-tail test. The dependent variable is the 'log change in average employment' in district/city i between year t and t-1 ($\Delta \log e_i$). The explanatory variable W_i is the 'log change of real employment cost' per worker at district i between year t and t-1. Estimates are from 28 districts/cities in West Java. IV (2) and IV (6) used 'log change in real employment cost per worker' in district/city i between year t-1 and t-2, and 'log change in employment' in district i between year t-1 and t-2 as instruments. IV (3) and IV (7) used 'log change in real employment cost per worker between year t-1 and year t-2. IV (4) and IV (8) used the 'log change in real employment cost per worker in district/city i between year t-1 and t-2 and log change in district/city minimum wages between year t-1 and t-2, as instruments. Four outliers from each estimate were omitted from the calculations.

IV estimates for the 2001-2002 period show slightly better results. Table 8.7 shows that the 2SLS estimates appear to have improved the coefficients of W_i . All three IVs shows marginally significant estimates (at 10 per cent level) compared to the OLS. The negative coefficient estimates also indicate that minimum wage level increases were beginning to bite in 2002. Nonetheless, the small negative impact might not represent the effect of minimum wage increases in 2002, which is significantly higher than in 2001. The use of changes in minimum wages, as instrumental variable, did not improve the estimates. The result is similar to the earlier OLS model where the minimum wage dummy did not have a statistically significant effect on employment. It is likely that it is the effect of wage increases in 2001. Similar to the 2000-2001 periods, changes in value added had statistically significant effects on employment changes for the OLS estimates, but marginally statistically significant effects for the IVs. As in the earlier OLS estimates, the negative wage elasticity in 2002 is likely to have resulted from minimum wage increases in 2001. The delay in implementing the 2002 minimum wages might have delayed the effect until 2003. Otherwise, large negative coefficients should have shown up in the estimates. Unfortunately, the 2003 data for this type of calculation were not yet available during the period the data were collected. One must look at other data sources which, however, may be of even lower quality than this one.

Lagged Effect

Only the estimates for the 2001-2002 period show marginally significant negative impacts of wage increases. The OLS and IV estimates reported slightly negative elasticity from increases in real wages, between 2001 and 2002. However, the results showed that minimum wage effects on employment were inconclusive. The IV (4) and IV (8) estimates, which used changes in real minimum wage levels as instruments, did not appear to change the elasticity coefficients significantly. There could be other reasons for the decline in employment, even though changes in wages certainly had a significant effect. Firstly, other factors have affected employment more than wages. The September 11 terrorist attacks on the World Trade Center occurred in 2001 and most likely affected overseas demand for Indonesian products, especially the TGF (textile, garment and footwear) products. Secondly, Statistics Indonesia reported that overall real wages actually decreased in 2001, rendering the

wage effect on employment insignificant. Thirdly, prior to the terrorist attacks, Indonesia was experiencing an economic recovery where employment actually improved in 2001. Lastly, but perhaps more crucially, is that significantly high minimum wage increases occurred in 2002 and its effects could have had a real bite in 2003. It could have taken some time for the minimum wage changes to effect firms' decisions to alter their employment structure. The reason being that, in 2002, there were incidences where employer associations took matters to court and were able to delay the imposition of the 2002 minimum wage increase. Even though they eventually all lost their cases and were forced to adopt the new minimum wage levels, it is probable that its impact on employment was delayed until at least 2003.

Unfortunately, data for 2003 and 2004, from the Annual Large and Medium Industry Survey, supporting this view on employment was not yet available during the development of this thesis. However, data obtained from the Industry Directory could be used instead, to approximate the trend in the number of firms and workers in 2003 and 2004. In addition, the quarterly survey data for 2003 was available but incomplete, due to a low response rate¹². The writer was cautioned by Statistics Indonesia officials about the incompatibility of the data with the official annual data. Nevertheless, both the annual survey and the quarterly survey, which produced the data, originated from the directory. It will be at least two more years before this data can be obtained. Thus, both data sets could only be used as an approximation for employment changes in 2003.

Firm closures

The conditions of large and medium manufacturing establishments in 2002 appeared to confirm the fears of many scholars and employers alike. The year 2002 seemed to be a dreadful year for establishments in the manufacturing sector. Table 8.8 shows that the number of establishments decreased from 22,569 in 2000, to 22,257 firms in 2001 and further to 21,655 in 2002. This is unfortunate as this sector seemed to have recovered slightly from the 1998 crisis. The decrease, therefore, was a significant blow to the government because it had been making a great deal of effort to ensure

¹² As a comparison, the West Java sample for 2001 and 2002 had approximately 200 respondents. However, in the 2003 sample only about 60 respondents provided data.

that the manufacturing sector got back on track. A combination of factors, i.e., economic crisis, domestic political instability, increasing labour cost and the recent Iraq war were blamed as the main reasons for the decline in exports of textile products (*BharatTextile.com*, 2001). On the domestic market, the industry was also under threat from imports of cheap fabrics from China and other countries.

Table 8.8 Number of Establishments (New, Old, Downscaled and Closed) in the Large and Medium Manufacturing Sectors in Indonesia 2000-2004

Description	Year				
	2000	2001	2002	2003	2004
Whole Sector					
New	1539	1243	1497	858	958
Old	22054	22180	21760	21366	20684
Downscaled ¹³	503	447	767	466	467
Closed	521	719	835	834	778
Total	22569	22257	21655	20924	20397
Textile, Garment and Footwear					
New	372	299	359	123	221
Old	4818	4853	4731	4512	4339
Downscaled	107	111	154	101	113
Closed	94	183	242	229	190
Total	4989	4858	4694	4305	4257

Source: Statistics Indonesia, unpublished registrations of large and medium manufacturing establishments, 2000-2004.

Note: Figures are based on pre-survey registration of establishments¹⁴.

The number of closures for the whole sector increased from 521 establishments, in 2000, to 835 establishments in 2002. In the case of the textile, garment and footwear sector, the number of closures more than doubled (from 94 in 2000 to 242 in 2002). Moreover, the number of new establishments for the whole sector had significantly

¹³ Downscaled means firms size decrease from large or medium to small, and omitted from the survey.

¹⁴The reader has to be cautioned that the data are based on the unpublished manufacturing industry registrations. This directory is used as a frame for the Annual Large and Medium Manufacturing Survey. The fact that it is continuously being updated by births and deaths of manufacturing establishments, as well as other weaknesses in the system, such as less editing, implies that it is used as an approximation only and cannot to be compared with the annual data year by year.

decreased from over 1000 establishments per year to a mere 858 establishments in 2003. The fact that there were not many new firms possibly indicates a deteriorating investment climate in manufacturing. In addition, the conditions were worsened by the fact that demand for exports from Indonesia had decreased significantly.

The textile, garment and footwear sector seemed to be the hardest hit. Although there were more new firms in 2002, compared to 2001, there were in fact a lot of closures and down scaling. In 2002 there were 242 closures and 154 firms that shed workers and thus, were downscaled to small firms. However, there were 359 new firms in 2002, as compared to 299 in 2001. In 2004, the number of closures and downscaled firms appeared to decrease significantly. However, the number of new firms also decreased in 2004. It is clear that investors were reluctant to set up new manufacturing firms for some reason. Could it have been because of problems associated with the labour policies in Indonesia, or because of lower demand from overseas? It was revealed during the fieldwork that many garment and footwear firms in Indonesia were dependent on overseas demand.

Employment Changes using Births and Deaths of Firms

The BGDC calculation was based on firm births and closures, depicted in Table 8.8 above. BGDC stands for birth, growth, death and contraction of firms. Instead of using the number of establishment births and deaths, the associated employment changes were used to measure net employment change during the early years of decentralisation (2001-2004). The estimate was based on the quasi-elasticity concept discussed in Hammermesh (1993). According to this concept, change in employment is affected through establishment/plant openings and closures, which in turn are affected by the changes in the wage rates. The BGDC model assumes that the size of prospective firms, when they do operate, is independent of their target profit rates (Hammermesh, 1993, p. 142).

The assumption is that establishment/plant closures do not depend on the profitability of the firm, i.e. profit stays constant. The writer assumed that the Indonesian economy had stop contracting and was recovering from the crisis during 2001-2004, and thus had relatively low growth compared to the 1990s. Plant openings are assumed to

depend only on wage rates, where the lower the wage rates the higher the probability of an entrepreneur opening an establishment/plant (Hammermesh, 1993). On the other hand, the higher the wage rates, the higher the probability of establishment/plant closings. Moreover, the higher the wage rates, the more likely workers prefer staying in one firm. Thus, in the context of a binding minimum wage policy, the higher the minimum wage level the more likely the establishment closes.

The basic model for this estimate is based on four components: Births of new establishments (B); Growth of existing establishments (G); Death of existing establishments (D); and contraction of existing establishments (C)¹⁵. The components are linked to net employment change by the equation:

$$\Delta E = B + G - D - C \quad (8.4)$$

Where, ΔE is the net percentage change in aggregate employment (Hammermesh, 1993, p. 150).

The role of wages is perhaps related to the birth and death of firms, due to the fact many multinational firms found Indonesia desirable because of low wages, mainly in the light manufacturing sectors like garment and footwear. On the other hand, firm closures could also be related to significant increases in minimum wages. A previous study by Rowter (1990, cited in Hammermesh, 1993, p.153) reported high annual net employment growth of 5.5 per cent in Indonesia, between 1975 and 1984. However, this study was conducted when economic growth was high and the minimum wage shock was non-existent. The same technique was applied here for the period 2001-2004 when the Indonesian economy was recovering from a crisis, the country was experiencing decentralisation and minimum wage levels were vigorously increased. The method was primarily used for measuring the effects of large increases of minimum wage levels in 2001 and 2002.

The BGDC calculation suggests that even the 2002 minimum wage increases did not cause significant negative overall employment impacts in Indonesia. Table 8.9 shows

¹⁵ Contraction is defined in this thesis as establishments that downscaled from large or medium to small establishments.

that the net employment change in 2002 was still slightly positive, suggesting that there was even a slight growth in employment. Even accounting for the delayed effect, due to the postponement of the 2002 minimum wages, figures for 2003 and 2004 only showed small negative impact, -0.23 and -1.03 per cent respectively. However, the net employment growth was much lower than the net employment growth reported during the 1975-1984 periods (Rowter, 1990 cited in Hammermesh, 1993).

Table 8.9 Percent of Employment Change in Indonesia, West Java and Jakarta using Births and Deaths of Manufacturing Establishments

Description	Percentage Change in Employment due to				Δ Emp
	B	G	-D	-C	
Indonesia					
2001	2.52	2.88	-2.10	-0.12	3.18
2002	3.09	-0.17	-1.82	-0.21	0.88
2003	2.82	-0.33	-2.60	-0.12	-0.23
2004	2.40	-1.14	-2.17	-0.13	-1.03
2001-2004	2.71	0.31	-2.17	-0.15	0.70
West Java					
2001	1.90	5.14	-2.50	-0.05	4.49
2002	3.84	-2.31	-1.03	-0.05	0.44
2003	3.44	0.20	-2.43	-0.04	1.17
2004	2.27	0.82	-1.77	-0.05	1.27
2001-2004	2.86	0.96	-1.93	-0.05	1.84
Jakarta					
2001	4.33	4.46	-2.17	-0.14	6.48
2002	-1.47	3.80	1.85	-3.30	0.10
2003	0.23	-2.46	-5.91	-0.14	-8.29
2004	1.86	-3.72	-4.15	-0.13	-6.14
2001-2004	2.56	-0.89	-3.89	-0.13	-2.36

Source: Large and Medium Manufacturing Directory, Statistics Indonesia

Notes: Calculation is based on the quasi-elasticity approach based on the births and deaths of manufacturing establishments explained in Hammermesh (1993, p.150).

B – Births of large and medium manufacturing Establishments

G - Growth of large and medium manufacturing Establishments

D – Deaths of large and medium manufacturing Establishments

C – Contraction of large and medium manufacturing Establishments

Δ Emp – Percent of net employment change.

It was within provinces that large negative impacts could be seen. Jakarta appeared to experience a large decrease in employment. The delayed effect appeared to affect Jakarta significantly. Table 8.9 shows that, assuming that the 2002 had a delayed

effect, there were significant employment decreases in 2003 and 2004. The minimum wage levels in 2003 and 2004 were only adjusted to the prevailing inflation, and thus, the writer assumed that the 2002 minimum wage increase was the cause of the negative employment change. Large and medium manufacturing firms in Jakarta experienced net employment losses of 8.29 per cent and 6.14 per cent in 2003 and 2004, respectively. These results appeared to force Jakarta's authorities to intervene in the 2005 minimum wage setting. The central government, via the Minister of Manpower, intervened by 'discussing' the 2005 minimum wage level with the Jakarta Governor even though provinces have the final authority to set their own minimum wage levels (*Kompas*, 2005). Despite protests from various trade unions, that the 2005 minimum wage was far below the minimum subsistence need¹⁶, the Jakarta authority went ahead with the new minimum wage levels. Government intervention, in the 2005 minimum wage setting, appeared to be an attempt to put the brakes on minimum wage increases. The government did not attempt to influence the wage council, but only stepped in when the final decision was shifted to the hands of the Jakarta Governor. Perhaps, interfering in the wage council could constitute a derailment of the democratic process in Indonesia?

Employment in West Java appeared to be less affected by the increases in minimum wage levels than employment in Jakarta. Table 8.9 shows that net employment change had stayed positive (0.44 per cent), even though it was much lower than in 2001 (4.49 per cent). Even in 2003 and 2004, the positive net employment change meant that the shock of the 2002 minimum wage increase did not significantly affect overall employment in West Java. However, interviews with wage council members in West Java districts and cities on the periphery of Jakarta suggested that, the intervention by government officials in the 2005 minimum wage might eventually affect neighboring regions in West Java and affect the minimum wage levels in those regions, because some districts/cities base their minimum wage calculation on Jakarta's. Minimum wage setting in West Java tends to use Jakarta wage levels as the starting point for setting their own minimum wages.

Looking at net annual employment changes for sector 32 (Textile, garment, footwear and leather goods), Table 8.10 shows negative annual changes for Indonesia, West

¹⁶ One of the criteria for setting minimum wage levels was the minimum subsistence need.

Java and Jakarta. This means that significant increases in minimum wage levels could have had a detrimental effect on the mainly labour intensive manufacturing sector. Jakarta experienced the worst negative impact, with an annual rate of net decrease of 3.43 per cent, the negative change mainly occurring in 2002 to 2004. This has most likely been due to the fact that many of the large and medium TGF firms are located in the export processing or bonded zones, meaning that they were susceptible to global demand fluctuations. West Java also experienced negative annual employment growth for sector 32. From these figures it appears that the 2002, perhaps also the 2001, minimum wage increases had contributed to a detrimental impact on employment in sector 32. Although West Java still experienced a positive change overall, it is obvious from the figures that sector 32 experienced a decline.

Table 8.10 Percent of Employment Change in Sector 32 in Indonesia, West Java and Jakarta using Births and Deaths of Manufacturing Establishments

Description	2001-2004 Annual Percentage Change in Employment due to				Δ Emp
	B	G	-D	-C	
Indonesia	2.20	-0.05	-2.85	-0.10	-0.81
West Java	1.99	-0.31	-2.23	-0.03	-0.58
Jakarta	4.34	-1.36	-6.24	-0.17	-3.43

Source: Large and Medium Manufacturing Directory, Statistics Indonesia

Note: Calculation is based on the quasi-elasticity approach based on the births and deaths of manufacturing establishments explained in Hamermesh (1993, p.150).

B – Births of large and medium manufacturing Establishments

G - Growth of large and medium manufacturing Establishments

D – Deaths of large and medium manufacturing Establishments

C – Contraction of large and medium manufacturing Establishments

Δ Emp – Percent of net employment change.

However, the data used in the BGDC analysis was fraught with inconsistencies. Since the data was obtained from the Large and Medium Manufacturing Directory, data from one year could not be completely compared with those of another year. This directory of large and medium manufacturing establishments is continuously updated. This means that the manufacturing situation could change on a daily basis, depending on the speed of the listings. For instance, a large manufacturing firm could transform

into a small firm if, in one day, the firm decides to fire most of its workers. Moreover, the data for 2004 were still temporary and will probably change many times before these are finalised. The data was extracted in mid-2004, which meant information for 2004 was not yet complete. Nonetheless, the data were useful as a rough approximation on firm closures and new openings and, for the purpose of this thesis, gross employment change.

Summary of Results

Analysis of the data suggested a significant negative employment impact in West Java during the start of the decentralization. However, it is not clear whether minimum wage increases were really to blame. Decreases in employment occurred when the government had increased minimum wages substantially, especially in 2002. The negative employment changes appeared to extend to the 2003 and 2004 period, even though increases in minimum wages for that year were considerably less than 2002 or 2001. Using the BGDC methods, it was found that there was negative employment growth during 2002 and 2003 in West Java, especially for sector 32. However, the data did not show that minimum wage increases were mainly responsible for employment decline in West Java. On the other hand, increase in wages had a strongly positive effect on flexible workers. However, the increasing use of flexible workers was most likely due to increasing trade union participation, and less to the minimum wage policy. As Chapter VII showed, businesses were more afraid of increased trade union activity than complying with the minimum wage provision. They did not mind paying minimum wages, as long as the level of increase was not on the magnitude of the 2002 increase. The government also appeared to be well aware of this impact and had taken steps to prevent a repeat of high minimum wage level increases, by attempting to peg minimum wages to inflation (It is clear that the balance of power, in determining minimum wages, had shifted towards increasing investment and regional development). It is perhaps more crucial for trade unions to also develop their negotiation skills and not dwell too much on the minimum wage provision.

However, decrease in employment does not mean that increases in minimum wages were mainly responsible for the decline. The regression methods, that estimated the

effect of real wages on employment, did not provide sufficient results for the writer to draw any definite conclusion. The estimates, from both the OLS and 2SLS methods, contained outliers that had to be omitted from the calculations. Although the estimates yielded some negative elasticities, it is possible that the small negative effect was due to minimum wage increases in 2001 rather than 2002. It is likely that, due to the delay in imposing the 2002 minimum wages, the effect on employment might have been delayed until 2003. The BGDC method did reveal large decreases in employment in 2003 and 2004. The TGF sector is the biggest loser in this respect. However, it is not clear whether increases in minimum wages were a major factor which affected employment. Other factors, such as lack of overseas demand and increasing global competition, could also have played a part in the employment decrease. Moreover, the reliability of the data had come into question because they were designed for registry, not for analysis or publication.

The only significant conclusion that can be drawn from the regression results is that there appears to be a substitution of part-time workers for full-time workers, due to wage increases. Part-time employment appears to be on the rise. However, it is likely that minimum wages are not the only factor affecting the rise of part-time employment. The fieldwork, explained in Chapter VII, revealed that the rise of trade union activities could have contributed to the rise in flexible employment. Other factors related to economic globalisation, such as increased global competition, as well as lack of overseas demand, corruption, changes in employment legislation and macro-economic factors could also have been responsible for employment changes in Indonesia.

An important issue is the inclusion of the trade union as a control variable in the analysis. However, the characteristics and behaviors of trade unions could not be explained by using secondary data. As explained in the early chapters, trade unions in Indonesia have been undergoing transformation since Indonesia ratified the ILO Convention Number 87 on Freedom of Association in 1999. As a consequence, there are many trade unions of different types proliferating in the country. It is insufficient also to provide a conclusion based on the presence of trade unions alone. The different characteristics of trade unions make the trade union variable questionable at best. It is more constructive to go beyond the minimum wage policy to analyse trade

union participation in relation to the minimum wage fixing process. In addition, the novelty of the decentralized minimum wage fixing and the increasing use of flexible workers had prompted the central government to introduce two new legislations: the first, Law number 13, 2003 on Employment: the second, Law Number 2, 2004 on Industrial Relations Dispute Resolution. The next chapter explores issues related to and beyond minimum wages, as well as assessing the social impact of the decentralized minimum wage fixing and other factors on trade union participation.

Chapter IX

The Minimum Wage Policy and the Changing Industrial Relations in Indonesia

We believe that any economic strategy aimed at improving economic growth must be inclusive and not simply imposed on workers (Wilson, 2002).

Introduction

The decentralisation process which transformed the minimum wage fixing process emerged as a new challenge for trade unions and the workers they represent, especially in West Java. Trade unions, whether they are at national level or firm level, have flourished since the ratification of ILO Convention Number 87 on Freedom of Association. Currently, there are at least 71 registered national level unions in Indonesia, with branches at provincial and district level (during the fieldwork in 2003). However, district level union now has the primary role of negotiating for better minimum wage levels at district/city wage council. The decentralisation of authorities to regional governments created other profound changes that could affect employment as well as trade union involvement. In addition to the increasing power of trade unions, increased empowerment of local authorities meant that they are able to set their own local regulations, i.e. local taxes and levies. These regulations alone could have an effect on business cost which could eventually affect employment. Moreover, two newly approved employment legislations, Law Number 13 2003, on Employment (one which also emphasize the current minimum wage policy) and Law Number 2 2004, on Industrial Relations Dispute Resolution could also potentially increase affect employment, trade union participation and businesses.

This chapter attempts to assess the impact of the changing political and legal environment, particularly in relation to the minimum wage policy on industrial relations. It sought to test a hypothesis that the decentralized minimum wage fixing creates secure and harmonious industrial relations. It also seeks to find indications on whether or not the decentralisation of minimum wages is contributing to polarization, disempowerment, de-unionization of trade unions when the Indonesian trade unions are

just starting to develop. Firstly, the chapter introduces two crucial new pieces of legislation which could have potential impact on industrial relations. Then, the chapter provides examples of industrial relations in two closed firms. Finally, the chapter also addresses other factors that affected the employment outcome and business environment.

Industrial Relations in Indonesia

Labour relations in Indonesia prior to the crisis of 1998 were based on the notion of Pancasila Industrial Relations (henceforth, PIR). The PIR system was based on the state ideology of Pancasila which promoted consultative agreement between opposing parties¹. The Pancasila concept of the labour relations in Indonesia was best described by Suwarno and Elliot (2000):

The PIR system emphasizes partnership between workers, management and the government. The government has argued that the spirit and values of Pancasila, the state ideology, should be applied in the workplace as in other aspects of life. The justification is that the continuing national development requires a stable yet dynamic situation for sustainable economic growth. This in turn requires national stability in the production process. The primary objective of PIR is to ensure an ideal society. This objective can be achieved only through peace and stability (p. 131).

During the Soekarno presidency from independence to his downfall in the mid-1960s, industrial relations in Indonesia seemed far from the peace and stability needed for high economic growth. When Indonesia proclaimed independence in 1945, unions were assumed to have an important role in economic, governmental and political activity (Suwarno and Elliot, 2000, p. 129). Employment relations appeared to favour the working class during that time. In 1957 there were at least 12 trade union federations, most with political affiliation (Suwarno and Elliot, 200, p. 129). Under the umbrella of Indonesian Communist Party the All Indonesia Central Organization of Trade unions

¹ The Pancasila ideology is based on the five basic principles: 1) Believe in one God, 2) Civilized and just humanity, 3) The unity of Indonesia, 4) Democracy led by wisdom and prudence through consultation and representation, 5) Social justice for all Indonesian (Bourchier & Hadiz, 2003, p. XXVI Glossary).

(SOBSI) became the most powerful trade union federation in Indonesia. It had the capacity to challenge the other power broker in the country, the military. The fall of the communist party in 1965 and the subsequent fall of President Soekarno also contributed to the decline of trade union power in the country. Under the New Order government of President Soeharto, capitalist development was favoured through a high degree of centralized control as a way to move the country forward. This meant peace and stability in industrial relations was achieved through restrictions of trade union freedom. The PIR system was chosen as a way to achieve this goal. Peace and stability in production process meant that industrial disputes had little room in the PIR system. Even though strikes were allowed, they were discouraged. Workers planning to strike had to obtain permission from the Ministry of Manpower and must provide prior notice regarding the intent to strike (Levine, 1997, p. 197).

In the past this type of industrial relations had a positive impact in creating a high degree of economic growth. During the oil boom of the 1980s and the neo-liberal economic regime of the early 1990s Indonesia was becoming one of the new Asian Tigers. Economic growth exceeding seven percent per annum in the early 1990s was followed by an increasing number of new jobs for the growing labour force. A high number of the workforce, some four million workers worked in the large and medium manufacturing sector, not to mention millions more in the small and cottage industries. Nonetheless, this achievement hid some disturbing revelations about industrial relations which started to show its true colours in the early 1990s.

It was alleged that the PIR system was misused by the New Order government to justify labour control in the name of industrial peace (ILO, 2001). In reality, industrial relations during that period resembled many other countries in the developing world, especially Asia. The government played a central role in industrial relations and both unions and employers were required to conduct their relations in line with industrialization strategies of the government (Parasuraman, 2004, pp. 153-154). The fundamental reason for the state's industrial relations policy was that managed cooperation and coercion were needed to maintain Indonesia's low wage economy in order that it can attract foreign investment and increase the rate of capital accumulation (Gall, 1998, p. 368). Subsequent industrial disturbances which culminated in the labour riots of 1994 were attributed to the government's efforts to enforce the so-called industrial peace.

The main reasons for workers dissatisfaction were issues related to wages (or minimum wages), welfare facilities and the setting up of a union (ibid). Although officially the government allowed the setting up of unions, in reality, they were severely restricted. The failure of ratifying the ILO Convention Number 87 on Freedom of Association meant that although workers were allowed to set up unions (as Indonesia ratified ILO Convention 98 on Freedom to Organize), they had to affiliate under the umbrella of the state-controlled All Indonesia Workers Union (SPSI). Independent unions such as the SBSI (The All Indonesia Welfare Labour Union) were banned prior to 1998. As earlier stated in the thesis, the government wanted to maintain industrial peace based on the PIR system and the presence of such independent unions could undermine the general objective of the PIR system which is to maintain industrial peace.

Pressures from abroad, especially through the threat of elimination of GSP preferential treatment from the United States had caused the Indonesian government to significantly alter its industrial relations policy. The government executed the so-called employment-income protection to appease workers². The government launched a series of employment protection scheme to improve workers' conditions via the JAMSOSTEK or the social security insurance for workers. It covers four different types of insurance cover: accident, health, life insurance and pension. In addition, the government also made the minimum wage much more binding than before. Nonetheless, the government still maintained the PIR system and still outlawed independent unions such as the SBSI and SBM. Consequently, the move did nothing to appease the growing strength of trade unions.

The transformation of the industrial relations recently placed the PIR system under intense scrutiny, and there were calls for it being discarded. The new industrial relations conflict resolution law envisaged a four-tier conflict resolution system consisting of conciliation, arbitration, mediation and adjudication. This means that in the new system, industrial conflict is inevitable, whereas in the PIR system industrial conflict is to be

² The logic of employment income protection manifested in increased demands for worker protection against lay-offs, long working hours, poor health and safety conditions, discrimination, and arbitrarily exercised managerial power (Frenkel and Kuruvilla, 2002). There were also demands for a living wage, unemployment pay, and pensions. In Indonesia, such employment protection is manifested in the Jamsostek and a significant increase in the statutory minimum wage.

avoided at all costs. Nevertheless, Suwarno and Elliot (2000) did not suggest an abolition of the PIR system, saying that Indonesia's socio-political structure may need to be considered in the new industrial relations system.

Trade Unions and *Decent work*

While the PIR system may not be a practically workable agenda, the idea of industrial peace could still be applied in firm level industrial relations. The *social dialogue* envisaged in the *decent work* discourse has much more appeal. As explained in Chapter II, *decent work* is defined as work which is carried out in conditions of freedom, equity, security and human dignity. *Decent work* is focused on increasing employment, social protection, workers' rights and *social dialogue*. In practice, the ILO has focused *social dialogue* in Indonesia and had taken the initial step of improving negotiating capabilities of grass root trade union i.e., firm level union. The strength of *social dialogue* would be industrial peace through negotiations between workers and employers. Negotiations concerning minimum wage provisions at district or city level would greatly encourage negotiations of wages and other labour conditions at firm level.

Indonesia could meet the challenges of *decent work* because independent trade unions are flourishing. These newly formed trade unions are relatively free of government intervention. The establishment of trade unions and the willingness of the government to consult and negotiate are the ingredients needed to start a *social dialogue* between the parties involved, i.e. employers, unions and the government as the facilitators (ILO, 2001). Katherine Hagen, the ILO director of *social dialogue*, elaborated:

Social dialogue is understood to include all types of negotiations, consultation, or simply exchange of information between representatives of governments, employers and workers, on issues of common interest relating to economic policy. ILO wishes to help Indonesia to look for a structure of *social dialogue* that will work in the Indonesian context and will promote development, equity, and justice (ILO, 2001).

The hope is that *social dialogue* will become a new paradigm in improved industrial relations that benefits all parties. The benefits of *social dialogue* are:

- a. A good climate of industrial relations between workers and management,
- b. Fewer grievance and strikes,
- c. Loyalty of workers and trade unions to the company,
- d. A freer exchange of ideas between the parties on ways to improve business and production process,
- e. Greater understanding and cooperation by workers and trade unions when the company is experiencing a period of difficulty, and
- f. Companies that practice *social dialogue* are usually market leaders and stand out within their field (ILO, 2001, p. 33).

The decentralized minimum wage fixing machinery could promote *social dialogue* because it concerns negotiations between stakeholders. The first objective towards *social dialogue* in Indonesia appears to be to improve union wage bargaining skills at firm level. Minimum wage negotiations at regional level could be used as a point of reference to be used for wage and other forms of negotiations at firm level. For instance, a firm that could not pay their workers the prevailing minimum wage could negotiate with their workers in a bipartite dialogue to solve the problem and avoid costly confrontation with workers. The fieldwork revealed that such practices were not uncommon. Moreover, many firm level trade union officials were found to be involved at some level at district/city level trade union. As a consequence, trade bargaining skills at firm level could have a snowball effect on trade union bargaining at a higher level, say, district or city. In the end, the key to *social dialogue* depends primarily on the level of cooperation between workers and their representatives, the trade unions.

The New Employment Law Number 13, 2003

The provisions of the minimum wage fixing and other employment issues are reflected in two new employment laws which were recently approved by the House of Representatives and the central government. The new laws appeared to protect workers from the growing insecurity of work. The new employment law recently approved by the House of Representatives and President Megawati Soekarnoputri focused mainly on employee protection. A second bill on industrial relations was being discussed by the House when the researcher was in the field in 2003, but was approved in January 2004. Even though the law is relatively new, it was actually a culmination of events that started after the fall of the Soeharto regime in 1998 and after the ratification of the ILO

Convention Number 87 on Freedom of Association. It includes provisions on the formation of independent trade unions and the minimum wage fixing machinery which already became legal under ministerial decrees after 1998.

The new laws were under assault long before they became law. Businesses in general had agreed to the new law, whereas trade unions gave mixed reactions. Several major trade unions gave reservations about the new law, but were willing to accept it because the government promised to provide further details on the implementing regulations. Other unions rejected the law because it was not sufficient in providing adequate protection for labour. The Industrial Relations Conflict Resolution Bill was vehemently rejected by most labour representatives. Nonetheless, this bill was also passed by the House in December 2003 (*Kompas*, 2003e). This meant that the new law would have been applicable in 2004.

Table 9.1 Selected Comparison of old and new Employment law

Description	Old Employment Law Number 25, 1997	New Employment Law Number 13, 2003	Strengths	Weaknesses
1. Minimum wages	Article 111 - The Minister of Manpower approves minimum wage levels of each province - Central government has the final say in determining the level of minimum wage	Article 89 - The governor approves minimum wage levels with recommendation from the wage council and district head or mayor Article 88 - Special emphasis on comfortable living, productivity and economic conditions	- Minimum wages may now reflect the conditions of each individual regions because minimum wage determination is now being conducted and implemented by local administration, not by the central government as was previously done	- Even though each region follow the same criteria for minimum wage setting, differences in calculating minimum wage in each district may be different due to the political nature of minimum wage setting - Some regions were not ready to set minimum wages, and thus chaos occurred
2. Regional Wage Council	Article 115 - Regional wage council members are chosen by the Minister of Manpower	Article 98 - Regional wage council members are chosen by governor/mayor/district head	- The wage councils are more active than before in setting minimum wage levels. - Employers and employees can now negotiate on relatively even terms on the appropriate levels of wages	- Labour representatives now have a greater influence on minimum wage settings, thus higher minimum wage levels may be expected (as occurred in 2002)

Description	Old Employment Law Number 25, 1997	New Employment Law Number 13, 2003	Strengths	Weaknesses
3. Outsourcing	None	Article 64 - A firm can sub-contract jobs through sub-contracting arrangement for jobs or outsourcing for workers	- Outsourcing is now allowed by the law, thus firms are liable to administrative and criminal charges. Previously, there was lack of government regulation on outsourcing	- Firms can now only outsource workers outside their core business. For instance, manufacturing firms cannot outsource production workers
4. Fixed term contract workers	Article 20 - Allows a 3 month period of trial, but does not mention extensions - Stipulated further in government regulations	Articles 56 to 59 - Workers of fixed term contract can only be extended up to 2 years. Otherwise, the worker has to be elevated to position of permanent or regular worker	- Employer could not unilaterally use fixed term workers indefinitely.	- Employer may have to find other means of cutting costs.
5. Foreign workers/ expatriates	Chapter 10, Articles 152 to 157 - Expatriates and the types of jobs that can be held must be approved by the minister of manpower - Type of jobs are	Chapter 8, Articles 42 to 49 - Emphasise that human resources department is off-limits to expatriates	- May help the development of local human resources managers - May cut cost on the use of expatriates	

Description	Old Employment Law Number 25, 1997	New Employment Law Number 13, 2003	Strengths	Weaknesses
	specified in government regulations			
6. Facilities for women	Article 105 - A firm must provide facilities for breastfeeding women - Women experiencing menstruation can take 1 to 2 days leave	Abolished	- Firms are not obligated to provide facilities for breastfeeding and nursing, thus avoiding potential cost - Women experiencing menstruation are not given any leave	
7. Occupational Safety and Health	Article 108 - A firm is obliged to provide protection for employees for occupational safety and health, moral and religious rights	Article 87 - A firm is obliged to provide occupational safety and health protection and management system - Regulated by government regulations	- Workers are now provided with a comprehensive system of health and safety, not just protection - May decrease accidents in workplace in the long run, and ultimately decrease labour cost	- Setting up a management system for health and safety may incur additional short term labour cost
8. Severance pay	None under the old law, but under Ministerial Decree Number	Article 156 - Firms are obliged to provide severance,	- Workers now have legal rights to receive fixed amount of	- The maximum cost of compensation increased from 7 to 9 months of

Description	Old Employment Law Number 25, 1997	New Employment Law Number 13, 2003	Strengths	Weaknesses
	150/2000 (KepMen 150/2000) Article 22	reward or replacement pay to laid-off workers - Replacement pay for unused leaves are omitted	compensation - Cost cutting for replacement pay of unused leaves	pay because the number of monthly pay increased for those workers with 8 or more years of service
9. Service Reward/replacement pay for voluntary resignation	None under the old law, but under Ministerial Decree Number 150/2000 (Article 26) - Employee who resigned voluntarily may receive service reward pay and replacement pay	Article 162 - Under the new law employee who resigned voluntarily only receive replacement pay, but not service reward pay	- Cost cutting for service reward pay	
10. Service Reward/replacement pay for employee dismissed for grave offences	None under the old law, but under Ministerial Decree Number 150/2000 (Article 18) -Employee dismissed due to grave offences may receive service reward pay and replacement pay	Article 158 - Under the new law employee dismissed due to grave offences only receive replacement pay, but not service reward pay	- Cost cutting for service reward pay	
11. Child Labour	Article 95 and 96 - Children are not allowed to work unless they have no	Article 69 - Firms are allowed to employ children aged 13 to 15 to do light	- May help smaller, family based firms to cut labour costs by employing children	-Indonesia has ratified ILO convention on disallowing child labour under any

Description	Old Employment Law Number 25, 1997	New Employment Law Number 13, 2003	Strengths	Weaknesses
	choice but to work - Firms that employ these children must observe certain conditions to protect child workers	work under certain conditions - Child workers are allowed to work in family business		condition. - The issue may spark protest in the future - Enforcement will be difficult because many-many children, even the ones below 13 years still work.

Notes: 1. Issues discussed are limited to those articles that can significantly affect the cost of firms.

2. The new Employment Number 13,2003 is much more detailed than the Employment Law Number 25, 1997 because the new law included improvement of previous government regulations, as well as ministerial decrees. Thus, the researcher could not make exact comparisons between the two laws.

3. Some issues in the old law were not specifically mentioned in the law, but were stipulated further in government regulations. For instance, Ministerial Decree Number 150, 2000 was not in the 1997 Employment Law, but was issued through the ministerial decree. The decree was rejected by both labour unions and businesses. The government moved to improve the decree through a new Ministerial Decree Number 171, 2000 in an attempt to diffuse tensions. Eventually, they included the provision in the new law with some improvements to accommodate all parties.

The Employment Law Number 13, 2003 was designed to resolve approximately 60 contentious issues, including controversial issues from previous government and ministerial regulations. Some unresolved issues would be detailed further in upcoming government or ministerial regulations. The discussion in this report is limited to issues that may affect production costs of manufacturing firms, especially on employment relations, e.g. outsourcing and fixed-term contract workers (Chapter 9 in the law). The issue of employment protection (Chapter 10) focuses on improvements in working conditions and post-job protection, such as the amount of severance pay. In addition, the new law also improved on existing government regulations and decrees, such as the controversial Ministerial Decree Number 150, 2000³ (Ministry of Manpower and Transmigration, 2000), which businesses vehemently rejected. Other new issues like the permission to strike are not discussed because it is unlikely they constitute more cost to firms. However, it may affect firms in terms of power dynamics and firm stability. Table 9.1 compared the strengths and weaknesses of selected articles of The New Employment Law to businesses compared to the previous law and regulations.

Potential Cost of the New Law

Obviously the new employment law was designed to protect workers from exploitation by employers. The consequences of providing more protection to workers, as some of the articles in the law were suggesting, has the potential to increase labour cost to firms. In addition to this law, a new bill on industrial relations, currently under discussion at the House of Representatives, would also potentially put more pressure on firms. At the time when improvement of investment climate is needed from all quarters to increase employment, improvement in employment protection may do more harm than good in the short term.

There are several important aspects of the new labour law that have the potential to increase labour costs in firms. Undoubtedly, the most important issue that dominated the controversies on both sides of the stakeholders is work relations between employer and employee. There are two issues within the work relation concept that

³ The decree posits that workers who were laid-off were entitled to compensation, even if the reason for lay off was due to criminal negligence on the part of the worker.

have sparked controversies across the country. The first is the concept of outsourcing and the other is about fixed term contractual workers.

Outsourcing, explained in Article 64 of the new law, is a relatively new strategy for firms to minimize labour costs. Workers are recruited through third party providers. The responsibility of workers' compensation and benefits is therefore shifted to the manpower agency. In the past, outsourcing has not been included in any law or regulations in Indonesia, thereby allowing firms to recruit any type of workers they wish. These include production workers or workers for the core business of a firm. Outsourcing started out as recruiting support workers, such as administration, cleaning and security. However, the fieldwork found that in recent time firms in the electronics and automotive sectors have been using outsourced workers, as well as fixed term contract workers, to run their production.

The inclusion of outsourcing in the new law meant that firms are only allowed to recruit supporting workers and not workers for their main business line. The fieldwork found that trade unions actually argued that by allowing outsourcing as a company policy, firms could indiscriminately hire outsourced workers and thereby leaving regular workers out in the cold. They pointed to the fact that the government lacked the resources to monitor the application of outsourced workers within certain firms. In addition, they also argued that outsourcing weakens the membership of the unions because outsourced workers are not part of the company workforce and structure and hence cannot join the plant level union.

The second controversial issue is the fixed term contractual working agreement in Article 59 in the new law. The government has strengthened employee protection for workers who worked under the fixed term working agreement. In the new law, fixed term working agreement periods cannot be applied to continuous or regular work. Fixed-term working agreement can only be used for temporary work, work that takes at the most three years to complete, seasonal work and work for new products or process that are in the experimental stage. In addition, the regulation is now legally binding. Previously, the government could only apply administrative punishment to firms who violated the fixed term working agreement scheme. Under the new law

firms who violate the law are subject to criminal as well as administrative punishment.

Trade unions and other labour activists have, in the past, accused firms of cutting costs through the continuous use of fixed term working agreement scheme. Workers under this contract were allegedly re-used as contractual workers without having been elevated to regular status after several extensions. In addition, it was disclosed during the interviews that contractual workers of this type worked on jobs normally reserved for regular workers. Indeed, findings in the field seemed to confirm the allegations that contractual workers worked alongside regular workers and worked in similar jobs. Only two electronics firms (eight percent of the sample) admitted to increasingly use contractual workers, though all trade unions officials interviewed alleged that most firms where their members work use contractual workers in addition to permanent workers. They also reported that these contractual workers normally do not belong to any trade unions, and thus not included in the collective bargaining.

In addition to work relations there are also other new articles in the law that can potentially increase labour cost to firms. In Article 156 on severance pay and other compensation, there is an increase in the maximum number of months for severance pay. In the previous law the maximum number of months for severance pay was seven months. Under Article 156 of the new law, workers who have worked in the company for eight years or more are to be given at least nine months of salary. Companies that lay-off their workers would have to spend more for laying off workers, especially if they were to lay off older workers (for example, workers aged 45 and above), and replace them with younger workers. Replacement costs, such as recruiting, selecting, training and facilities costs, are always high.

Another potentially costly endeavor for firms is the additional management system for occupational safety and health. Occupational safety and health has been an important part of work relations as stipulated in the old law. However, Article 87 under the new law would require firm to set up a whole new system (which could mean a new unit or department) that specifically tasked for such an endeavor. This would mean additional cost for hiring new workers with occupational and safety management skills, namely workers with ergonomics skills and so on. In addition, extra supervisor

or managerial positions may have to be set up to meet the new standard. However, in the long run, the new system may improve working conditions and productivity by decreasing the number of accidents and injuries to workers.

Other Significant Changes in the Law

A notable improvement is an article related to recently controversial Ministerial Decree No. 150 (*Kepmenaker No. Kep-150/Men/2000*) which stipulated that severance pay should be given to employees who left the company no matter what the reason, including those who quit or commit an offence (SMERU 2002). However, under the new law, as stipulated in Article 158, an employee dismissed due to a grave offence can only be given replacement pay⁴. Under the previous ministerial decree employees of this type not only receive replacement pay, but also reward pay, while Article 162 of the new law stated that an employee who voluntarily resigned could only receive replacement pay.

Another important change in the law is the provision allowing child labour under certain conditions. Contrary to the fact that the government has ratified the ILO convention of not allowing children to work alongside adults, Article 69 reaffirmed that stand with a few exceptions. Children are allowed to work if they are working in family-owned businesses. The issue of allowing child labour in this condition was rejected by several trade unions. They argued that by legalizing child labour, firms could employ children under the pretext of helping their families.

The issue of minimum wage is also reaffirmed in the law. Article 89 under the new law stresses the decentralisation of minimum wage fixing from the central government to local government. In addition, even though the need for sectoral minimum wage was mentioned in the old law, it is now vigorously pursued by trade unions. Several unions, notably unions in the high paying manufacturing sub-sector are pressing very hard to apply sectoral minimum wages to their sub-sector. In fact, the interview revealed that they have succeeded in applying sectoral minimum wages in two sectors in the district of Bekasi. Results from the field have confirmed that the district of Bekasi has applied sectoral minimum wage in 2003 for the electronics and automotive sectors. The sectoral minimum wage is 15 percent higher than the

⁴ Replacement pay is a pay given to employees who, for some reasons, were laid off.

prevailing district minimum wage in Bekasi. Even though the minimum wage only applies to firms with final products, the respective unions are pushing to expand the minimum wage to sectors that does not produce final manufacturing products.

The application of sectoral minimum wages also has the potential to increase labour cost. By definition, the sectoral minimum wage must be higher than the regional minimum wage (Reference). Trade unions argued that sectoral minimum wage for certain sectors should be applied because wages in high paying sectors cannot be compared with wages in low paying sectors. However, they added that wages in their sector are already much higher than the general minimum wage and that applying the sectoral minimum wage is only legitimizing their already high pay. They do not take into account the differentials of wages even in their own sector. The researcher could not find evidence of firms that can only pay workers at the minimum wage level. However, an interview with a trade union official in an electronics firm revealed that workers in a neighboring electronics firm received wages at the prevailing minimum wage level. These firms may suffer if sectoral minimum wage were to be applied. Moreover, minimum wage setting was based on workers minimum needs and thus, it is unclear what criteria would be used to determine sectoral minimum wage, not to mention the complication of the process for determining it.

Potential Impact of the New Employment Law on the Business Climate

The ultimate concern about the potential costs of the implementation of the labour laws will not just be the negative investment climate, but also whether there is de-industrialization or but a hollowing out of manufacturing sector. The sectors that will potentially suffer the most will be those that tend to be labour intensive, such as footwear and garment, and medium-size industries. The number of establishments and workers in these sub-sectors would substantially decline. These sub-sectors were already under tremendous pressure due to decreasing global demand. Subsequently, potentially laid off workers from these sectors would end up in the informal sector. They tend to be unskilled and thus, unlikely to join the high-skilled technology sector. Eventually, in the long run, the crowding of the informal sector would put enormous pressure on the government to do more for the informal sector. The high tech sector such as the electronics and the automotive parts will experience somewhat slower growth. Interviews with managers from the electronics sector revealed that the

establishments were not significantly affected by increases in minimum wage. However, other potential labour costs explained above would surely affect these sectors as well.

The potential danger of the new employment laws, which includes the implementation of the sectoral minimum wage, is that it may harm those sectors which were previously did not experience the negative of the economic crisis and the minimum wage increases. High technology sectors such as the electronic and the automotive sector still enjoyed growth and would only contend with international competition. Firms in this sector also rely on new products to increase production and sales. However, if conditions are not conducive due to the new labour law, then this sector would also be in trouble. For instance, the implementation of sectoral minimum wages in which many trade unions are now pursuing vigorously may do more harm than good. Based on the fieldwork and secondary data, it was observed that many of the firms in the electronic sector are paid significantly above the prevailing minimum wage and applying the sectoral minimum wage will not affect some of these firms. However, the fieldwork also revealed that some other firms i.e., firms that still pay workers regional minimum wages may be adversely affected by the new sectoral minimum wage. In addition, different settings of minimum wage by different regional wage council may also have a significant affect where different province, or even district, have different method of applying sectoral minimum wages.

Law Number 2, 2004 on Industrial Relations Dispute Resolution

To lesser extent, but perhaps more futuristically controversial is the hotly contested new Law Number 2, 2004 on the industrial relations dispute resolution. Approved in January 2004, the law is still being criticized by many labour representatives as well as businesses. Even though the bill was eventually passed by the House and became Law Number 2, 2004, there were still debates on the implementation of the law. That debate had resulted in the delay in the implementation of the law until 2006 by the newly elected president, Susilo Bambang Yudhoyono (*Kompas*, 2005). The issue of dispute resolution was an important aspect of that law that can potentially increase the influence of trade unions.

The main content of the law is the dispute resolution machinery which consisted of four types of mediation and an employment court. It replaces the previous mechanism of dispute resolution through the local and national dispute resolution committee (*P4D and P4P*)⁵. One of the changes in the bill is the change of dispute resolution between employer and employee. It is difficult to understand the objections of trade unions on the issues other than being too favourable to businesses. Perhaps, the reason for their objection lies in the potentially lengthy legal procedure workers must endure to help solve industrial conflict. Unlike the previous law where local administrative court is the last resort for dispute resolution, the new bill proposed that disputes can now be settled at the ad-hoc local court where three judges, one career, one appointed by trade unions and one by employer association, are chosen to lead the proceedings. The results of the dispute resolution will be much more objective, at least viewed from worker's perspective, than the previous method.

In addition, the new bill also introduces a new system of arbitration for industrial dispute between the disputing parties. The new system introduces mediation, conciliation, arbitration and adjudication. In the previous laws (Law No 2 1957, Law No 12 1964, and Law No 5, 1986), the government provided three systems, arbitration, dispute resolution council and local court. The new law will focus more on negotiations between employer and employee with less government intervention. Dispute resolution will be settled in court only as a last resort. Even then, the principles of negotiation still apply because each side can represent themselves in court via adhoc judges. Previously, the government intervened frequently because prevention of labour disputes was considered crucial for national stability.

The new law is not directly related to the decentralized minimum wages as it focused more on firm-level industrial relations. However, lack of compliance of minimum wage law could be a significant precedence to industrial conflicts. Recent data showed in Chapter V confirmed the lack of minimum wage compliance as the number one cause of industrial conflict. Nonetheless, freedom of association to any union is already allowed and should minimize industrial conflict. The future of industrial relations should shift away from minimum wage compliance and union presence

⁵ P4D or PPPPD (Panitia Penyelesaian Perselisihan Perburuhan Daerah) stands for the regional committee for industrial dispute resolution, whereas the P4P or the PPPPP stands for the national committee for industrial dispute resolution.

issues to non-basic labour rights such as those included in the collective labour agreement.

Current Development of Trade Unions

The discussion on the impact of minimum wage would be incomplete without also discussing the impact of trade unions that enjoyed significantly greater freedom since *reformasi of 1998*. Prior to the ratification of ILO Convention Number 87 on Freedom of Association in 1998 and since 1955, trade unions in Indonesia did not enjoy greater freedom of organization. Prior to the ratification workers were only allowed to join a state endorsed union, the SPSI (All Indonesia Labour Union). After 1998, workers could set up their own trade union, firm level or otherwise, with a minimum of ten workers. Up to 2003 there were 71 registered trade unions, federations and two confederations (consisting of federated unions) registered with the Ministry of Manpower and Transmigration (Ministry of Manpower and Transmigration, 2003; ILO, 2003). Each federation has its own regional branch and establishment or plant level unions as members. In addition, there are also firm level workers' associations that do not belong to any of the trade union federations. The implication of greater union freedom means greater bipartite and tripartite bargaining power of workers in determining their compensation and other welfare, and workers are more adequately represented in any government policy making. Trade unions had been more and more involved in collective bargaining, helping to determine minimum wage levels in the designated area and also in formulating the new labour law. They are also maintaining grass-root level power pressure on the government. Some have even gone so far as establishing their own political party to vie for the next election in 2004. The greater union activity was never more so than in manufacturing.

Trade Unions in Manufacturing

Indonesia experienced an explosion of newly established trade unions in 1998. In addition to 71 national level trade unions or federations, there are also two confederations of unions competing for members. The newly formed Confederation of Indonesian Trade unions (*Komite Serikat Pekerja Indonesia-KSPI*) is the main rival to the established Confederation of All Indonesia Workers Union (*Konfederasi Serikat Pekerja Seluruh Indonesia-KSPSI*). Many workers had been disappointed in

recent times by the *KSPSI*'s alleged ties with the central government. *KSPSI* was also seen as an agent of control rather than reform if political struggle intensifies (Manning, 1998). In addition to federated unions, there were also instances where independent trade unions did not answer to any higher-level unions. Among the 71 registered trade union federations, more than fifty percent are active in the manufacturing sector⁶. Most operated in the formal sector, though findings in the field revealed at least two trade unions were active in the informal sector.

Trade unions in Indonesia have been undergoing transformation since the ratification of ILO convention Number 87 on Freedom of Association. They have been enjoying certain privileges provided by the government. For instance, they have more significant influence now in the provincial as well as district and city wage councils. Under a new proposed industrial relations bill, they are even allowed to legally represent labour as ad-hoc judges in local court to settle industrial dispute. Moreover, with their newly acquired powers they were able to, in some cases, influence district heads, and even governors, to overturn earlier verdict on the minimum wage. One trade union was able to receive the attention of the Supreme Court to review the West Java governor's decision to delegate district and city minimum wage fixing to districts and city (Wirahyoso, 2002, p. 83). Even the allegedly weak *KSPSI* (formerly known as the state-controlled *SPSI*) were now found to be more vocal in their pursuit of welfare for their members than before the crisis. It can be assumed that government intervention in trade union affairs has been significantly reduced. The balance of power has shifted somewhat to the side of labour.

Although the current employment law allows the formation of more than one firm level union, the research could not find evidence in the field of any multiple unions in any of the firms surveyed. A trade union can be established with at least 10 people. However, interviews with trade union officials did reveal the possible existence of more than one union in one firm. Unions do not object to multiple unions in the firms where they operate. However, in principle, they argued that more than one union in a

⁶ The writer found that unions employ different method of dealing with employers: The majority of unions interviewed prefer to actively negotiate with employers. There were also passive unions that seemed to be content in dealing with employers. The researcher found one union which tended to employ radical methods to put pressure on employers as well as the government in achieving their goals.

firm might diminish their bargaining power. The writer found that in one firm in Tangerang, the official interviewed acknowledged that while only one union exists in the firm, he could not rule out the possibility of other small unions operating within the firm. This suggested the reluctance of employers to deal with more than one union within a firm because of complications in negotiation with more than one union.

Firms also negotiate with only one union in the firm. Normally, a firm only negotiates with the dominant union in the firm. Minority unions were not allowed to negotiate and should join forces with the dominant union to negotiate. Moreover, most firms accepted the existence of trade unions but vehemently rejected the establishment of more than one union in their firms. In one interview a trade union official accused some firms of allegedly creating another union in their firms deliberately to counter the growing power of the union. Two firms even preferred only firm level unions without any link to federated unions. The researcher also found three firms, all in Bandung, which did not have any form of workers' association.

The establishment of so many unions may also be a two-edged sword with respect to the bargaining power of the union itself. There is a concern that too many unions may eventually diminish the collective power of each union. One study by Al Hamba concluded that the existence of rival management-controlled firm level union, inter-union rivalry to obtain seats in tripartite institutions and decentralisation of minimum wage setting to province and even district level, may cause polarization of union power (2002, p. 48). In addition, the economic downturn may also decrease the power of unions due to massive lay-offs. Since many unions are active in the textile, garment and footwear sector and many workers from these sectors were laid off due to firm closures and efficiency, and it could be also argued that unions losing membership also diminish a union's capability to bargain.

Findings from the Fieldwork

The fieldwork found that 12 out of 16 large firms interviewed had some form of trade unions. However, six of eight medium firms did not have any form of worker's union. This means a 58 percent union presence in total. The result is somewhat similar to the result from the ADB/Worldbank survey explained in Chapter VIII which showed a 55

percent union density. The tendency was for large firms to have a union and medium firms not to have a union. The figure showed a lower percentage than the minimum wage compliance level. Thus, these figures confirm that firms were likely to pay the minimum wage rather than allow unions to flourish. However, in the future, the new era of openness may have prompted firms to change their views on unions lest they face legal challenge from workers.

Several managers who were interviewed showed that many firms dislike the idea of having trade unions. The majority of managers interviewed showed genuine apprehension to union militancy. Nonetheless, there were occasions where employer-employee relationships seemed to be reasonably peaceful. The researcher found two firms in which unions and management had a good relationship that the management allowed the firm level union to be interviewed at the same time frame with the top management. In an electronics firm, the researcher was allowed to interview both management and firm level union officials, albeit at different times. The relationship was relatively amicable also that during the riots which followed the 1998 crisis employees were more than willing to guard the firm from looters. In another interview, a garment firm had shown a good relationship with workers by virtue of being allowed not to pay the prevailing minimum wage to workers due to lack of overseas demand. A confidential document was shown during the interview detailing the negotiations between the management and workers not to increase wages to the current minimum wage. Even though no trade union official was present during the interview, the document seemed to indicate that the workers understood the problems faced by the firm and opted to disregard the new minimum wage for the time being. The document did not show any coercion on the part of the firm, or any objection on the part of the workers.

All the unions studied, with the exception of one, focused on negotiations via the collective bargaining agreement to increase the welfare of its members. However, their so-called struggle was still at national, and to some extent, at regional level. Increasing the nominal value of the minimum wage appeared to preoccupy trade unions rather than bargaining for better wages at firm level. The statutory minimum wage, in this case provincial and district/city level, is still considered a non-negotiable

basic right which firms must pay without reservation. Firms that cannot pay must register at the manpower office and provide evidence of their inability to pay.

Most trade union officials still appeared to regard minimum wages as sacred. Only one official from the SPTSK agreed with the “new” concept of minimum wage as a safety net wage, and should still be negotiated with firms. Other union officials echoed the same demand as workers in general with regards to the minimum wage provision. They insisted that the statutory minimum wage cannot be negotiated and firms must comply with this regulation. In fact, workers tend to conduct strikes, wildcat or otherwise, if firms do not comply. Figure 4.6 in Chapter IV indicated that main cause of strikes was overwhelmingly due to the refusal of firms to comply with the minimum wage provision.

Composition of Firm-level Unions

During the interviews with firm-level unions the researcher found several indicators which could undermine the independence of trade unions. The new regulation allows workers in one firm to form more than one union. However, none of the 24 firms surveyed had any indication to have more than one union operating in any one firm. All five firm-level unions interviewed said that the majority of workers in their respective firms were members of their unions, but did not say of any other rival union in the respective firm. One firm level union official, nonetheless, mentioned that several workers had planned to set up rival unions in the company. He could not elaborate further and the researcher could not confirm or substantiate his explanation. Interviews with trade union officials from two national and one regional union official did mention that there were firms that had more than one trade union. In addition, firms tended to deal with only one union, and might disregard other unions which could operate in the firm.

The writer also found other irregularities in the trade unions interviewed. Firstly, the writer found that the unions had ‘good’ relationships with the management. Considering the antagonistic relationship between management and unions in the past, it seemed too good to be true. There could be two reasons why this happened. The union is either from the old guard SPSI, where they tend to be more cooperative or the

unions really do preferred collective bargaining to voice their demands. The second profile that did not fit the pattern was that on two firms, part of the management (i.e. lower or middle managements) was also included in the trade union. Even though the managers were only middle managers who were also members of the union, the arrangement could undermine the independence of the union. It was not clear whether this is the firm's strategy to control the trade union to promote industrial peace or because the membership of that particular union was also open to supervisory level. Thus, there is lack of clear understanding on who should compose the trade union. The fact that these firms were controlled by Japanese multinationals might explain the reasons behind the inclusion of management in the firm level union⁷. Nonetheless, it seemed that the workers interviewed did not have any objections to this arrangement. It was also notable that wages in these firms were higher than the prevalent minimum wage level.

This method of Corporatist control appeared to be different in different Japanese multinationals. The researcher found at least two methods during the field visit. While the two firms visited did not discourage firm level unions, the management opted to include middle or lower level management to control or at least monitor union activities. In another Japanese multinational, firm level union was discouraged. However, wage levels were said to be much higher than the minimum wage.

Impact of Unions

Though the existence of official independent unions only started in 1999, their presence had already reverberated throughout the country. Clearly the fieldwork revealed differences of opinions regarding the presence of trade unions in companies. The interviews revealed that most firms still regarded unions as intrusive and they were reluctant to allow their presence in the company. Others (two firms) with similar opinions prefer establishing their own workers association, but banned them from affiliating with outside unions for whom they regard as militants. Those that do

⁷ Firms with Japanese FDI appeared to follow Japanese style of export-led industrialization. Labour peace and continuous industrial investment relied on traditional corporatist controls at enterprise level (Deyo, 1987, p. 199). The inclusion of middle management in the two firms, both of whom were even leader of the enterprise union, appeared to be a way of monitoring union activities. Nevertheless, workers in the firm also appeared to be considerably content with the arrangement. They were even allowed to join a solidarity protests in other firm to support workers of that firm.

recognize unions in their firms prefer the former state controlled union (SPSI) that they do not regard as militant.

In addition, the chairperson of SPTSK claimed that the government still treated trade unions as political organizations rather than social organizations (Interview S01, February 2003). He argued that the current decision making of trade unions at national level are still politically linked and not based on grass-root needs. The government conception is not without evidence. The FNBI trade union interviewed displayed a Marxist approach to industrial relations. The notion of the approach is that the ultimate goal of workers' struggle is the overthrow of the current government and hence, capitalism (Interview S07, February 2003). During the interview they regarded themselves as labour activists, not a trade union, even though they are registered officially as a trade union. Their approach to industrial relations seemed to mainly focus on popular pressure, rather than through negotiations that dominant unions aim to achieve. Other evidence also point to a linkage between a labour union and a political party. Furthermore, one trade union also set up a political party to fight for the 2004 general election.

Evidence found in two closed firms showed that decreasing market demand for their product was the primary reason for the closures. However, upon closer inspection the researcher surmised that these two firms have had similar labour problems prior to their closures. One firm experienced constant labour problems even though the employer alleged that employees were paid minimum wages. The other firm also experienced labour problem due to the changes in the production process. These labour problems which also caused riots may have accelerated the employers' decision to close the factories rather than maintaining it further.

Interviews with labour union officials had revealed the difficulties of managing a union in a firm. Although management to some extent accepted the existence of unions, discrimination still existed. Unions have revealed that management sometimes harassed their active members. One official from the closed footwear firm stressed that he was worried that he may never obtain another job due to his infamous reputation as an outspoken labour activist. Indeed, there were two firms in the electronics sector that showed dislike for federated union. The management only

allowed firm level union, but did not allow any affiliation with any federated union. Smaller firms, like those found in Bandung, objected to any type of workers' representation without explaining the reasons.

Thus, it is safe to assume that the evidence points towards a significant level of resistance towards the increasing power of trade unions to the point that firms tried to find ways in dealings with unions. Disputes between newly empowered trade unions and employers, in addition to widespread security problems, were often cited factors discouraging investors from coming to Indonesia (*The Jakarta Post*, 2003b). Some electronic firms would rather pay workers high wages rather than have workers form independent trade unions. Thus, the union threat effect prevailed in two electronic firms that the researcher visited. One firm clearly explained that they asked the workers whether to choose between joining unions or receiving wages higher than the prevalent minimum wage level. The firm insisted that workers in the company preferred to receive higher wages than organizing into a union. The Human Resource Manager commented:

...minimum wages does not effect the company objectives...our relationship with our workers are generally sound, but we do not have a labour union, only an employer-employee forum...trade unions tend to become oppositions to management rather than partners of production (Interview 07, March 2003).

The manager interviewed pointed to the militancy of trade unions as a threat to the production process. The other firm could not confirm the union threat effect, but admitted to providing high wages and not allowing the formation of firm-level trade union independent of any influence from outside unions, i.e. regional or federated union. However, both firms did have their own workers' association, even though the researcher was not allowed access to the workers.

This view is actually similar to the view of the government *vis a vis* the ILO. Both envisaged a development of labour union at grass root level, i.e. firm-level union. The idea was that a stronger firm-level union would be better equipped at collective bargaining with employers. The interview with several trade union officials revealed

that the central or regional offices often intervened in matters of industrial dispute between its members and employers (Interview S01, February 2003; Interview S03, February 2003; Interview S06, February 2003; Interview S09, February 2003). Even though they insisted that they only assist as a last resort, they did report a lot of assistance to the firm-level unions. In one interview in Bekasi, the regional head of a trade union even assisted in industrial dispute at a firm that produced Sony electronics products.

There were also indications that much greater flexibilisation of labour is in the offing. Evidence from the field suggested that firms were increasing their non-full time workers through fixed-term contract and outsourcing. Even worse, one union official reported that firms were even considering the flexibility of working time in which workers could only work on demand (Interview S12, April 2003). Greater flexibility could also spell trouble for union members as flexible workers are usually non-union members and meant that regular workers, where most union members belong to, are under threat of lay-offs.

With the legalisation of outsourcing and fixed-term workers under the new employment law, there is likely to be more flexible employment in the future for two reasons. First, part time workers decrease the cost of benefits supposedly given to full time workers. Even though firms still pay them minimum wages, firms have little concern for benefits enjoyed by full-time workers. Secondly, part time workers usually do not belong to trade unions. Thus, firms can negate the effect of both trade union power and minimum wage increases by using more and more part time workers. The union threat effect could also induce firms to gradually switch to non-permanent workers to minimize the risk created by union activities. The researcher found that although some unions genuinely prefer collective bargaining, firms were still weary of damaging strikes posed by workers especially when firms are still recovering from the recent crisis.

It is likely that trade union activities, in addition to corruption in which Indonesia has been consistently voted as one of the worst in Asia, presented a much greater challenge to economic development than the minimum wage policy. Under the current development strategy of EOI (Export Oriented Industrialization), increasing

foreign investment is seen a crucial step to increasing employment. Levine stressed that wages are not the only factor in attracting investment and if labour activism grows to the point where it drives off present employer to other countries, to say nothing of prospective investors, it is difficult to see how Indonesian workers will benefit from the actions of hard line trade unions (1997, p. 214). Fortunately, the current dominant trade unions in Indonesia, including Pakpahan's SBSI, had chosen the welfare state approach to industrial relations by focusing more on collective bargaining rather than political pressure. However, the recent set up a political party by SBSI to actively fight for the welfare of their members showed a sign of the politisation of the issue. Their party, the PDSB (*Partai Buruh Serikat Demokrat*) or the United Democratic Labour Party recently took part in the 2004 election where the party only won approximately two percent of the votes (KPU, 2004). The party eventually joined other party to contest for the presidential election in August 2004. They had chosen to ally themselves with other parties to promote Amien Rais as president.

Other evidence from the field suggested that most of the large trade unions prefer collective bargaining rather than the FNPBI's Marxist approach to industrial relations. Still, there were many smaller unions who acted as pressure groups. The probable reason for their actions is because they were not allowed to participate in the formulation of labour policies. The simple fact is that, even at local level where trade unions negotiate local minimum wages, smaller unions were not often included in the negotiations because they were small and considered to have insignificant number of members, even though they offered the loudest voice when it comes to protesting seemingly unpopular labour policies.

Impact of Decentralised Minimum Wage Fixing on Union Participation

The decentralisation of minimum wage setting has had a significant impact on union activities, especially in local areas. The organization of trade unions since the 1998 reformasi has been growing strong at national level. Union bargaining leverage had been strengthened by the amalgamation of unions to form federations and even confederations. However, the weakness of a labour union as an institution has been

exposed by decentralisation process. Many trade unions, especially the top unions, were politically based and relied on the top-down approach to organization. Many of their leaders were politicians or people allied to political parties. Indeed, during the fieldwork many of the unions visited were non-grass root unions. Of the ten unions visited, only two showed that they were grass root unions. However, one union had ties to political parties and one was considered true grass root union.

The decentralisation process had the potential for the polarisation of the power base of unions. Al Hambra charged that decentralisation of policy to local level was one of the major factors contributing to the polarization of trade union power in Indonesia (2002, p. 48). Officials from eight of the ten interviewed unions admitted reluctantly that they were not quite ready to adapt to decentralisation. All the union officials interviewed even insisted that the decentralisation process has not affected them significantly. The danger of fragmentation and eventually weakening of the union might occur with the decentralisation of minimum wage fixing.

Nevertheless, during the interviews with union officials, they were making efforts to counter the situation. One of the strategies was to have their members at grass root level to be more active. They were planning to elect their officials from regional or firm level unions outside Jakarta, instead of appointing someone from the main office in Jakarta (Interview S01, February 2003). They hoped that local leaders would be more acceptable to firm level union members, as well as more aware of local conditions. Indeed, a firm level union leader was so active that he became something of a national icon among workers. He even said that he traveled to several countries to participate in international labour events, as well as conducting protests against the multinational company that controlled the firm where he used to work and was fired from (Interview S10, March 2003). The fieldwork also revealed that the trade union representatives in the wage council, who themselves were often union leaders at firm level, appeared to be successful negotiators at firm level (Interview S13, April 2003). Firms who employed these workers, of which the researcher also visited, also showed signs of stability in industrial relations. Obviously, their exposure to district level minimum wage negotiations had made them more experienced in negotiations at firm level. This type of exposure should be pursued by other trade unions. The advantage of firm level negotiations is due to its bipartism where only two sides are involved.

The government would act more as a facilitator only if negotiations break down at firm level. Thus, trade unions would not have to be concerned with unfair voting that they claimed they experienced in the wage council. Unfortunately, new and smaller unions were often not represented at the wage council and thus must rely on other means to get their point across, such as forming a united front with other smaller unions and conducted rallies.

A study by Wirahyoso (2002) also revealed responses of trade unions in West Java, especially the SPTSK. Among others, trade unions considered the provincial minimum wage in West Java to be inconsequential because the governor had delegated the minimum wage fixing to district or city officials. Secondly, trade union also wanted to set the minimum wage the same level as the minimum subsistence need. Thirdly, trade unions conducted their own comparative market survey to make sure that the survey conducted by the wage council is commensurate with the real world. Fourthly, trade unions need to lobby the government for a stronger bargaining position. They felt that, even though trade union representation in the wage council has improved, it was still deemed inadequate to truly involve trade unions in wage negotiations. Lastly, trade unions were making an effort to lobby for the abolition of minimum wage exemptions because it does not comply with the spirit of the minimum wage itself.

The fieldwork revealed trade unions were striving to capitalize on their new found power. Firstly, their stronger voice in the wage council appeared to have succeeded in obtaining large minimum wage level increases in 2001 and 2002. In fact, in the Bekasi wage council, trade unions were able to top the minimum wage increase by forcing the council to impose sectoral minimum wage for one sector, the electronics sector. The success had apparently prompted trade unions in Jakarta to do the same approach. Their argument stemmed from the fact that, on average, wages in that sector are relatively high compared to other sectors. Secondly, they were able to formulate their own level of minimum subsistence need in which they were able to present and discussed in the wage council. Even though their proposal was rejected by the council, it had a spillover effect of informing other trade unions in other districts/cities to present the same proposal. Thirdly, in some districts the power of the

trade union was shown in its ability to overturn decisions on the minimum wage level which they felt did not reflect the real situation.

'Best Practice' Industrial Relations

The writer also witnessed reasonably good relations between employers and workers where wage negotiations ended favorably on both sides. In one garment firm in East Jakarta, negotiations between workers and employer ended peacefully, even though the firm was unable to pay workers the current minimum wage. Workers and employers in the firm were able to strike a deal to postpone the minimum wage until such time that the firm is able to pay the workers the minimum wage. The firm cited lack of overseas order as the reason behind the inability to pay their workers minimum wage (Interview 10, February 2003). The workers seemed to agree with the firm's explanation and chose to follow the firm's suggestion. This was an example of cooperative industrial relations which seemed lacking in most Indonesian firms.

Another example viewed by the researcher came from a different outcome of wage negotiation, but with a similar result of achieving industrial peace. Workers in a famous battery firm in South Jakarta actually routinely receive the prevailing minimum wage every time there were changes at regional level. The firm's willingness to pay the minimum wage and other employment benefits were rewarded by employee loyalty and increased productivity. The managers of the firm explained that the relationship between the firm and its employees were relatively good that during the riot of 1998, employees were willing to take turns guarding the factory complexes against rioters and looters (Interview 01, February 2003). The manager said that the firm had never reneged on paying the workers minimum wage. The manager's assertion was confirmed by the union leader who was interviewed on the same day. They also added that instead of focusing on low wages, the firm emphasized improvement of product and market penetration. They also told the researcher that they were producing a new type of alkaline battery to be marketed abroad.

The new employment law and industrial relations dispute resolution could also improve industrial relations in the future because of the legal certainty entailed under these new laws. The new laws are very specific in regulating minimum wages, outsourcing and fixed-term contract workers, compensation, as well as creating a new employment court to settle disputes. The employment court would ensure much more objective rulings which would restrict government interventions in settling labour disputes. These new laws could potentially prevent many conflicts arising from too much government control in the past.

A Tale of Two Firms: Closures of Two Firms in the Jabotabek Region

In this section two examples of industrial conflicts which could have been solved arbitrarily and quickly are examined. One of the highlights of the field work was a visit to two distinctly different firms which had closed down or were in the process of closing down. The first firm to be visited was a footwear firm that supplied Nike sport shoes (Interview S10, March 2003). The second firm visited was an electronics firm producing Sony electronics products that was in the process of closing down. The writer was able to visit the factory of the first and was able to speak to several former employees of the firm, including the former head of the firm-level union. This person considered himself as the go-between where he helped negotiated settlements between workers and management. He was the union leader from the SPTSK trade union. He was kind enough to provide information on the firm's demise, and explained his view on the current labour issues in Indonesia. He became quite famous because of his involvement in labour disputes in the company. He also became a symbol of the struggle of Nike workers' oppression and had traveled to several countries to protest Nike products. Interestingly, apart from Nike operations, most export-oriented factories adhere to national laws in respect to wages and working conditions, yet it is rare for them to pay women all of their wage, benefits and leave requirements (Bennington and Habir, 2003, p. 387). One of the reasons being that most export-oriented factories needed skilled workers in which the majority of them were men.

Another licensed firm which produced the world famous Japanese electronics brand, Sony, was much more difficult to approach (Interview S15, April 2003). This was the second of the two closed firms that was used as a study. The researcher was not able

to enter the second firm due to the sensitivity of the situation. It was explained by the respondent that there was an intense industrial dispute concerning compensation between management and worker. Attempting to gain entry into the factory and speak to the managers would not be a good idea at the time. According to union officials, the management was under orders not to speak to anyone and was even accompanied by bodyguards for protection. Upon visiting the production site, the researcher found the place deserted, under lock and key. Nonetheless, the researcher was able to gain interviews with the local union leader as well as obtain several important documents from the union official on events culminating in the closure of the firm (SPMI, 2000).

The main goal of the visits was to find the reasons for the closures, whether increases in minimum wage had a significant impact in the firm's closure, or whether other issues were responsible for the firm's closure. Generally, minimum wages were found not as the main cause of the closure, but other factors, such as the rise of trade union power and their subsequent militancy, plus decreasing world demand were likely as the main cause of the closures. Even though union militancy occurred long before the democratic transformation of 1998, it appeared to intensify following the political euphoria. The initial cause of the strike stemmed from the fact that workers accused the firm of not paying the minimum wage and expanded other working conditions. Global alliance reported that mistreatment in highhanded unfair fashion were apparent in nine out of 11 Nike suppliers in Indonesia⁸. Even though the firm eventually paid the minimum wage, other labour issues started to emerge which earned Nike the infamous nickname, Satan's factory⁹. Breakdown of negotiations between management and union were followed by violent strikes by workers. The local union leader blamed this accumulation of labour problems as the pretext for Nike to take away the quota of this particular firm. According to the union leader, the Korean investor had already started to relocate their production to Vietnam and Bangladesh.

⁸ The mistreatment stemmed from the minimum wage problem, sexual abuse, lack of clinical facilities, etc (*Kompas*, 2001e). In addition, many workers were afraid of speaking out for fear of reprisal from the management. There were actually 11 Nike suppliers in Indonesia, and not 10 as reported by the respondent from the Nike supplier.

⁹ The term satan's factory came from Hancock's study of Nike workers in West Java who had to work from four in the morning and went home after eight pm, like walking ghosts who worked in Satan's factory (Clean Clothes Campaign, 1996). Ramos Horta, the East Timorese independence hero, even likened Nike contractors' operations to Japanese occupation of the archipelago (Center for Communication and Civic Management, 2005).

Initial findings in the field seemed to suggest at first that the establishment of trade unions did not lead to closures of establishments, but rather its subsequent militancy. After interviewing union officials in Bekasi and studying relevant documents, the researcher found two cases where workers' unrest was present prior to the establishments' closures. Furthermore, union officials from the two firms investigated argued that increased labour union activity might be one of the reasons for the demise of the two firms. The two strikes reported were caused by management decisions and solidarity strikes for workers who were about to be laid off for causing the first strike.

In the footwear firm that used to produce Nike shoes initially started to produce different types of shoes not related to Nike products. However, according to the union official, since 1993 the company struck an agreement with Nike to produce different types of Nike shoes. It became part of the Nike supply chains worldwide. Nike formerly employed only about 20 000 workers, but estimates that approximately 500 000 people employed in making their products (Oxfam International, 1999, 190). The company even planned an expansion by building another factory building at the back of the old one in 1996 due to a promise by Nike for more orders. The researcher did see a huge factory building at the back of the old one, although it did not seem to be operational at any stage.

Reports of appalling labour conditions were, in the point of view of the union official, greatly exaggerated. Though he did admit that there were instances where workers were treated unfairly, working conditions were much better than many other companies in the area. He explained that the main reason for the company to put pressure on workers was due to the fact that the profit margin provided by Nike to the company was very tight. Thus, the company had no choice but to put pressure on workers to meet the demand set by Nike. It appeared that the pressure put on the workers might have been a catalyst for labour problems in this company.

The main reason for closure was, according to the union official, Nike's decision to cut the quota from Indonesia by more than 40 percent¹⁰. Instead of decreasing the

¹⁰ A quota is a share of the total NIKE shoes produced worldwide given to the countries that produced them. Indonesia had 9 establishments that produced NIKE shoes and this establishment was the biggest

demand from each of the 10 establishments that produced shoes to Nike, demand from this establishment was annulled altogether. A union official from the footwear firm stressed that violent labour unrest occurred just before Nike officials were to decide on whether or not to decrease the quota from Indonesia. The union official was not entirely clear whether labour unrests within the establishment were the catalyst for its closure. The chairperson of the SPTSK also argued that the firm was sacrificed because the labour union had become stronger (Interview S10, March 2003). The sudden closure of the firm was unexpected and caught the workers by surprise. Although Nike claimed that the closure was not sudden and Nike had informed the factory's management as early as February 2002 (*Kompas*, 2002). This particular factory was said to be less productive than the other 10 factories in Indonesia.

Now thousands of former workers are trying to cope with new life without jobs. Some, including the labour leader, had attempted in vain to join the informal sector by selling noodle soup or locally known as *Mie Bakso* (Interview S10, March 2003). Others, according to the union leader, engaged in informal trade, *Ojek*, and some even resorted to prostitution. Those who were lucky were able to find similar jobs in other shoe factories. None were interested in becoming overseas workers. Many were still seen milling around the factories with no jobs. One of the reasons for staying at the factory was that they have to guard factory property from looting. Perhaps the reluctance to leave was also due to the fact that they had not resolved their severance pay with the firm. It was explained that the proceeds from the sale of the firm would be used as severance pay for the workers.

The other case involved an electronic firm that produced Sony electronic appliances in Bekasi. The decision to close the establishment was reportedly due to be the firm's global decision for retrenchment. Sony was reportedly planning to concentrate its manufacturing facilities in Malaysia. To achieve this objective, they felt that they had to close some of their factories in several countries, Indonesia being one of them. Nevertheless, a labour union leader interviewed explained that a few years prior to the closure there were several significant altercations between employers and employees that resulted in strikes. A document obtained from the union official provided the

prior to its closure. However, Nike reported that they actually shifted the demand to Nike suppliers in Thailand (*Kompas*, 2000b). They cited political instability as the main reason for the shift in order.

details of the altercations. The document showed an important initial conflict caused by changes in production process, but would eventually trigger other conflicts that culminated in the decision to close of the firm. The outcome bore a similar pattern with the Nike producing firms, though for different reasons. While minimum wages was the primary trigger for the former, changes in the production process appeared to be the main reason in this firm.

Apparently towards the end of 1999 the firm had changed the set-up of production line operation with the installation of new conveyor belts, making workers work in a standing position rather than sitting as the previous way. The workers charged that the management had implemented the changes without prior consultation with the union. The workers felt that the management breached their collective labour agreement, and thus resulted in strikes that went on for two months and consequently, lay-offs. Eventually, other past irregularities in working conditions, such as a change of transportation vehicle and the need to have permission to go to the toilet were also reported. Conflicts inevitably occurred in which management proposed mass layoffs for those workers who had stage a strike as a protest against the change in production process. Negotiations that involved the then Indonesian Manpower Minister Bomer Pasaribu failed to resolve the matter (*BizAsia News*, 2000). Finally, the management gave in and asked the workers to go back to work.

In contrast to the first closed firm, the minimum wage did not appear to be an issue in this one. The firm appeared to comply with the minimum wage requirements. However, the document stated that the KHM or the minimum daily need which formed the basis for calculating the minimum wage was deemed inadequate. The argument appeared to be directed at government institutions rather than the firm in question. The union rejected the imposition of the minimum wage level for 2003 because it was unrealistic for firms that pay high wages and workers cost of living. The document even provided the union version of what the minimum wage, or in this case the industrial or sectoral minimum wage, should be. They argued that minimum wages for electronic and automotive firms should be much higher (about 45 per cent higher than the 2002 minimum wage according to the document). However, it can be surmised that the minimum wage fixing machinery did not have significant impacts

on how unions operate or on employment decisions of firms, but could be attributed to other factors.

Other Issues Affecting Employment and Business Climate

As the government proclaimed year 2003 as investment year in Indonesia, concerns over the country's inability to attract new investments and even maintain current investments have increasingly mounted. One major concern with regards to the investment climate was the fact that the decentralisation process has not yielded favorable results for businesses since it was implemented. It was argued that labour issues, such as the minimum wage policy, were to blame for the deteriorating macro-economic conditions. A point of fact, Indonesia's high cost economy and the privilege of being called the most corrupt country in Asia, revealed more sinister problems. Corruption, or in economic term rent seeking, is arguably the most pressing problem which hampers recovery. Decentralisation also has the potential to aggravate the problem of corruption. Another such important concern relates to the fact that the decentralisation process has produced many new taxes and regulations that hampered rather than encouraged businesses. It is argued that the decentralisation process, which promised to improve business climate, initially tended to increase taxes to obtain direct income for regions (*Kompas*, 2003b).

New Local Tax Provisions and other Regulations in the Decentralisation Process

The decentralisation process has resulted in an explosion of new local taxes, as well as overlapping taxes within the region and with taxes issued by the central government. These multiple taxes or levies, as well as overlapping taxes or levies, could put establishments, already reeling from deteriorating conditions, in danger of collapsing. The majority of the establishments interviewed have not experienced the effect of these new taxes, but the researcher was able to obtain information from local employer association how these taxes may potentially affect businesses.

Even though many of these so-called local taxes were under review, many others may still cause potential problems (KPPOD, 2001). One example of overlapping levies, are the tax on occupational safety regulations. One regulation from the local manpower

office required establishments to have fire safety hazard scheme for workers. This means that establishments have to provide funds to accommodate the regulation. However, the local fire department also issued similar regulation on fire safety. Thus, for one apparently similar regulation firms pay double the amount. In addition, there are also other new regulations from the local manpower office, such as employment development scheme, in which firms have to pay for each worker annually. One firm in Bandung estimated the cost for employee development scheme amounted to 40 million rupiahs per annum.

Another form of overlapping regulation was reported in a REDI (Regional Economic Development Institute) study on regional development (*Kompas*, 2003b). According to their report local government in Manado, North Sulawesi issued a new business permit (Perda Number 6, 2001). The new regulation overlaps existing central government business permit collected by the Ministry of Industry and Trade. A by-product of these additional laws was, of course, additional *invisible cost* that has plagued the Indonesian economy. Unfortunately, the study was not able to assess the impact of these new regulations to production cost.

Rent Seeking

The fieldwork found that rent seeking was considered a problem by some businesses, while others accepted rent seeking as necessary. Rent seeking, as explained by respondents, included illegal levies paid by firms to corrupt government officials to speed up administrative process or to avoid legal procedures, and payment to local thugs as protection money. This type of corruption may be viewed as firm's responses to the distortions in the market created by government regulations (Lui, 1996, p.27). The decentralisation process has produced many more market imperfections at local level. One firm estimated the cost of illegal levies as high as 10 percent per regulation. Firms often had to pay illegal levies to speed up the process of obtaining permits or just paying taxes. Thus, more taxes and regulations implied more money firms have to pay. Another example as reported by the employer association, stated that in 2003 unloading cargo of imported products at the ship docks can cost at least 600 000 rupiahs or about US\$ 70 per container of illegal fees on top of regular administrative fees (*Kompas*, 2003). All trade union officials interviewed blamed rent seeking as the cause of low wages. A prominent labour activist, Dita Indah Sari

(*Tempo*, 2001), argued that employers should not complain about the minimum wage because wages is only about 10 percent of the total production cost¹¹. She added that the government should endeavor to get rid of the “high transaction cost” that made Indonesia such a high cost economy. Indonesia was the sixth most corrupt countries in the world and third in Asia in 2003 (*Kompas*, 2003b). Most firms interviewed also considered rent seeking as problematic, but indicated that it was a requirement for them if they were to continue to do business. In addition, they were skeptical whether rent seeking can be completely eradicated or even minimized, especially when early indication showed the decentralisation process had the potential to increase rent seeking and seriously undermine the government’s effort to improve business climate and proceed with development.

In addition to rent seeking, central and local government also do not consistently follow-up on regulations which required firms to pay. For instance, a textile firm showed their displeasure by pointing out that they had to pay the local government for street lighting when there are no lights on the street just outside the factory. The reason for the complaint was that many of their workers, most of whom were women, often had to come for night shifts and needed lights to walk safely from the bus stop to the factory at night. There were also other levies which the government extract from firms but did not follow up, like improvement of roads.

Relocation

Concerns regarding deteriorating investment climate have prompted many firms to consider relocation. Indeed, rumors were abound that some firms in the textile and garment sectors are considering moving to other location (*BharatTextile*, 2001). Findings in the field did not show any indication of any intentions on the part of any firm to relocate. The most important factor considered for relocation was the availability of infrastructure, not the level of wage (Gazali, 2001). The fieldwork revealed that 4 out of 24 firms considered other districts in West java as possible relocation areas. In one interview with a manager from a large export-oriented garment establishment in Bogor revealed that some garment producers were

¹¹ Dita’s comments were also confirmed by her deputy during our interview with officials in her union. The labour union in which she is the chairperson acted as pressure group to any government regulation deemed unfavorable to labour. Indeed, the labour union was one of those few unions that completely rejected the New Employment Law Number 13 and the proposed industrial relations bill.

considering relocating to the neighboring Sukabumi district where labour cost, i.e. minimum wage, is much lower (Interview 05, March 2003). In addition, even though they stressed that their companies did not plan to relocate, several managers (6 of 24 respondents) who were interviewed also targeted areas in Central Java as possible relocation areas. The interviews did not reveal any intentions of any firms to relocate abroad.¹²

Globalisation

The fieldwork also revealed that economic globalization had worried businesses, especially in relations to the general economic climate in Indonesia. Firms appeared to more concern with global economic integration in the long run than labour issues. More than 50 percent, 14 out of 24 interviewees, specifically stated globalization as their main concern in the future. The Asian Free Trade Area (AFTA) was also cited as the concern. The garment industry, specifically, is under threat from the future free trade agreement between China and ASEAN countries or CAFTA (*Kompas*, December 01, 2004). Even now, garments from China have already been marketed in Indonesia. Most respondents stated that efficiency is the only option for survival for businesses. Unfortunately, the interviews also revealed that 'efficiency' in the eyes of trade unions meant lay-offs. For sure, the global economic conditions that affect businesses in Indonesia would eventually affect employment as well. However, interviews with trade unions did not reveal any concern over the impact of globalization on the Indonesian labour market. Trade unions appeared to be more concern over the localization (decentralisation) of the minimum wage fixing and other issues concerning workers' welfare.

Concluding Remarks

The decentralisation of the minimum wage setting did not appear to catch unions unprepared. Contrary to those who fear union deterioration suggested by Al Hambra (2003), there was no indication of polarization of union's collective power. Based on the findings, there was no evidence of disempowerment of unions. On the contrary, the field work revealed that unions appear to have made steps to adapt to the new

¹² The researcher also found several firms that closed when he attempted to contact them to acquire consent for interview. These firms included those in the footwear and garment sectors. Their closures were caused by lack of overseas demand but only one firm indicated that it was relocating elsewhere.

situation by involving members from local unions (firm and district level) into decision making. The decentralisation of minimum wage fixing had actually provided opportunities for grass root unions, i.e., firm level unions to undertake a more active part in wage negotiations. Arguably, it is the whole industrial relations system as well as other factors which affected the overall employment situation in Indonesia.

The real problem with the new system is the industrial relations skills which many local union members may be lacking. As reiterated in Chapter VII, there were indications that union officials, as well government officials in the wage council lacked the abilities and knowledge to conduct negotiations and preferred direct conflict. ILO has just recently started to provide trainings to unions on how to negotiate wages with employers at firm level (ILO, 2002). The minimum wage fixing machinery at the local wage council is similar to wage negotiations at firm level. The difference is the fact the government is involved in determining minimum wage level by providing method, data and arbitration. Wage negotiation at firm level is usually done via bipartism with little or no outside influence. Another challenge for unions is to provide a powerful voice for the workers they represent. Even if unions form a bigger confederation, there is no guarantee that they will appeal to workers unless they improve the welfare of their members. In Korea it was found that internal relations between members and their leaders has been found to highly influence members' satisfaction with the unions rather than the economic benefits that the unions can deliver (Frenkel and Kuruvilla, 1999). Independent unions could use Korea as a model to appease existing members as well as attract new members, and the current employment laws (Law Number 13, 2003 and Law Number 2, 2004) appears to provide workers with the ammunition they need to improve their welfare. Thus, it would be the union's job to ensure that these laws are implemented correctly for the benefit of their members. One of the tasks is to monitor the implementation of the minimum wage provision.

The decentralized minimum wage fixing could also benefit the *social dialogue* agenda in which ILO has taken a special interest. Successful minimum wage negotiation at district level could be used as a starting point at firm level negotiations with employer and workers and their representatives. A *social dialogue* may prevent costly conflicts due to the inability of the employer to meet the demand of workers. This is important

in light of the deteriorating economic conditions in the country. Better understanding of the *social dialogue* concept by workers would help improve industrial relations in the country. Perhaps, Indonesia should emulate industrial relations in Korea where some companies such as the Daewoo Group successfully switched from antagonistic to cooperative system of industrial relations (Lee and Rhee, 2004). The company ranked best among the listed companies in Korea in terms of operating profit ratio, in 2000 (Lee and Rhee, 2004, p. 100). Instead of changing their age-old paternalistic employment relations, they gradually improve on it because they realized that paternalism does not reduce conflict but cause negative effects on productivity. The *social dialogue* based on bipartite negotiations at firm level envisaged by the ILO could improve the PIR system. Exposure to minimum wage negotiations could be used as a catalyst for firm level negotiations.

On the other hand, the current business climate may also create a de-unionization in some sectors of the economy, especially those relying in low cost unskilled labour, such as the garment and footwear industry. The fact that most firm closures and layoffs occurred in these two sectors had caused a significant decrease in the number of workers in sectors where industrial conflict was at the highest intensity. Unions' hard won victory of 1998 could become a hollow victory because many low wage workers in these sectors whom the unions were supposed to represent might not enjoy their victory. Those workers fortunate enough to keep their jobs could enjoy the benefits of being union members. Moreover, better minimum wages also means that their average wage would also increase, provided that the economic climate does not deteriorate further.

A threat of de-unionisation also comes from labour flexibility, i.e. firms are turning more and more to flexible workers to keep their competitiveness. Fixed-term contract workers and outsourcing are some of the threats to the well-being of unions. The fact that these types of workers receive less benefit and outside the union control has made unions weary of their continued presence. Nonetheless, the re-regulation concerning these types of workers would lessen union anxiety over the use of flexible workers. For instance, the new regulation as stated in the new employment law limits the use of outsourcing to non-core workers. In the case of manufacturing this means using

outsourced workers in non-processing activities, such as clerical, security and cleaning jobs.

The current labour laws are a major concern for many businesses, but it has taken a back seat to other issues such as decentralisation. Decentralized minimum wage setting had initially caused friction between employer and employees. However, there are indications that it might help improve industrial relations in the future as was designed for. Even other labour issues should not be a cause for alarm as the government has already made efforts to remedy the long-term situation by reforming the current regulations through the new employment provisions (The New Employment Law Number 13, 2003 and the Employment Relations Dispute Resolution Law Number 2 2004 to all firms).

These new labour laws have the potential for either increasing as well as decreasing labour costs in the future. The vigorous pursuit of sectoral minimum wage in manufacturing, increased compensation pay and occupational safety and health management set-ups may increase short run cost, but may prevent excessive future costs by minimizing potential industrial disputes between employer and workers. The legalisation of fixed term contract workers and outsourcing has put limits on the activities, but may prove the firm's solution to the perceived problems of the increasing power of trade unions and increasing wage costs. Other issues, such as conditional allowance of child labour and abolishing some dubious past laws and regulations may also avoid more cost in the future. Eventually, the challenge will be proper enforcement of the new law, where the Indonesian government is currently lacking.

Chapter X

Conclusion

The purpose of the thesis was to assess the impact of the decentralised minimum wage fixing process in West Java. Particular attention was devoted towards analyzing how the minimum wage fixing process affected workers' participation in determining their own wages and the process of bargaining for minimum wages, and the effects of minimum wage increases on employment. Lastly, the thesis also assessed whether the minimum wage policy, specifically, and other labour standards and regulations in general, provided sufficient insulation from the negative effects of globalisation. This chapter summarises the findings explained in the last three chapters, and discusses the implications of these findings in relation to development, industrial relations and *decent work*.

There were several factors why decentralising minimum wage fixing process is important for development. The decentralisation process, which followed democratic transformation, has affected the minimum wage fixing process in more ways than one. Firstly, with the greater authority to determine the minimum wage level in their locality, local government units are able to represent the actual interest of the minimum wage policy stakeholders within their own borders. Secondly, the democratic transformation allows greater worker participation, via trade unions, in the minimum wage bargaining process. Thirdly, with the passage of significant changes to employment legislations, part of which support a meaningful process towards improving industrial relations, there is a promise for greater worker's protection. West Java is a unique example of an area where all these factors are integrated, aside from the fact that it is the first province to delegate minimum wage fixing to district and city level governments.

Analysis for this study was conducted using two methods: qualitative method through fieldwork and quantitative method using secondary information. The fieldwork involved interviews and interview surveys of stakeholders of minimum wage policy. The fieldwork was conducted in selected areas of West Java and Jakarta where there is a large concentration of large and medium manufacturing firms. Selected trade unions and government officials were also included in the interviews. Regression analysis and

descriptive statistics were employed to measure the impact of minimum wage increases on employment. The data used in the quantitative analysis was obtained from the large and medium annual manufacturing statistics and a special one-off Productivity and Investment Survey funded by World Bank/ADB (2003).

Summary of Major Findings

The decentralisation of the minimum wage fixing process has had a significant influence in improving industrial relations. The minimum wage fixing process appears to have helped create more stable industrial relations by allowing negotiations to proceed between rival stakeholders without too much influence on the part of the government. Allowing local trade unions greater participation in determining wages promotes greater development of enterprise or firm unions rather than federation. Decentralisation of minimum wage fixing to local government also enables local government to assess how minimum wages impacts on the local economy. Strengthening local government capacity is a major goal of decentralisation: it acknowledges that the local government rather than the central government is more knowledgeable in determining the level of minimum wages suited to its own local area.

The decentralised minimum wage fixing appears to be a useful tool for future *social dialogue* between the stakeholders of the minimum wage policy. Although the minimum wage negotiations at district or city level are still developing, the fieldwork found indications that all stakeholders were willing to cooperate with each other. More importantly, the decentralized minimum wage fixing also allowed not just greater participation of local trade unions, but also participation of local employers and local governments. The wage council that has been created for tripartite cooperation can be certainly be expanded and used to elicit and promote multi-sectoral representation similar to the works council in European countries. However, none of this could be achieved without the full backing of the central and local governments.

Despite its usefulness, however, the minimum wage policy has shortcomings that local governments have become aware of. Based on the empirical evidence and, in agreement with the conventional view described in Chapter III, the study found some negative effects of minimum wage increases in 2001 and 2002 in West Java, especially in relation to the future ability of firms to hire more workers. The empirical evidence

found that under current economic conditions, any significant increase in minimum wages is likely to exacerbate the unemployment problem in West Java. The interviews also validated that increases in the 2002 minimum wage affected the firms' future abilities to hire workers. Nevertheless, the fieldwork found that even though employers/managers were critical of the 2002 minimum wages levels, they do not reject small increases in minimum wages. Interestingly, the study found that increases in minimum wages were unlikely to increase labour productivity, as trade unions viewed minimum wages as basic rights which should not be linked to productivity. Increases in minimum wages were more likely to prevent strikes, and thus assist in promoting industrial peace. In addition, the study found that the greater impact of minimum wages was on future employment, rather than current employment. Thus, employers have tried to alter their employment structure to cut costs, such as hiring temporary or non-standard workers, even though the new employment legislation has limited the use of these types of workers. The increase in the number of firms using non-standard workers suggests that labour flexibility is becoming a norm rather than an exception in the local economy.

These shortcomings are making it difficult for the minimum wage policy to provide a beneficial long-term solution to unemployment problems in Indonesia. Its potential negative impact on employment looms as a danger to the government's strategy of employment growth. At best, decentralising the minimum wage fixing process constitutes a short to medium term solution to the employment problem. Its function as a stabilizing tool to prevent the decline in real wages promotes more peaceful industrial relations. Once industrial peace is achieved, more stable industrial relations will usher greater economic development.

The study also found that there were also other factors that contributed to the employment problems in Indonesia. The study found that the decentralisation of government functions also provided local governments with the leverage to impose taxes and increase levies. These increases, as well the problem of corruption raise production costs for firms trying to recover from the crisis. If coupled with significant increases in minimum wage levels, Indonesia would find it hard to recover from the pre-crisis level of economic development.

Results of the fieldwork suggest that it is unlikely the government will increase the minimum wage by as much the same rate as in 2001 and 2002. Evidence suggests that the wage policy was aimed at stabilization rather than increasing the welfare of workers in real terms. It appears that the main reason for significant increases in minimum wages during the 2001-2002 periods was to catch up on falling real wages during and after the 1998 crisis. The local governments were concerned that large increases in minimum wage levels could create negative impact on the overall business conditions. From 2003 onwards the government appears to keep real minimum wages constant by pegging the minimum wage increase to inflation. Although this would fall short of improving workers' wages, at least it keeps real wages from falling.

The process of setting minimum wage at local level emphasizes the role of the government in balancing the needs of workers and employers. The government has the deciding vote in the minimum wage council if negotiations between trade unions and employer associations reach a deadlock. Despite claims by trade unions and employers about the subjectivity of government members in the council, the government's role is to balance the results, depending on which way the development agenda of the government swings. The 2001 and 2002 minimum wage determination was proof that the government could countervail support from being pro-employers to pro-labour. Moreover, even though minimum wage setting had been delegated to local governments, it is apparent that some central government influence still remains in determining the magnitude of the minimum wage increase.

In addition to the continuing viability of the minimum wage policy, *social dialogue* is promoted if the process is conducted in a proper manner. Despite the continuing conflict between trade union and employers during the minimum wage fixing process, both have considered each side to be an integral part of the industrial relations process. Even though the initial process was conducted improperly due to its novelty at district/city level, subsequent events show that the process had improved significantly. In addition, there is evidence that firm level bargaining at many firms, including whether to apply minimum wages or not, had gone relatively smooth. A combination of bargaining at district/city level and firm level bargaining could be nurtured into developing a *social*

dialogue in Indonesia¹. Trade unions must also present a united front at local level if they want greater influence in the bargaining process.

Enterprise bargaining may not be viable to protect the interest of workers as a whole. Even though there are good enterprise level industrial relations in Indonesia (SMERU, 2002), they may not be sufficient to help the overall workers' interests. Experience in South Korea showed that isolated enterprise-level bargaining is not recommended as studies show that enterprise-based bargaining has consistently been weak in bargaining power, vertical and structural independence from management, and persuasion and misuse of authority (Jeong, 2003). This situation occurs even though Korea has already undergone a huge transformation of its industrial relations systems and processes, and its experience is a decade more advanced than Indonesia. The collective power of the trade unions, strong at national level but weak at regional level, could be weakened at enterprise level as employers try to exert influence on trade union activities. It is less effective in ensuring employment security. The wage council via minimum wage determination and, perhaps industrial level wage bargaining, would perhaps be more effective in voicing out workers' interests. Sectoral or industrial level minimum wage bargaining could be a step in the right direction.

Trade unions need to strengthen their collective activities and conduct legitimate forms of representation, even though based on this study there were no indications that the decentralised minimum wage bargaining had undermined the collective strength of trade unions. Trade unions must demand basic rights, such as the minimum wage, improvements in general working conditions, and employment security. Trade unions must also ally themselves to other social groups, like NGOs and to show greater strength in numbers, they could include the informal sector in their struggle (though it must be clarified and clear to this sector why their representation as a collective should be necessary). Otherwise, struggling amongst trade unions would indicate fragmentation and disunity and leave them exposed to employers' machinations. Only one union was found to have alliance with the informal sector.

¹ It is somewhat similar to the multi-tier bargaining process conducted in Europe, where bargaining occurred at enterprise and industry level. In the case of Indonesia, industry level bargaining could be done at district/city level. Sectoral or industry minimum wage is also set at district/city, as well as provincial level throughout Indonesia.

Implications of Findings in the Research Location

Findings in the field suggest that the minimum wage determination at district or city level has improved since the start of the decentralisation process. It would not be prudent to revert back to provincial minimum wage determination because reverting would undermine the general principle of decentralisation – because it is supposed to give districts or city levels more autonomy in determining the directions of local development. Conditions at the district or city level are quite different when seen from a provincial viewpoint, e.g., a city's demographic, labour and socio-political variables would have greater weight in determining the level of minimum wage. Therefore, it would be in the interest of district and city officials to ensure that minimum wage fixing process is included in the district or city development plan.

As for trade unions, the study found that local trade union officials within the districts and city in West Java appeared to lack the necessary expertise in minimum wage negotiations. The lack of expertise is in such areas as legal requirements, interpretation, and ramifications of negotiated issues. Officials also lack the desired bargaining and negotiation skills which can only be acquired through experience and training. Under the new employment laws, workers must have adequate legal representation that could assist them win legal battles against employers. Under a proposed scheme, the new employment court would require workers to find professional legal assistance. Local trade unions also appeared lacking in the economic know-how to defend their position on any minimum wage issue. Such incapability subjects trade unions to unnecessary manipulation if they are unable to analyse and interpret economic data so important in wage negotiations.

Implications outside the Research Area

Successful implementation of decentralised minimum wage fixing is critical in the overall development objectives of West Java as neighbouring provinces are already eyeing West Java as a model for their own minimum wage fixing agenda. It is apparent from the fieldwork that other provinces could replicate the decentralised minimum wage fixing at district or city level in West Java. Other provinces such as Central Java and East Java appear poised to follow suit. West Java and Banten provinces have been

implementing district/city level minimum wage fixing since 2001. This would mean there is a promise for *social dialogue* in negotiations for minimum wages at district/city level. However, it remains to be seen whether other provinces outside Java would have the same level of expertise and experience as the provinces in Java. Local governments in outer provinces should not rely too much on *putra daerah* (indigenous sons), and should not hesitate from acquiring expertise from other more experienced provinces.

Implications for Indonesian Development

It is clear that the decentralized minimum wage fixing at district/city level in West Java has wider implication in regional economic development, especially for those provinces where manufacturing is the primary source of regional revenues. The minimum wage determination process appears to represent a marriage of popular policies with capitalist development, and industrial peace stands as the ultimate success. Industrial peace can be achieved with the successful implementation of the minimum wage determination process and would ensure a more stable economic development in the regions. At the moment industrial peace is still a remote possibility because the industrial relations systems, processes and general working conditions supportive of industrial peace are not yet in place. However, the decentralisation of minimum wage fixing appears to also decentralize trade union activity. This means that strikes could become more localized in certain regions, i.e. district or city, rather than centralized. It would minimize the potential political damage caused by strikes to provincial or national stability.

The central government has the task of improving wages of workers by keeping inflation low to prevent prices of goods related to the KHM (minimum subsistence need) from increasing significantly. Another task is the crackdown on corruption. The government's target of keeping inflation between three to five percent per annum should be achieved if real wages were to stabilize. In addition, it would ensure not just economic stability, but also preventing workers purchasing power to deteriorate. A crackdown on corruption activities is much more difficult to achieve and decentralisation also has the potential of "decentralising" corruption.

Industrial Relations

It is clear that improving industrial relations is the key to solving the minimum wage dilemma and other labour problems. It is apparent that solving the employment problem cannot be done merely by legislation. *Social dialogue*, one of the key instruments of *decent work*, is a workable agenda in Indonesia. It shows a more participatory process both on the part of the employers and trade unions. Experiences in the wage council are valuable, in particular for trade unions, to be applied to enterprise level bargaining. Decentralized minimum wage fixing can be used to promote a wider context of *social dialogue*. Even though the initial process in 2001 and 2002 created so much controversy, the 2003 process showed a marked improvement in the determination of district and city minimum wage level. The wage council has the potential to be used as a model for institutionalizing *social dialogue* similar in scope to the works council institution in the Europe.

Workers should continue their support for minimum wages as it represents safety net wages, as well as a collective bargaining substitute. Minimum wages represent the basic needs of workers that alleviate them from poverty. However, workers' representatives at local a level should also strive to develop collective bargaining skills when engaging in bipartite enterprise bargaining. Minimum wages could become a basis for negotiations between the stakeholders, even if a firm cannot afford to pay. *Social dialogue* at the local level, i.e. firm level trade unions, can achieve a settlement and avoid costly conflicts. This is where *decent work*, through *social dialogue*, has a chance to achieve its goal.

Even though participation of trade unions in minimum wage determination appears to improve, they must improve not just their knowledge on collective bargaining, but also knowledge on the economy and legal system. They should also maintain cohesion at national level and form coalitions with other trade unions and social groups to avoid costly confrontation that will only lead to union decline. Decentralisation could create fragmentation and diminish the collective strength upon which workers rely on.

Decent Work

It is also clear, based on the available evidence, that if *decent work* was to be a realisable objective, local governments, especially district/city, should be key actors in building good industrial relations. The major functions of the central government should be to formulate policies, such as changing the quality of the minimum wage criteria, and monitor implementation. The researcher already witnessed more dynamic worker-employer-government dialogue during the minimum wage fixing process. Much more increased employee participation, not just in minimum wage fixing, but also public discussion on the new employment legislations is an encouraging sign of Indonesia's leaning towards *social dialogue*. The minimum wage fixing mechanism at local level should also be developed further to commensurate with the *social dialogue* framework. The wage council is already an important part of the provincial and district/city government and an appropriate model of tripartite negotiation, which is an important ingredient for *social dialogue*. Furthermore, to improve its legitimacy the *social dialogue* approach should be inclusive in the national and regional development agenda.

At present, the government needs to work harder to achieve the goals of *decent work*. *Social dialogue* needs the full coordination of both central and local government. Available evidence suggests that *social dialogue* can be a realized process in the near future because decentralisation process is not proceeding smoothly as planned. However, at the moment, the central government is focusing more of its attention on employment creation, citing the widening wage gap between formal and informal sector employees (Bappenas, 2004), rather than a mechanism to improve workers' welfare – one such process being *social dialogue*. Another reason is the delay of implementing the 2004 legislation on industrial relations dispute resolution. For these reasons, it is unlikely that the *social dialogue* objective of *decent work* can be achieved in Indonesia anytime soon.

Globalisation and Decentralisation

The negative impacts of globalization on labour are unlikely to be eradicated by changes in labour regulations. Growing insecurity of work through so-called flexibilization of the workplace, which produces more non-standard work, appears to be thriving in developed as well as developing countries. The development of trade unions

in developing countries is being circumvented by the existence of flexible workers which does not belong to trade unions. Indeed, there is evidence that workplace flexibility in Asian countries goes hand in hand with the weakening of trade union power, despite less government intervention in industrial relations (Kuruvilla, 1996). Even the modern high-skilled sector, where unionism is still strong, is not immune to flexible work arrangements. Thus, the freedom of association and the development of collective bargaining skills can become a hollow victory for workers if trade union membership declines as a result of more non-union employment. Nonetheless, the minimum wage policy could still be applicable to represent workers' interests even in the absence of trade unions. At the very least, it provides a standard or safety net wage that could prevent real wages from falling.

It has been suggested that decentralisation could work in favour of globalisation and against workers' participation. In addition to potentially fragmenting trade union power via decentralizing wage bargaining and by devolving central government power to local level, there is likely competition among local governments to generate income by any means. Provinces that could not rely on natural resources to generate income are likely to find sources of income from firms which operate within its borders. Decentralisation also works in favour of businesses that seek direct local-global business connection, such as export, with less intervention from the central government. Consequently, this competition will likely affect the minimum wage policy at the local level if it is deemed too costly and seen as deterring capitalists from investing in the area. Thus, minimum wages could be curtailed or even decreased, in real terms, to attract or retain investment.

Recommendations and Concluding Remarks

The implication of binding minimum wage policy means that Indonesia can no longer depend upon low-wage workers in the modern sector in the near future. Government will likely need to increase spending significantly to further educate future labour workforce and to up-skill existing workers. The demands of high technology and restructuring of work organizations (e.g. flexibility) will certainly edge up and throw low-wage workers in the periphery unless their wages are similarly made competitive and their skills upgraded. There are encouraging signs that some multinational corporations could use Indonesia as the center of production. The development plan of

the new government relies on relatively high technology production that requires more skilled workers in the future. The current budget showed that the government spent less than two percent of the GDP and less than 10 per cent of total state budget on education (United Nations Development Programme, 2004). The figures were quite low compared to other comparable Southeast Asian nations such as Malaysia (20 percent of state budget in 2001) and Thailand (31 per cent of state budget in 2001). With Indonesia's large population and workforce, spending on education and training should be increased substantially, as well as optimizing the use of existing funds.

Further studies should focus on how firms and workers respond to the increased minimum wage brought about by the improvement in the minimum wage policy. The fieldwork was conducted during a chaotic period of decentralisation where there was still confusion in managing the minimum wage fixing. It is likely that newer information could provide clearer outcome in analyzing the impact of the minimum wage policy². Further studies could also study the impact of minimum wages and trade unions on flexible workers. In light of where Indonesia's employment relations is heading, these two studies are highly important and need to be pursued, supported by recent data as the findings could add clearer inputs in assessing the long-term implications of minimum wage fixing. This study accepts the realistic fact however that the decentralisation process in Indonesia is still in its infancy, and that it would take several more years to really assess the longer-term impact of the decentralized minimum wage fixing process. With regards to the role of stakeholders in the decentralized minimum wage fixing process, further studies need to explore the extent of, and effectiveness of this participation in creating a doable operational framework for *social dialogue*. It would be interesting to find out the depths of this role in relation to successfully negotiated issues-other provinces can learn from this experience of effective social partnership in minimum wage fixing process.

Thus, assessing the impact of the minimum wage policy needs to be tracked over time and should be approached from a holistic point of view. Despite its apparent usefulness and shortcomings, the minimum wage policy should not be viewed as a magic pill that

² Hammermesh (1993) states that it takes some time before an imposed increase in minimum wage generates the full reduction in the employment of low skilled workers (p. 205). A firm would need some time to adjust to the changes in minimum wage levels, which was why they suggested that the minimum wage fixing should be conducted every two years instead of one.

can solve all of workers' problems. It has to be seen as a representation of the goals of development. Minimum wages cannot solve absolute poverty, but provide minimum basic needs in which the poor can strive to attain. The minimum wage fixing process promotes *social dialogue* because it epitomizes dynamic bargaining that can be further developed into bipartite collective bargaining and improvement in industrial relations. Finally, successful implementation of minimum wage fixing at local level can also represent a successful transition to regional autonomy, plus support socio-economic and political stability.

Appendices

Appendix 1. List of Interviewees from Firm-level Trade Union, Description Interview and Codes

Name of Firm-Level Trade Union	Description	Date of Interview	Coding
1	Electronics- under SP LEM, FSPSI	February 2003	S04
2	TGF union – under SPTSK	March 2003	S10
3	Electronics – under SPMI	April 2003	S13
4	Electrical appliances – under SPMI	April 2003	S14
5	Electronics – under SPMI	April 2003	S15

Appendix 2. List of Interviewees from Apindo Employer Association, Description Interview and Codes

Name of Employer Association	Description	Date of Interview	Coding
Bekasi Chapter of Apindo	Group Interview (4 Officials)	February 2003	A01
Bandung Chapter of Apindo	1 Official	March 2003	A02
Bogor Chapter of Apindo	1 Official	March 2003	A03
West java Chapter of Apindo	1 Official	March 2003	A04



Appendix 3. List of Interviewees from Trade Unions, Date of Interview and Codes

Name of Trade Union	Description	Date of Interview	Coding
KSPSI (FSP LEM) – Serikat Pekerja Logam, Metal dan	Sectoral union branch (metal, Electronics and Automotive), part of the KSPSI confederation (24 federation)	February 2003 (Group interview)	S02
SBSI – Serikat Buruh Sejahtera Indonesia (Indonesian Prosperous Labour Union)	All sectors	February 2003	S06
SPTSK – Serikat Pekerja Tekstil, Sandang dan Kulit (Textile, Garment and Leather Labour Union)	Biggest Textile, Garment and Footwear Union	February 2003	S01
KSPSI (West Java) – West Java regional branch of KSPSI Confederation	West Java branch of KSPSI	March 2003	S11
KSPSI (Bekasi)	Bekasi branch of KSPSI	February 2003	S09
KSPSI Reformasi – Reformed All Indonesia Labour Union	Splinter group from the KSPSI confederation	February 2003 (Group interview- 4 officials)	S08
Gasbiindo Jakarta	Industrial union	February 2003	S05
GSBI - Gabungan Serikat Buruh Independent (Independent Labour Union Federation)	Grass-root union covering all sectors, including the informal sector	February 2003	S03
FNPBI – Front Nasional Perjuangan Buruh Indonesia (The National Front for Labour Struggle in Indonesia)	Grass-root union covering all sectors, not including informal sector	February 2003	S07
SPMI – Serikat Pekerja Metal Indonesia (Indonesian Metalworkers Union)	Metal, Electronics and automotive parts labour union	April 2003	S12

Appendix 4. List of Interviewees from Government Offices, Description Interview and Codes

Name of Government Office	Description	Date of Interview	Coding	
Jakarta Manpower Office	Official	February 2003	G01	
Jakarta Manpower Office	Wage Member	Commision	March 2003	G04
Bekasi District Manpower Office	Official	March 2003	G02	
Bandung City Manpower Office	Wage Member	Commision	March 2003	G03
Bekasi District Manpower Office	Wage Member	Commision	March 2003	G05
Bandung District Manpower Office	Official	March 2003	G06	
Bogor City Manpower Office	Wage Member	Commision	March 2003	G07
Bogor City Manpower Office	Official	March 2003	G08	
East Jakarta Manpower Office	Official	February	G09	
Serang District District Manpower Office	Wage Member	Commision	April 2003	G10
Bandung District Manpower Office	Wage Member	Commision	March 2003	G11

**Appendix 5. List of Respondents/Interviewees from Manufacturing Firms,
Description Interview and Codes**

Firm	Description	Date of Interview	Coding
1	Electronics	February 2003	01
2	Textile (Yarn)	February 2003	02
3	Electronics	February 2003	03
4	Garment	March 2003	04
5	Garment	March 2003	05
6	Electronics	February 2003	06
7	Automotive parts	March 2003	07
8	Automotive parts	March 2003	08
9	Garment	March 2003	09
10	Garment	March 2003	10
11	Garment	March 2003	11
12	Footwear	March 2003	12
13	Footwear	March 2003	13
14	Garment	No Interview	14
15	Garment	No Interview	15
16	Garment	No Interview	16
17	Textile	No Interview	17
18	Garment	No Interview	18
19	Textile	No Interview	19
20	Textile	No Interview	20
21	Electronics	April 2003	21
22	Electronics	April 2003	22
23	Footwear	No Interview	23
24	Electronics	March 2003	24

SURVEY OF MINIMUM WAGE AND ECONOMIC DEVELOPMENT

		NO									
1. Province:											
2. District/City:											
3. Sub-district:											
4. Village:											
5. Name of Organisation:											
6. Address of Organisation:											
				Postal	<table border="1" style="display: inline-table; border-collapse: collapse;"> <tr> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> </tr> </table>						
		Code									
Telp:	Fax:	Email:									
7. Name of contact person:											
Telp:	Fax:	Email:									

Statement: This study is conducted as part of a requirement for a doctoral thesis in Development Studies at Massey University, New Zealand. Responses are treated highly confidential. Ethical consideration has been approved by Massey University Ethics Committee.

If you have problems completing this questionnaire please contact:

I. General Information on the Labour Union

1. a. In what year was this labour union established ?

b. Was the organisation active during the New Order period?

No comment

2- No

1- Yes

3-

c. Does this organisation have branches in most major provinces?

1- Yes

2- No

3- No comment

d. Approximately, how many workers are members of this union?

--	--	--

e. Approximately, what proportion are women?
.....

--	--

f. How does this organisation select its executives? Please clarify the process.

--

g. Please explain your organisational structure:

--

2. How does the organisation receive funding ? (you may circle more than one answer)

- 1- Membership fees
- 2- Receipts from activities
- 3- Funding from outside the organisation (domestic)
- 4- Funding from abroad (international unions)
- 5- Funding from abroad (other institutions)
- 6- Others sources, please specify

--



3. How does the organisation represent workers ? (you may circle more than one answer)

- 1- Help settle disputes with employers
- 2- Provide legal assistance to workers
- 3- Provide financial support to workers
- 4- Provide information to workers
- 5- Provide advice to workers
- 6- Represent labour issues to employees
- 7- Other types of representation, please specify;

4.a. Does the organisation represent workers in medium-sized manufacturing establishments, i.e. firms with 20 to 99 workers?

1- Yes

b. If yes, please explain their working condition relative to large establishments:

c. What is the extent of your knowledge of the current minimum wage laws? (please explain)

II. Wages and Minimum Wages

5. Does this labour union help ensure the effective implementation of minimum wage laws?

1 - Yes

2 - No

5.a If yes, how?

6. Does this labour union also help ensure fair labour conditions to workers?

1 – Yes

2 - No

If yes how?

7. Do you think increasing the minimum wage could increase workers' sense of belonging in the company?

1- Yes

2- No

3 - Depends, please explain

8.a. Do you think increasing the minimum wage could increase workers' productivity or performance?

1- Yes

2- No

b. If yes, how? (Please explain)

c. Do you think employers adhere to the minimum wage laws? (Please explain)

9.a. Do you think increasing the minimum wage could improve relations between employer and employees?

1- Yes

2- No

b. If yes, how? (Please explain)

c. If no, how? (Please explain)

10. a. Do you agree that the government should set statutory minimum wages ?

1- Yes

2- No (go to question 11)

b. Why ?

1- To make sure that the lowest paid workers receive a decent wage

2- So that businesses can follow the standard industry level wage

3- Others, please specify:

11. If not, what do you think is the appropriate method of wage setting ?

1- Collective Labour Agreement

4- Based on productivity

2- Individual contract

5- Based on overall performance

3- Industry standard

6- Others, please specify

12.a. Do you agree to the decentralisation of minimum wage setting to provincial level or even to district level?

1- Yes

2- No

b. If yes, why ?

1- Easier to set

2- Easier to implement

3- Easier to enforce

4- Easier to monitor

5- Other reasons, please specify:

c. If no, why not? (Please explain)

d. Is the current level of minimum wage sufficient for worker's daily needs?

1- Yes

2- No

3- Not clear

Please explain:

e. Was the 2002 minimum wage sufficient for worker's daily needs?

1- Yes

2- No

3- Not clear

f. was the 2001 minimum wage sufficient for worker's daily needs?
 1- Yes 2- No 3- Not clear

g. Was the 2000 minimum wage sufficient for worker's daily needs?
 1- Yes 2- No 3- Not clear

h. In your opinion, are increases in minimum wage a significant cause of employee lay-offs?
 1- Yes 2- No 3- Not clear

i. Does increases in minimum wage affect other benefits, such as overtime or accident insurance, or other insurance such as Jamsostek?
 1- Yes 2- No 3- Not clear

If yes how?

j. Other comments regarding the decentralisation of the minimum wage setting:

III. Industrial Relations

13. a. Does this union recognise the tripartite (mediation, conciliation or arbitration) negotiation in dispute resolution?

1- Yes 2- No (Go to Question 14)

b. Is tripartite negotiation better than bipartite negotiation?

1- Yes (Go to Question 14) 2- No

c. If no, why not?

- 1- More expensive
- 2- Slow disposition
- 3- Not satisfied with the result
- 4- Others, please state

(.....)

14. a. How do national labour unions differ from establishment level unions? (please explain)



b. Are workers more adequately represented in national unions than enterprise unions?

- 1- Yes
- 2- No

c. Why? Please explain:

15.a. How many establishment level unions are members of this organisation?

- 1- None
- 2- 1-4
- 3- 5-10
- 4- 11-99
- 5- More than 100, please specify
(.....)

b. There are reports of more than one unions operating in one establishment/company, is this true?

1- Yes

2- No

c. Do you agree that there should be more than one labour union operating in any establishment?

1- Yes

2- No

Why?

16. What do you think is (are) the benefit(s) of joining a national union? (please explain)

17.a. During the last 3 years, has this organisation been involved in labour disputes?

1- Yes

2- No (Go to question 18)

b. If yes, what kind of disputes? (you may circle more than one answer)

- 1- Minimum wage
- 2- Salaries and benefits, such as holiday bonus(THR)
- 3- General working conditions
- 4- Work hours
- 5- Severance pay
- 6- Harassment
- 7- Violation of company policy
- 8- Other basic rights, please specify
- 9- Other non-basic, please specify

(.....)

c. How does this labour union help in resolving these disputes?

18.a. In your opinion, during the last 2 years, what has been the main reason (s) for employee lay-offs? (you may circle more than one answer)

--	--

- 1- Low demand due to difficult economic times
- 2- End of contract
- 3- Redundancy
- 4- Lack of performance
- 5- Involvement in strikes/labour unions
- 6- Violation of company policy
- 7- Increased statutory minimum wage
- 8- Increase in non-permanent workers
- 9- Low productivity
- 10- Having reached retirement age
- 11- Other reasons, please specify

b. What type of workers do you think were mostly being laid-offs? (you may circle more than one answer)

--	--

- 1- Women
- 2- Unskilled workers
- 3- Young
- 4- Non-permanent workers
- 5- Unproductive
- 6- Others, please specify

(.....)

c. What do you think these laid-offs employees do next? (you may circle more than one answer)

--	--



- 1- Look for other jobs in the same profession
- 2- Become self-employed
- 3- Join other informal sectors, i.e service or trade sectors
- 4- Become migrant labour
- 5- Seek education/training
- 6- Other initiatives, please specify
(.....)

IV. Affiliation with Other Labour Unions

19. a. Is this organisation affiliated with any enterprise union in manufacturing?

1- Yes

2- No (Go to question 20)

b. Please explain the type of arrangement you have with enterprise unions:

20. If no, how is the arrangement of membership with workers in manufacturing companies, such as membership, fees or assistance? (please explain)

21.a. Is this organisation affiliated with any of the existing political parties involved in the last election?

1- Yes

2- No (Go to question 22)

b. If yes, what is the reason for affiliating with this (these) political party (ies)?
Please explain

22.a. Is this organisation affiliated with any of the other political parties involved in the next election?

1- Yes

2- No (Go to question 23)

b. If yes, what is the reason for affiliating with this (these) political party(ies)?
Please explain

23.a. Is this organisation affiliated with any of the other political parties involved in the next election?

1- Yes

2- No (Go to question 24)

b. If yes, what is the reason for affiliating with this (these) political party(ies)?
Please explain

24.a. Is this organisation affiliated with any Non-government Organisation (NGO)?

1- Yes

2- No (Go to question 25)

b. If yes, what is the reason for affiliating with this NGO? Please explain

25.a. Is this organisation affiliated with any international workers' union, such as ICFTU (International Confederation of Free Trade Unions)?

1- Yes

2- No (Go to Question 26)

b. If yes, under what arrangement, activities etc.? (Please explain)

26. What is the benefit of affiliating with international labour unions?

- 1- Solidarity
- 2- Funding
- 3- Information
- 4- Other support, please specify
(.....)
- 5- Others, please specify
(.....
.....)

V. Decentralisation

27. a. Are there changes to this organisation to adapt to the new decentralisation process?

1- Yes

2- No (go to question 28)

b. If yes, please explain below

28. Now that the decentralisation process has been implemented, how will this labour union conduct its activities when dealing with the government or local government?

29. How does this differ from your previous dealings with the government/local government?

30. Which new government/ministerial regulations/laws do you feel are not sympathetic to employees?

1- 2- 3- 4- 5-
Please explain why?

Statement:

1). Name of Interviewee :

2). Position:

3). Telp.: Facsimile: E-mail :

4). Signature : Please affix company seal:

5). Date : / /2003

6). Name of Interviewer :

7). Document received: / / 2003

8). Signature :



Appendix 7. Establishment's Questionnaire (Fieldwork)



SURVEY OF MINIMUM WAGE AND ECONOMIC DEVELOPMENT

			No.			
1. Province:						
2. District/City:						
3. Sub-district:						
4. Village:						
5. Name of Organisation:						
6. Address of Organisation:						
			Postal			
		Code				
Telp:	Fax:		Email:			
7. Name of contact person:						
Telp:		Fax:		Email:		

Statement: This study is conducted as part of a requirement for a doctoral thesis in Development Studies at Massey University, New Zealand. Responses are treated highly confidential. Ethical consideration has been approved by Massey University Ethics Committee.

I. General Information on the Establishment

1. When was this company established ?

2. a. Does this establishment have foreign direct investment ?

1- Yes

2- No (Go to Question 3)

b. If yes, what is the percentage of foreign ownership ?

- 1- Less than 50 percent
- 2- Approximately 50 percent
- 3- More than 50 percent
- 4- 100 percent

3. a. In the last two years has the overall economic/business conditions changed ?

1- For the better

2- For the worse

b. If for the worse, what are the main reasons for the deteriorating conditions? (you may circle more than one answer?)

- 1- Lower overall world demand
- 2- Lower domestic demand
- 3- Increase in energy consumption, i.e. fuel and electricity
- 4- Employment, please state

(.....)

- 5- Uncertain political and security situation
- 6- Unfavorable government policies, please state

(.....)

7- Others, please state

(.....)

c. How does it affect this establishment? (Please explain)

d. If there has been a change, how has it affected employment in this establishment ?

1- Increased

4. a. How many workers does this establishment currently employ, including non-permanent workers?

- 1- Less than 50
- 2- 50 to 99
- 3- 100-499
- 4- 500-1000
- 5- 1000 +

b. How many permanent workers does this establishment currently employ ?

- 1- Less than 50
- 2- 50 to 99
- 3- 100-499
- 4- 500-1000
- 5- 1000 +

5. How many work shifts does this establishment have in one day?

No. of shift:

6. a. Do you export some or all your products this year?

1- Yes

b. If yes, approximately what percentage of total production was exported?

- 1- Less than 50 percent
- 2- 50 percent
- 3- More than 50 percent
- 4- 100 percent

II. Information on Employees

7.a. For permanent workers, please fill in the average number of employees by category

	Management	Professionals	Skilled Production Workers	Unskilled Production Workers	Non-production workers	Total
Av. number of workers at the end of the fiscal year of 2000						
% of which Female						
Av. number of workers at the end of the fiscal year of 2001						
% of which Female						
Av. number of workers at the end of the fiscal year of						

2002						
% of which Female						

7.b. For permanent workers, please fill in the average number of employees by age distribution

	< 15	15-29	30-44	45-55	56 <	Total
Av. number of workers at the end of the fiscal year of 2000						
% of which Female						
Av. number of workers at the end of the fiscal year of 2001						
% of which Female						
Av. number of workers at the end of the fiscal year of 2002						
% of which Female						

8. a. In the last two years, has this company employed the following non-permanent workers ? (you may circle more than one answer)

--	--

- 8- Part time
- 9- Contractual
- 10- Vendor (third party labour provider)
- 11- Casual/Daily workers
- 12- Temporary/seasonal workers
- 13- Apprenticeship
- 14- Home-based workers
- 15- Other non-permanent workers
- 16- No (go to question 2)

b1. If you answer, what is (are) the main reason (s) for employing these workers? (you may circle more than one answer)

--	--

- 1- Lower cost of monitoring
- 2- Lower cost of training
- 3- Lower wage
- 4- Lower administration cost
- 5- Special skills
- 6- Lower leisure time
- 7- Lower benefit
- 8- Fluctuating demand
- 9- Workers prefer this kind of arrangement

- 10- Lack of workers
- 11- Market uncertainty
- 12- Higher productivity
- 13- Higher work quality
- 14- Company policy
- 15- Due to manpower regulations
- 16- Other reasons, please specify:

b2. If you answer, what is (are) the main reason (s) for employing these workers? (you may choose one or more answers)

--	--

- 1- Lower cost of monitoring
- 2- Lower cost of training
- 3- Lower wage
- 4- Lower administration cost
- 5- Special skills
- 6- Lower leisure time
- 7- Lower benefit
- 8- Fluctuating demand
- 9- Workers prefer this kind of arrangement

- 10- Lack of workers
- 11- Market uncertainty
- 12- Higher productivity
- 13- Higher work quality
- 14- Company policy
- 15- Due to manpower regulations
- 16- Other reasons, please specify:

b3. If you answer, what is (are) the main reason (s) for employing these workers? (you may choose one or more answers)

--

- 1- Lower cost of monitoring
- 2- Lower cost of training
- 3- Lower wage
- 4- Lower administration cost
- 5- Special skills
- 6- Lower leisure time
- 7- Lower benefit
- 8- Fluctuating demand
- 9- Workers prefer this kind of arrangement

- 10- Lack of workers
- 11- Market uncertainty
- 12- Higher productivity
- 13- Higher work quality
- 14- Company policy
- 15- Due to manpower regulations
- 16- Other reasons, please specify:

b4. If you answer, what is (are) the main reason (s) for employing these workers? (you may choose one or more answers)

--	--

- 1- Lower cost of monitoring
- 2- Lower cost of training
- 3- Lower wage
- 4- Lower administration cost
- 5- Special skills
- 6- Lower leisure time
- 7- Lower benefit
- 8- Fluctuating demand
- 9- Workers prefer this kind of arrangement

- 10- Lack of workers
- 11- Market uncertainty
- 12- Higher productivity
- 13- Higher work quality
- 14- Company policy
- 15- Due to manpower regulations
- 16- Other reasons, please specify:

c. Do these workers receive more, less or the same pay scale as permanent workers

- 1- Higher
- 2- Lower
- 3- Same

d. What is the ratio of non-permanent workers to permanent workers:

- 1- Less than 10 percent
- 2- Less than 50 percent
- 3- Approximately 50 percent
- 4 - More than 50 percent
- 5 - 100 percent non-permanent workers

9. a. During the last two years, did this company outsource/sub-contract some or all of its production?

- 1- Yes
- 2- No (Go to Question 10)

b. What are the main reasons for outsourcing/sub-contracting your production (you may circle more than one answer)

- 1- Lower production costs
- 2- Increased market demand
- 3- Lower wage costs
- 4- Lower administration costs
- 5- Special skills
- 6- Lower leisure time
- 7- Lower benefit to workers
- 8- Fluctuating demand
- 9- Workers preferred that type of jobs
- 10- Lack of manpower
- 11- Company policy
- 12- Higher work quality
- 13- Manpower regulations
- 14- Other reasons, please specify:

c. Compared to 2 years ago, what is the magnitude of outsourcing/subcontracting ?

- 1- Higher
- 2- Lower
- 3- Same

10.a. During the last two years have you employed homeworkers?

- 1- Yes
- 2- No (Go to question 11)

b. What is (are) the main reason (s) for employing homeworkers? Please explain below:

11. a. During the last year, Did this establishment receive subcontracting arrangements from other companies ?

1- Yes

2- No (Go to question 12)

b. Approximately how many percent in values does this subcontracting arrangement compare to your main production?

.....% value

12. a. Does this establishment have an apprenticeship policy?

1- Yes

2- No (Go to question 13)

b. How long before the apprentice becomes an employee?

..... months

c. During the last 2 years what is the percentage of apprentices who became employees

..... % permanent

.....% non-permanent

d. How does the wages/salaries received by apprentices compare to permanent employees working on the same job?

1- Higher

2- Lower

3- Same (Go to question 13)

e. If not the same, how much is the percentage difference? %

f. How does the benefits received by apprentices compare to permanent employees working on the same job?

1- Higher
3- Same

2- Lower

13. During the last year, what is (are) the main reason (s) for employee lay-offs? (you may circle more than one answer)

- 1- Low demand due to difficult economic times
- 2- End of contract
- 3- Redundancy
- 4- Lack of performance
- 5- Involvement in labour unions
- 6- Involvement in dispute/strikes
- 7- Violation of company policy
- 8- Increased statutory minimum wage
- 9- Increase in non-permanent workers
- 10- Low productivity
- 11- Having reached retirement age
- 12- Rise in other input cost, i.e., fuel and electricity
- 13- Other reasons, please specify

14. During the period of lay-offs, what types of employees were mostly affected? (you may circle more than one answer)

- 1- Male
- 2- Female
- 3- Skilled workers
- 4- Unskilled workers
- 5- Employees on probation
- 6- Other types of employees (please specify)

15. a. To what extent are you aware of the current minimum wage laws?
(Please explain)

b. Did the increase in statutory minimum wage significantly affect the establishment's decision to lay off workers?

- 1- Yes 2- No (Go to Question 16)

c. If yes how? (Please explain)

For instance, hypothetically, if minimum wage were increased by 10 percent would it make the company decide to lay off workers? What about 20 percent or 30 percent?

16. Does increases in minimum wage affect other employments costs, such overtime, bonuses, or employment insurance (i.e. Jamsostek)?

1 -Yes

2- No

If yes, How?

III. Information on Wages

17. What is the establishment's policy on wages? (please explain, for example: wages are set by piece rates, daily wages etc)

18. Please explain the components of salaries or wages by general types of employees (for example, if the employee is a supervisor, he/she would receive: basic salary+ transportation allowance+ medical benefits, car, housing, etc., while if an employee is at staff level, he/she would receive all except for car and housing benefits.

19. For permanent employees, does the regulation to adopt the new minimum wage increase, decrease or does not change the following? 1- Increase 2- Decrease 3- No change

- a. The lowest wage
- b. Difference between the lowest wage to average wage
- c. Wages above the average wage
- d. Number of workers
- e. Proportion of permanent employees with other employees
- f. Proportion of female employees with male employees

20. a. Do you agree that the government should set statutory minimum wage ?

1- Yes

2- No (go to question 21)

b. Why ?

- 1- To make sure that the lowest paid worker receive decent wage
- 2- So that businesses can follow the standard industry level wage
- 3- Other reasons, please specify:

21. If not, what do you think is the appropriate method of wage setting ?

- | | |
|--------------------------------|---------------------------------|
| 1- Collective Labour Agreement | 4- Based on productivity |
| 2- Individual contract | 5- Based on overall performance |
| 3- Industry standard | 6- Others, please specify |

22. Do you think increasing wage through statutory minimum wage can increase employee's productivity or performance?

- 1- Strongly agree 2- Agree 3- Somewhat agree 4- Do not agree
5- Don't know

23. Do you think applying minimum wage can improve relations between employer and employees?

- 1- Strongly agree 2- Agree 3- Somewhat agree 4- Do not agree
5- Don't know

24.a. Do you agree to the decentralisation of minimum wage setting to provincial level or even to district level?

1- Yes

2- No

b. If yes, why ?

- 1- Easier to set
- 2- Easier to implement
- 3- Easier to enforce
- 4- Easier to monitor
- 5 - Other reasons, please specify:

c. If no, why not?

d. What is your opinion regarding the decentralisation of minimum wage setting to local government? (please explain as thoroughly as possible)

e. What do you think are the implications to your firm of the government's decentralisation process, giving more power to local government?

f. How does the current level of wage compare with wages in the past three years? (Please explain)

g. How will increasing levels of wage affects this establishment's employment decision in the future ?

1- Strongly 2- Moderately 3- Little effect 4- No effect
5- Not clear

h. If there would be an effect, how do you think the establishment will solve the problem?

- 1- Decrease present number of employment
- 2- Decrease or withhold employing more workers in the immediate future
- 3- Decrease number of unskilled workers
- 4- Decrease number of younger workers
- 5- Decrease number of female workers
- 6- Relocate to other areas with lower wage levels
- 7- Relocate abroad
- 8- Others, please explain

- i. If you opted for decreasing the number of employee, how will you accomplish this? (please explain)

- j. If you choose to relocate, which of these locations are preferable to you? (You may choose more than one answer)

--	--

- 1- Lampung (specifically:.....)
- 2- Central Java (Specifically:.....)
- 3- West Java (Specifically:.....)
- 4- East Java (Specifically:.....)
- 5- Others (please state:

- k. What is the main reason(s) for relocating to these places ? (you may choose more than one answer)

--	--

- 1- Cheaper minimum wage level
- 2- Better security
- 3- Better infrastructure
- 4- Strategic location
- 5- Other reasons, please specify

- l. Do you plan to relocate overseas if it's not possible to relocate to other provinces/islands?

1- Yes

2- No

- m. Do you think the current level of wage is sufficient to ensure employee welfare?

1- Yes

2- No

Other comments regarding the decentralisation of the minimum wage setting:

IV. Technology and Training

25.a. During the last two years did this company introduced new technological innovation in production?

1- Yes

2- No (Go to Question 26)

b. What were the main changes ?

- 1- New product
- 2- Computerisation
- 3- New Machines/equipment
- 4- Others, please specify

c. What are the reasons for introducing new technology? (please explain below)

d. Has these changes affect the number of employees ?

1- Increased

2- Decreased

3- No change

e. If increased or decreased, does this affect the proportion of permanent to non-permanent employees ?

1- Increased

2- Decreased

26. a. During the last 2 years, has this establishment introduced a non-technological innovation in production ?

1- Yes

2- No (Go to question 27)

b. What is (are) the main changes? (You may circle more than one answer)

- 1- Change the position of machinery/materials or facility
- 2- Introduce "*Just in Time*" in production
- 3- Introduce *Zero Inventory*
- 4- Improve cooperation among employees
- 5- Introduce continuous improvement/TQM
- 6- Increase mobility between jobs
- 7- Compacting weekly work
- 8- Job rotation
- 9- Increase work independence and obligation
- 10- Flatten hierchical structure
- 11- Other reasons, please specify

(.....)

c. What is (are) the main reason (s) for making those changes ? (you may circle more than one answer)

- 1- Lack of market demand
- 2- Increased compeition
- 3- High production costs
- 4- Loss
- 5- Changes in management/investors
- 6- Increased employment costs due to higher wages
- 7- Overhead cost
- 8- Other reasons, please specify

(.....)

d. Has these changes affect the number of employees ?

1- Increased

2- Decreased

3- No change (Go to question 27)

e. If you answered either 1 or 2 to question 28.d, how did this innovation affect the proportion of permanent employees?

1- Increase

2- Decrease

3- No change

f. How did this innovation affect the number of female workers ?

1- Increase

2- Decrease

3- No change

g. What are the opinion of workers on this innovation ?

- 1- No comment
- 2- Open, accept
- 3- Varied
- 4- Negative reaction, please specify

27.a. Does this establishment provide any training to its employees ?

1- Yes

2- No (Go to Question 28)

b. Does this establishment plan to increase training opportunities to its employees in the next five years ?

1- Yes

2- No (Go to Question 28)

c. What would be the main consideration for increasing training opportunities? (please explain below)

29. What types of workers receive the most training?

- 1- Managers
- 2- Supervisors
- 3- Staff
- 4- Professionals
- 5- Non-staff
- 6- Other workers

V. Information on Labour unions

29. a. Does this establishment have labour unions ?

1- Yes

2- No

b. How many ?

c. What types of workers comprise the biggest labour union?

- 1- Production workers
- 2- Other workers

3- All

d. When was the labour union set up ? (.....)

e. What is the type of the labour union ?

1- Plant level

2- Enterprise

3- Affiliation (national/regional)

4- Independent

f. Is the labour union recognised by management?

1- Yes 2- No

g. Who set up this labour union ?

1- Employees themselves

2- Employees with assistance from outside

3- By organisation outside the company

4- Assisted by management

h. How does management view this labour union?

1- Encourage plant-level unions only

2- Encourage affiliation with outside unions

3- No reaction

4- Negative reaction

i. Is the labour union protected by the collective labour agreement(CLA)?

1- Yes 2- No (Go to question 30)

j. What are the components of the CLA?

1- Scope of agreement

1- Yes 2- No

2- Obligations of company and employees

1- Yes 2- No

3- Recognition of employee rights

1- Yes 2- No

4- Employment relations

1- Yes 2- No

- 5- Work hours
 - 1- Yes 2- No
- 6- Wages
 - 1- Yes 2- No
- 7- Benefits
 - 1- Yes 2- No
- 8- Leaves
 - 1- Yes 2- No
- 9- Employee development program
 - 1- Yes 2- No
- 10- Grievances/dispute resolution
 - 1- Yes 2- No
- 11- Termination of employment/Lay offs
 - 1- Yes 2- No
- 12- Length of Collective Labour Agreement
 - 1- Yes 2- No

- I. Has this labour union conducted strikes
 - 1- Yes 2- No

- 30. a. What is the opinion of management regarding labour unions?
 - 1- Not relevant
 - 2- Relevant to protect workers
 - 3- Labour union has to reorganise
 - 4- Others, please specify

- (.....)
- b. What kind of workers' organisation is deemed more appropriate in your opinion ?
 - 1- Cooperative
 - 2- Social organisation
 - 3- Sports club
 - 4- Workers' association
 - 5- Others, please specify

- (.....)
- 31. a. Does this establishment have workers associations other than labour unions ?

35. a. In the next two years, what do you think would be the type of employees deemed difficult to obtain ?

- | | |
|----------------------------|---------------------------------|
| 1- Managerial, Executive | 5- Skilled production workers |
| 2- Professional, Technical | 6- Unskilled production workers |
| 3- Administration | 7- Other workers |
| 4- Sales, services | |

b. What steps should be taken to overcome these difficulties?

- 1- Limit production
- 2- Optimise existing employees
- 3- Change the type of product
- 4- Change the job structure
- 5- Increase costs
- 6- Increase training
- 7- Others, please specify
- 8- None
- 9- Don't know

Statement:

1). Name of Interviewee :

2). Position:

3). Telp: Fax: E-mail :

4). Signature :

5). Date :

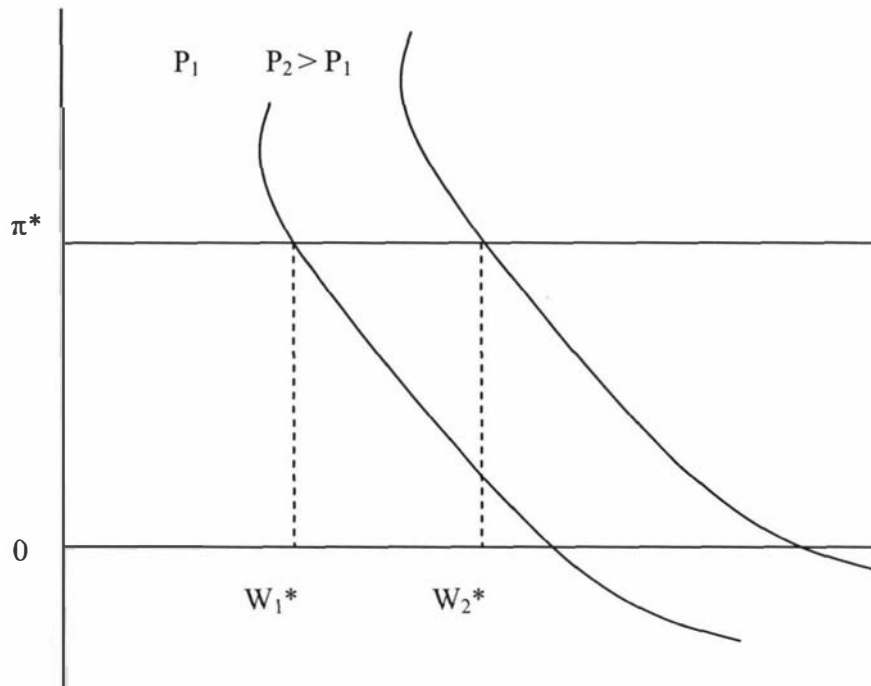
6). Name of Interviewer :

7. Document received:

8. Signature :

Appendix 8. Theory of Firm Births and Deaths (Quasi-elasticity)

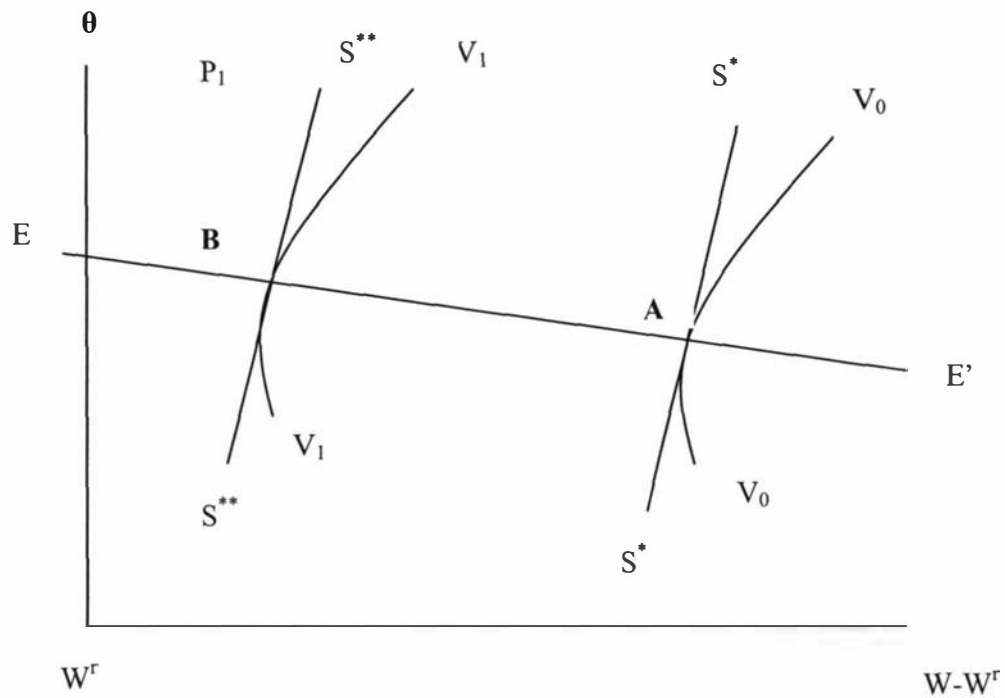
Figure 8A. Wages and Plant Openings



Source: Hamermesh, 1993, Chapter 4.

The decision for plant openings can be affected by the changes in wages. Profit is assumed to be constant. Figure 8A shows that with a given target profit of π^* and the product price P_1 , the establishment will only open if the wage rate is less than W_1^* . If there is a demand shock and product price rises to P_2 , then the firm would still open if wage rate were above W_1^* , but below W_2^* . If wages were increased to W_2^* or even above it as in the case of minimum wages, then profit would be less than π^* . Then, the establishment would be reluctant to open because the target profit would not be met.

Figure 8B. Equilibrium Combinations of Wages and the Probability of Plant Closings



Source: Hamermesh, 1993, Chapter 4.

The model for the death of firm is more complicated than the birth of firm due to the presence of workers who are attached to the firm. The typical worker chooses between a higher wage and a reduced risk, depicted by $W - W^r$. If wages in the firm fall below wages in other places, then the worker will leave the firm voluntarily. In Figure 8B, θ is the probability that a firm will close and S is the probability of plant shutdown where S^{**} is preferable to S^* because excess profit will be earned. However, with respect to workers, S^* line with a combination of V_0 , represented by A is preferable to S^{**} line with V_1 indifference curve, depicted by B , because at V_0 the wage is higher and the risk lower. To the right of S^* the wage rates will be higher and the risk of closing is also higher. V_0 and V_1 are a pair of indifference curves where a combination of wage rates and risk of establishment closing. The combination along V_0 is preferred to those along the V_1 because at V_1 the risk of the establishment closing is higher than at V_0 . The line E is the

equilibrium of the internal labour market defined by the tangency of the indifference curve V_0 to the probabilistic shutdown frontier for fixed S^* . In other words, where the S^* intersect the V_0 at point A is the condition accepted by workers and employer. A negative demand shock will shift the A combination to the left, B, and raise the risk of shutdown. The quasi elasticity is the negative of the percentage change in the probability that a plant closes in response to a one percent increase in the wage rate paid, holding product-market shocks constant.

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