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**Poverty, Employment and Wages:  
An Indonesian Perspective**

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## EXECUTIVE SUMMARY

It is widely recognised that Indonesia was the worst hit country in the tragic episode of the 1997 Asian crisis, and after numerous debates on how badly the poor were affected, a consensus emerged that poverty shot up for a period before stabilising again. Yet, innovations in poverty measurement and analysis have suggested a disenchantment with simple notions of poverty and a number of studies have emerged suggesting that the magnitude of poverty in Indonesia is much more widespread than was initially thought. These findings are emerging precisely at a time of decreasing fiscal resources, prospects of prolonged slow growth against a faltering global economy and political uncertainties. Faced with such harsh realities, it is imperative that Indonesian policy makers develop a deeper appreciation of the sources of the manifold manifestations of poverty and identify cost-effective and credible policy instruments that could lift the many millions who are poor today – and those who are likely to become poor tomorrow – towards a reasonable secure and prosperous future. This rethinking on poverty in Indonesia should entail a greater understanding of the interaction between the labour market and those who are poor. The purpose of this paper is precisely to explore this linkage.

Reflecting current intellectual trends, the paper highlights multiple dimensions of Indonesian poverty in both the pre- and post-crisis period. This involves an empirical synthesis of trends in income/consumption poverty, capability deprivation encompassing the UNDP's 'human poverty index', vulnerability and powerlessness. According to the income/consumption approach, the percentage of people living below the poverty line fell from 40% in 1976 to 18% in 1996, yet rose again to 37% in September 1998 before falling to its pre-crisis level of 18% by August 1998. By contrast, the capability deprivation indicators (malnutrition, literacy, access to health services and low life expectancy) suggest that in 1999 more than 50% of Indonesians did not have access to health services while the incidence of child malnutrition was 30%. Similarly, vulnerability (the risk of falling into poverty or getting deeper into poverty in the future) in Indonesia is more significant than current consumption poverty, recent estimates suggesting that the incidence of vulnerability is 34%. Thus despite decades of sustained economic and social gains prior to the 1997 Asian crisis, Indonesia has still to grapple with the manifold manifestations of poverty.

The paper explores the extent to which the evolution of consumption poverty (and consumption-based indicators of vulnerability) can be reconciled with developments in the labour market. During the 1980-90's, there was a reallocation of labour from low productivity, low-paid jobs in the rural economy to better paid employment in the urban and formal economy. Moreover, rapid growth in the pre-crisis era was accompanied by a deepening of skills of the workforce and a corresponding increase in the share of the educated/skilled workforce. In addition, 'casualisation' of the workforce and involuntary underemployment (major attributes of poverty) were not widespread. These labour market features are consistent with the sustained decrease in consumption poverty as documented above, and suggest a strong link between labour market developments and progress in poverty reduction. Another important aspect of the poverty-labour market nexus in Indonesia is the role that the employment-intensity of rapid growth played in the pre-crisis period. Higher employment elasticity translates to the fact that for any given growth rate, the job creation rate is higher.

The available evidence suggests that employment elasticity was quite low (0.3) in the 1970's, rose appreciably in the 1980's (0.8) and tapered off a little with the onset of the 1990's. These estimates are consistent with conventional interpretations of the evolution of the employment-poverty linkage in the Indonesian context.

In addition to employment, wages is another dimension of the poverty-labour market nexus, which affects the welfare of workers. The paper reviews the long-run behaviour of real wages in Indonesia, highlighting episodes of falling/stagnating real wages, with specific reference to the 1997 financial crisis. Moreover, the relationship between real wages, productivity and poverty is explored, in particular the role that changes in productivity have played in underpinning wage growth. The findings suggest apparent co-movements in real wages, productivity and consumption poverty with substantial declines in poverty being accompanied by rising productivity and real wages. For instance from 1978 to 1997, real wages and productivity grew by 5% p.a. on average, yet in 1998 real wages declined by 40% and remained 10% below their pre-crisis level three years later in 2000. A debate that has emerged under these circumstances is the extent to which employment and wage adjustments during the crisis period reflect the virtues of 'labour market flexibility'. The paper argues that whilst useful, the notion of labour market flexibility can only represent the beginning rather than the end of any analysis of the linkage between poverty and the structure of the labour market.

In attempting to develop a policy framework for dealing with issues that directly and indirectly impinge with the evolution of poverty, it is important to be aware of the key labour market challenges. These include; the need to create enough durable jobs annually to absorb new entrants to the workforce and clear the backlog of the unemployed and the underemployed. Moreover, there is a need to empower workers – both in the formal and informal economy – to cope with the problems of vulnerability to future episodes of poverty. In addition, there is a need to develop a credible industrial relations system that can represent the interests of both formal sector and marginalized workers and thus contribute to alleviating the sense of voicelessness and powerlessness of the poor.

As for the elements of a policy framework that one could devise for dealing with these labour market issues, the paper provides some thoughts as follows. Firstly, there is a need for the return of rapid and sustainable growth. Secondly, employment concerns must be reflected in macroeconomic policy, enabling the government to track the employment intensity of growth through estimates of employment elasticity. A third policy challenge involves ensuring that barriers are not erected against broad-based participation by the poor in the education and training system. A fourth policy element is concerned with the strengthening of more formal systems of social protection in order to deal with labour market risks, particularly those triggered by economic shocks. A fifth component is concerned with the building of appropriate labour market institutions, which provide 'voice' and representation for ordinary workers. This involves a process of 'social dialogue' (between government, employers and worker organisations), which builds on a labour rights-driven industrial relations system.

## 1. Introduction

What a difference a crisis makes! Not too long ago Indonesia was heralded as a rare exemplar of a low-income economy that has managed, over the space of two decades, to reduce mass poverty significantly. In the 1970s, this was attributed to rapid growth and the judicious use of revenues derived from Indonesia's oil wealth to fund public infrastructure, especially in agricultural and rural sectors. Such an activist policy eventually fuelled demand for unskilled workers in agriculture and construction-related activities and had a positive impact on real wages. In the mid-1980s, sustained poverty reduction was seen as the product of broad-based employment growth fuelled by the implementation of a trade liberalisation-cum-deregulation reform agenda.

Certainly, the available poverty statistics and pertinent social indicators pointed in the direction of a country that, under the tutelage of the authoritarian Suharto regime, delivered both political stability and sustained prosperity shared by many. Not surprisingly, these achievements bred a sense of complacency on the battle against poverty. It was felt that the latter – as a generic phenomenon – was largely tamed. The government needed to focus on pockets of poverty that marked the archipelagic terrain of Indonesia.<sup>1</sup>

The 1997 financial crisis and its aftermath have shaken – perhaps forever- the sense of optimism that characterised the Suharto era. It is widely recognised that Indonesia was the worst hit country in the tragic episode of the 1997 Asian crisis. After an initial bout of robust debate on how badly (or mildly) the poor were affected by the terrible recession of 1998 that followed the financial crisis, a consensus seems to have emerged that poverty shot up for a period, but the worst seems to be over.<sup>2</sup>

Under normal circumstances, such a finding would have inspired cautious optimism. Instead, several developments have overshadowed the onset of even cautious optimism. Innovations in poverty measurement and analysis have suggested a disenchantment with simple notions of poverty – such as insufficient income to acquire the basic necessities of life – and a growing recognition of its multidimensionality. It is increasingly being couched in terms of *deficient capabilities* (lack of basic education, adequate health, nutrition etc), *vulnerability* (the risk that people can move in and out of poverty) and *powerlessness* (the notion that the poor feel helpless and unable to influence the institutional, social and political circumstances that affect their daily lives and their future).<sup>3</sup>

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<sup>1</sup> Breman (1999) offers a critique of the way poverty statistics were used in Indonesia under the Suharto regime. This, does not, however, undermine the genuine progress against poverty that was made in the high-growth era prior to the 1997 financial crisis.

<sup>2</sup> For a thorough review of this debate, see UNSFIR (1999). See also Booth (1999, 2000).

<sup>3</sup> For a comprehensive statement on the changing views on global poverty, see World Bank (2000a), World Development Report, 2000/2001. See also Kanbur and Squire (1999). The notion of poverty as 'capability deprivation' has been forcefully argued by Sen (1999) and is one of the core planks of the UNDP's global reports on human development. UNDP has also made the point that capability deprivation is equivalent to deprivation of human rights. See, for example, UNDP (2000). The notion of powerlessness is a key feature of a landmark 'voices of the poor' study drawn from the responses of a large sample of poor individuals and households spread across a large number of countries in the developing world. See Narayan et al (2000). For a critique of the broadening of the notion of poverty, see McCawley (2000).

Based on this notion of multidimensionality, findings in the Indonesian context have emerged that suggest that the magnitude of poverty is much more widespread than was initially thought. At least one study claims that as much as 50 per cent of Indonesians are 'poor' based on the notion of vulnerability (vis-à-vis a little over 20 per cent based on conventional definitions of poverty).<sup>4</sup> Another study has suggested that the incidence of capability deprivation was more than twice the rate of poverty (as conventionally defined using consumption expenditure data) that was officially recognised to have prevailed in the Suharto era.<sup>5</sup> Survey data also suggest that approximately 87 per cent of those who are in the bottom quintile of households (in terms of expenditure distribution) do not have the incentive or the capacity to participate in political and civic activities.<sup>6</sup>

Such sombre findings are emerging precisely at a time of dwindling fiscal resources, prospects of prolonged slow growth against a faltering global economy and political uncertainties.<sup>7</sup> To compound these challenges, Indonesia has embarked on what one author has aptly called a 'systemic transition'. It is engaged in the quest for democratic consolidation; it has embraced decentralised governance after decades of highly centralised rule; it is struggling to implement a broad-based economic reform agenda.<sup>8</sup>

Faced with such harsh realities, it is imperative that Indonesian policy makers develop a deeper appreciation of the sources of the manifold manifestations of poverty and identify cost-effective and credible policy instruments that could lift the many millions who are poor today – and those who are likely to become poor tomorrow – towards a reasonably secure and prosperous future.<sup>9</sup> A salient aspect of this rethinking on poverty in post-Suharto Indonesia should entail a greater understanding of the interaction between the labour market and those who are poor. To what extent has poverty reduction strategies in the past been a reflection of broad-based employment growth? What has been the role of productivity-driven wage increases in influencing the living standards of ordinary Indonesians? How have employment and real wages adjusted during the Indonesian crisis of 1997 and what has happened since then? What are the corresponding normative and policy implications? What is the way ahead?

These, then, are the issues that are explored in this paper. **Section 2** offers an account of Indonesian poverty before, during and after the crisis. Reflecting current intellectual trends, a distinction is made among the multiple dimensions of poverty. In particular, trends in consumption poverty, capability deprivation, vulnerability and

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<sup>4</sup> See World Bank (2000b) that draws on Pritchett et al (2000).

<sup>5</sup> See Dhanani and Islam (2000, 2002).

<sup>6</sup> As reported in World Bank (2001, table 4, p.9).

<sup>7</sup> Growth in 2001 is now expected to be below 3.5 per cent after being close to 5 per cent in 2000. The central government budget deficit is expected to increase to 6.0 per cent of GDP in the absence of countervailing measures. See World Bank (2001: 4-6).

<sup>8</sup> See Mishra (2001).

<sup>9</sup> Media reports claim that the Indonesian government appears to be 'aloof' to the theme of a renewed engagement with the battle against mass poverty that is now a major part of the agenda of the international development community. For example, media reports allege that the Indonesian government made a low-key representation at the recently concluded *UN Conference on Financing for Development* held in the Mexican City of Monterrey which re-affirmed the UN Millenium Goal for halving global poverty by 2015. See the *Jakarta Post*, March 25, 2002.

powerlessness are highlighted. This sets the context for a discussion of the relationship between poverty and different indicators of employment (**section 3**), of the relationship between poverty and real wages (**section 4**), as well as the different ways in which employment and real wages adjusted during the Indonesian crisis and developments since then. Finally, **section 5** summarises the key findings, while **section 6** discusses some policy options.

## **2. The multiple dimensions of poverty in Indonesia: pre- and post-crisis perspective**

This section will briefly review trends in consumption poverty, capability deprivation and vulnerability and powerlessness. All of them represent important aspects of impoverishment in Indonesia.

### Consumption poverty

Perhaps the most researched, and publicised, aspect of poverty in Indonesia draws on the so-called income/consumption approach. The latter entails the use of expenditure/distribution data to derive a 'poverty line' below which people are classified as poor, that is people who have inadequate purchasing power to acquire the basic necessities of life. When expressed as a proportion of the population, such a statistic becomes the well known and widely used 'head-count ratio'. In the case of Indonesia, current consumption expenditure, rather than current income, is used to estimate the head count ratio.

Estimates of consumption poverty are routinely provided by the Central Bureau of Statistics (CBS) and may be regarded as the official estimates for Indonesia. Long-term trends in pre-crisis poverty in Indonesia based on the income-consumption approach, is shown in Figure 2.1. Both CBS and alternative estimates are shown.<sup>10</sup> The sharp fall in poverty between 1976 and 1996 is evident, whether the CBS or the alternative approach is used. The only exception seems to be the 1976-1978 period when the alternative estimates suggest a slight increase in the head count ratio, but with the CBS measures showing a discernible decline.<sup>11</sup>

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<sup>10</sup> The alternative estimates take the 1996 poverty line and projects it backwards and forwards using the prevailing inflation rates. The procedure is described in Dhanani and Islam (2002). The CBS poverty lines in Figure 2.1, on the other hand, pertain to poverty lines derived for each period of observation.

<sup>11</sup> Note that the estimates presented in figure 2.1 vary in one significant respect from figure 2.2. In figure 2.1, the head count ratio is shown to be 11.3 per cent for 1996, while it is shown to be 18 per cent for 1996 in figure 2.2. This discrepancy is due to the fact that CBS has used two different poverty standards, the so-called 'old' poverty standard based on 1996 data (that is embodied in figure 2.1) and a 'new' poverty standard based on 1998 data (that is embodied in figure 2.2). The numbers depicted in figure 2.2 are readily comparable across time as they are based on a common poverty line. On the other hand, the statistics in figures 2.1 are less comparable across time because they are based on period-specific poverty lines.

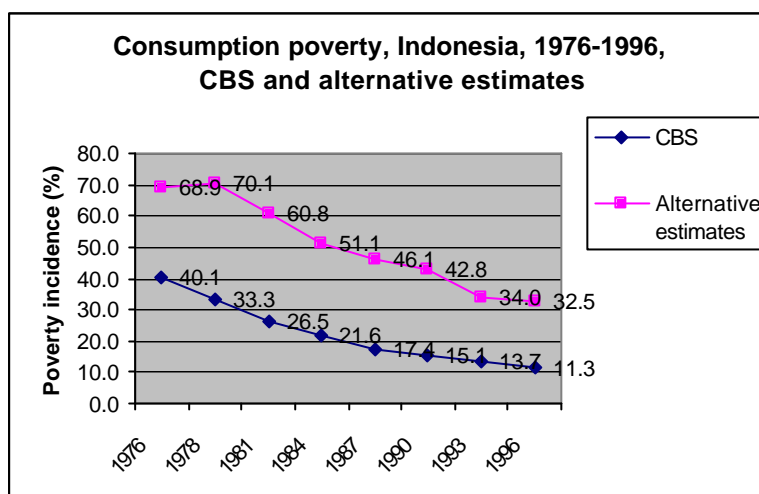


Figure 2.1

The most conspicuous aspect of more recent poverty statistics in Indonesia, that is, immediately prior to and after the crisis, is its volatility. These are captured in figures 2.2 to 2.4. Figure 2.2 presents data on consumption poverty that is based on CBS estimates between February 1996 and August 1999, while Figure 2.3 shows alternative estimates of consumption poverty between February 1996 and February 2000. In both cases, consumption poverty rises sharply between 1996 and 1998, signifying the height of the crisis, but then begins to taper off quite quickly. For example, the head count ratio in September 1998 according to the CBS figures doubles from its 1996 level of 18 per cent to 37 per cent, but by August 1999, the value of the head count ratio has apparently returned to its pre-crisis level.

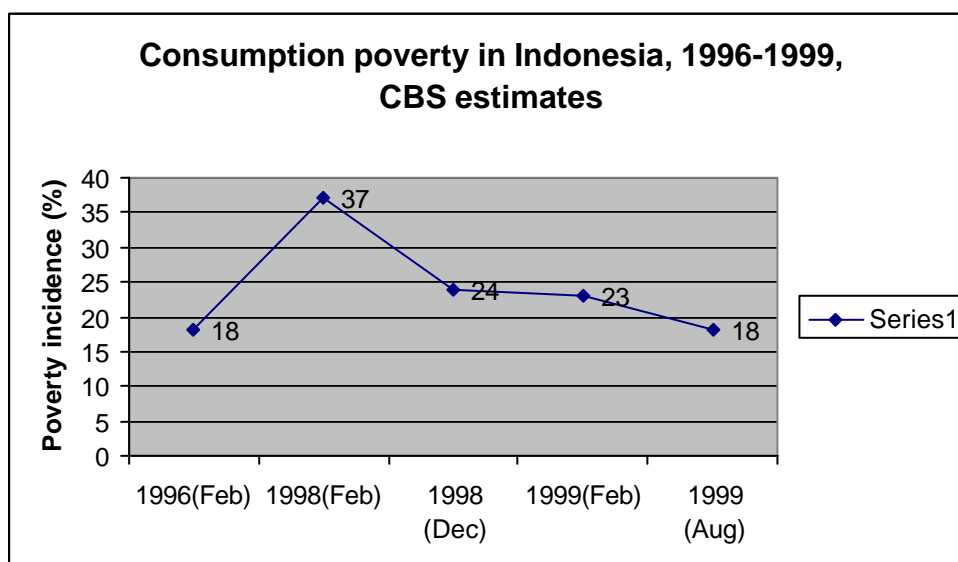


Figure 2.2



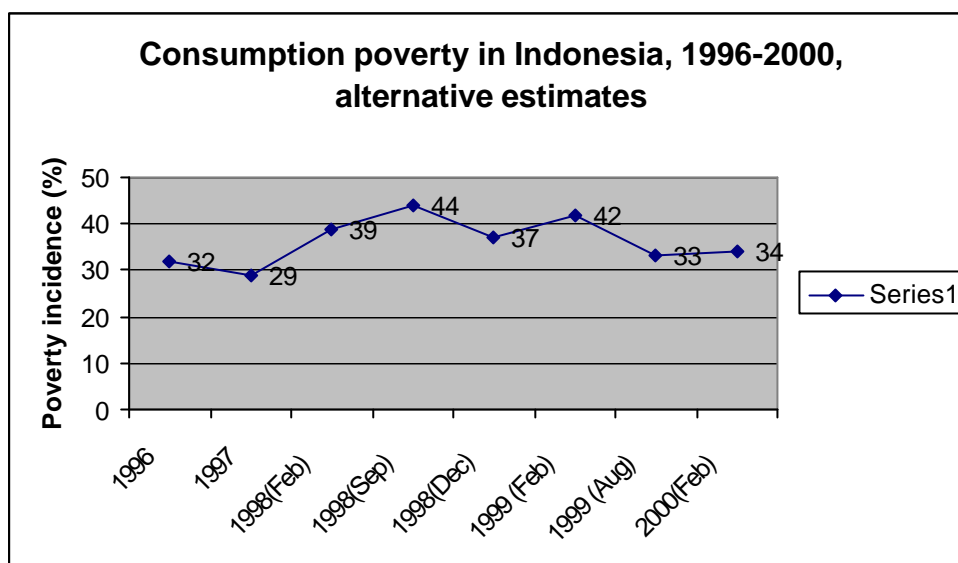
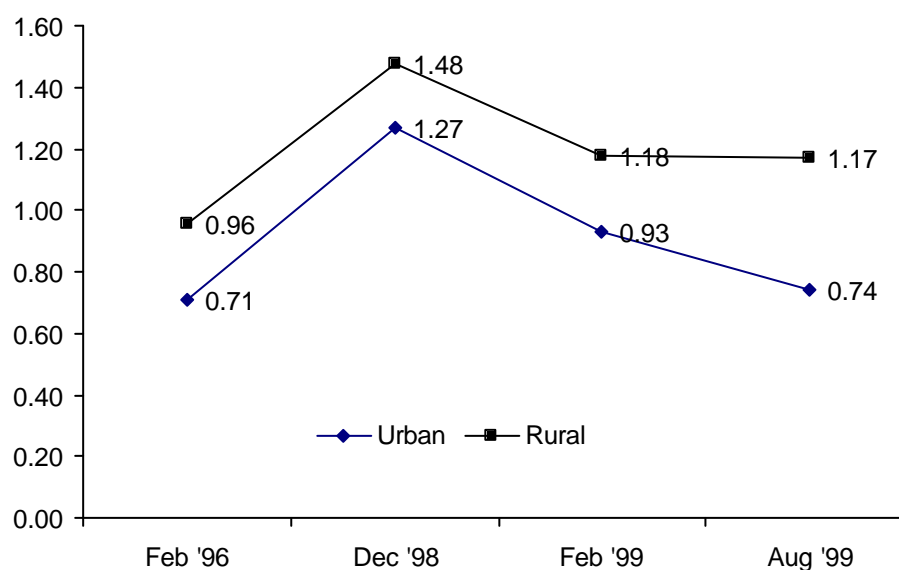


Figure 2.3

Figure 2.4 shows trends in the poverty severity index for Indonesia for the period 1996-1999 (derived from SUSENAS 1996, 1998 and 1999).<sup>12</sup> The data – as presented – shows that severity of poverty shot up between February 1996 and December 1998, but tapered off by February 1999, mirroring the trend in the overall head count ratio (see Figures 2.2 and 2.3). While the poverty severity index apparently returned to their pre-crisis levels by August 1999 in urban areas, this was not the case in rural areas, with the value of the severity index for rural Indonesia remaining a little higher than its pre-crisis level.

Figure 2.4 Trends in Poverty Severity Index ( $P_2$ ), 1996 – 1999



<sup>12</sup> Poverty severity indices capture both the depth of poverty and the degree of inequality among the poor. See Foster et al (1984).

### Income poverty using international poverty lines

An alternative way of depicting income/consumption poverty is to use so-called 'international poverty lines' (IPLs). This method has been popularised by the World Bank and entails the use of dual poverty lines, a 'one dollar a day threshold' and 'two dollars a day'. In other words, people earning either one dollar a day or two dollars a day would be classified as poor. The former may be considered to be a measure of extreme poverty, the latter a measure of the incidence of 'relative poverty', assuming a generous threshold by developing country standards.<sup>13</sup> IPLs have been criticised for their lack of reliability vis-à-vis national poverty lines,<sup>14</sup> but the point is that IPLs provide a basis for global comparisons of poverty. Subject to this caveat, what has happened to the evolution of income poverty in Indonesia using the World Bank standards? Figure 2.5 depicts some pertinent information that is derived from data maintained by an international agency.<sup>15</sup> According to both thresholds, poverty fell sharply between 1984 and 1996, and rose conspicuously between 1996 and 1999 under the impact of the 1997 crisis, but is projected to have stabilised since then. Obviously, in terms of the two dollars a day benchmark, poverty in Indonesia is widespread, being around 60 per cent in 2000.

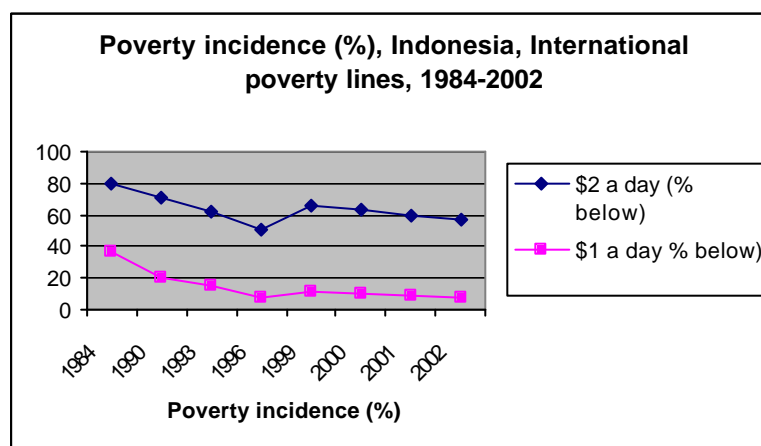


Figure 2.5

### Capability poverty

The income/consumption approach measures inadequate purchasing power as a measure of deprivation. Even if one could guarantee adequate purchasing power, it does not guarantee the elimination of actual deprivation. Thus, for example, people in a particular community could have the potential capacity to acquire basic education, but because of, say, lack of access to appropriate facilities may not be able to acquire basic education (at least at reasonable cost). Hence, while people in this hypothetical community may be 'non-poor' based on non-monetary dimensions, they would still be deprived in their inability to be educated. The converse may also be true. Someone could be deemed 'poor' in a monetary sense, and yet, because of, say, an activist

<sup>13</sup> Agenor (2002:4). One could argue that the higher IPL captures estimates of the 'near-poor'.

<sup>14</sup> See David et al (1999).

<sup>15</sup> Asia Recovery Information Centre Data Base. Unfortunately, the Centre does not make it clear whether estimates beyond 2001 are projections. The study assumes that this is the case.

public policy that provides free basic education, may have the capacity to acquire rudimentary schooling.

As the above admittedly contrived example shows, it has now become commonplace to view '...poverty...as encompassing not only material deprivation...but also low achievements in education and health'.<sup>16</sup> A more general statement of this notion is that poverty should be conceptualised as 'capability deprivation', that is the severe restriction on 'capabilities that a person has ...the substantive freedoms he or she enjoys to lead the kind of life he or she values'.<sup>17</sup> The ability to be literate and healthy is thus not only a means to an end, enabling people to escape from the trap of material deprivation by being productive members of society, but are ends in themselves. Indeed, such a line of thinking regards the elimination of capability deprivation as being at par with the acquisition and consolidation of core human rights. The right to be literate and healthy is as fundamental as the right to freedom of expression.

The current 'international development goals' recognise the notion of poverty as going beyond material deprivation.<sup>18</sup> Thus, the international development community, based on discussion at various United Nations conferences in the 1990s, declare the need to:

- Reduce by half the proportion of people living in extreme income poverty (living on less than \$1 a day)
- Ensure universal primary education
- Eliminate gender disparity in primary and secondary education (by 2005)
- Reduce infant and child mortality by two-thirds
- Reduce maternal mortality rates by three-quarters
- Ensure universal access to reproductive health
- Implement national strategies for sustainable development in every country by 2005, in order to reverse the loss of environmental resources by 2015.

Not all of these goals directly relate to poverty eradication goals (for example, the reference to environmental management), but the declarations make it clear that simply reducing income poverty is not enough. Furthermore, it is not merely an issue of focusing only on the education and health indicators prescribed in the international development goals. One could argue that capability deprivation should also take account of such indicators as malnutrition, access to safe drinking water, access to sanitation facilities and access to shelter of acceptable quality.

One issue that emerges in measuring capability deprivation is that the components of it are so diverse that they cannot just be added up in the way that monetary units can. UNDP has, over a period of time, attempted to offer a composite measure of capability deprivation. Known as the 'human poverty index' (HPI), the framework shares the spirit of the UNDP's well known 'human development index' (HDI). The HPI is an aggregation of several indicators of deprivation: the percentage of people not expected to survive to 40; the illiteracy rate; percentage of people without access to water and health services; percentage of underweight children under the age of five. One caveat that should be noted in interpreting estimates based on HPI is that the

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<sup>16</sup> World Bank (2000), World Development Report 2000/2001, p.15.

<sup>17</sup> Sen (1999).

<sup>18</sup> See, for example, the OECD (1996).

framework assigns arbitrary weights to the different components of capability deprivation by assuming that all the components are equally important. Furthermore, the HPI does not give a measure of the proportion of people living in human poverty in a way that could be compared with the proportion living in income/consumption poverty.

**Table 2.1: Key indicators of capability deprivation, Indonesia, 1990-1999**

	1990	1996	1999
HPI	27.6	25.2	25.2
Population not expected to survive to age 40 (%)	15.2	18.3	15.2
Adult illiteracy rate (%)	18.5	14.4	11.6
Population without access to safe water (%)	54.7	53.1	51.9
Population without access to health services (%)	14.0	10.6	21.6
Under-nourished children under the age of five (%)	44.5	35.4	30.0

Source: BPS/BAPPENAS/UNDP (2001: annex 1.2, p.15)

Table 2.1 offers an illustration of the use of the HPI framework in Indonesia. From the above table, one could infer that, the HPI improved between 1990 and 1996, but remained stable between 1996 and 1999, despite the onset of the 1997 financial crisis. In terms of individual indicators, the degree of capability deprivation varies from 52 per cent (more than half of the Indonesian population do not have access to safe water) to 12 per cent (this being the proportion of the adult population that are deemed to be illiterate). The extent of child malnutrition is also quite high (30%), particularly when judged against the benchmark that a well-nourished population typically has around three per cent of children who suffer from some form of malnutrition.<sup>19</sup> There have been improvements in the various indicators between 1990 and 1999, with the conspicuous exception being the deterioration of the population without access to health services (it jumped from 10.6 per cent to 21.6 per cent between 1996 and 1999).

Other important indicators of the well being of mothers and children pertain to primary schooling, infant and maternal mortality. Target reductions in these indicators are now part of the international development goals. The evidence, as at 1999, suggests that net enrolment rates at the primary level is around 95 per cent and infant mortality is around 47 (per thousand live births). One weak spot is the maternal mortality rate, which at 450 per 100,000 live births, is one of the highest in South-east Asia.<sup>20</sup>

How do these figures compare with estimates of consumption poverty? At around 18 per cent of the population, consumption poverty in 1999 is broadly aligned with some

<sup>19</sup> Sadaah et al (1999:2).

<sup>20</sup> BPS/BAPPENAS/UNDP (2001: ch.3).

indicators of capability deprivation, but is notably below the levels recorded by other indicators (especially child malnutrition and access rates to safe water).

### Vulnerability

There is a growing realisation that people can move in and out of poverty.<sup>21</sup> This has in turn inspired greater attention on the notion of vulnerability as an important dimension of poverty. Vulnerability may be defined as ‘...the probability or the risk today of being in poverty or to fall into deeper poverty in the future’.<sup>22</sup> Such vulnerability to a decline in well-being may be triggered by shocks at the *micro /household* level (e.g. illness, death of breadwinner in the family), at the *meso/community* level (e.g. a bad harvest, a collapse in the price of key products, environmental degradation) and the *macro/economy-wide* level (e.g. the 1997 Asian financial crisis).

Until the onset of the Asian financial crisis in 1997, vulnerability was not a widely recognised phenomenon in Indonesia. It was simply assumed that cross-section surveys offered an adequate description of the phenomenon of poverty. Certainly, this assumption appeared quite plausible during the long economic boom of the Suharto era, when popular expectations of uninterrupted improvements in living standards held sway. In the more sombre circumstances of the post-crisis period, when many from the emergent middle class joined the ranks of the poor, even if temporarily, it became evident that it was necessary to assess the risk of individuals and households falling into poverty or getting even poorer. Reflecting this mood to capture movements in and out of poverty, a spate of studies has explored the prevalence of vulnerability in Indonesia.<sup>23</sup> Some of these studies have been made possible by the fact that various surveys were carried out that tracked the same set of households over time. For example, the ‘100 Villages survey’ interviewed a panel of over 10,000 households four times from August 1998 to October 1999.<sup>24</sup> A ‘mini-SUSENAS’ (that is, a smaller version of the full SUSENAS) was carried out in December 1998 and about 7,500 households were re-interviewed in August 1999.<sup>25</sup>

An alternative technique that does not rely on panel data has also been developed. It relies on regression techniques to estimate a ‘...predicted mean consumption level, predicted consumption volatility and vulnerability to poverty for each household’.<sup>26</sup> The estimates are derived from cross-section data on expenditures and a number of household and community characteristics. In the case of Indonesia, this has entailed the merging of SUSENAS and PODES (village potential) data, the latter being a complete enumeration of villages in terms of such characteristics as size, population, infrastructure and local industries.<sup>27</sup>

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<sup>21</sup> Jo and Ellwood (1983) are among the pioneering studies that examined the dynamics of poverty.

<sup>22</sup> Coudouel et al (2001: 32).

<sup>23</sup> See Skoufias et al (2000), Pritchett et al (2000), Chaudhuri et al (2001), Suryahadi and Sumarto (2001), Widyanti et al (2001).

<sup>24</sup> The survey is conducted by CBS and funded by UNICEF. It should be noted that the 100 Villages survey is not meant on a representative sample of the country. It was designed (in 1994) to offer a representation of various parts of the rural economy. Hence, the conclusions of any study based on this survey needs to be treated with some caution.

<sup>25</sup> This was conducted by CBS and funded by UNDP.

<sup>26</sup> Chaudhuri et al (2001: 1).

<sup>27</sup> Suryahadi and Sumarto (2001).

An illustration of the key findings on vulnerability is provided in Tables 2.2 to 2.4. The first table draws on poverty transition matrices based on the ‘100 Villages Survey’, the others on regression techniques applied to SUSENAS.

**Table 2.2: Persistent, chronic and transient poverty, Indonesia, 1999**

Poverty category	Incidence (%)	Extent to which mean real per capita consumption is % below (-) or above (+) poverty line	Variance as measured by standard deviation
Persistently poor	17.5	- 30.0	0.1
Chronically poor	15.5	-10.0	0.1
Transiently poor	24.8	+ 20.0	0.2
Never poor	42.2	+ 90.0	0.7

Source: Adapted from Wideband et al 2001, Table 5, and p.11. The original data source is the 100 Villages Survey.

As Table 2.2 shows, 17.5 percent of the poor are ‘persistently poor’, that is, they are always poor over the periods observed. 15.5 are ‘chronically poor’, that is, they are usually poor over the period observed. 24.8 per cent ‘transiently poor’, that is, they are sometimes poor over the periods observed. 42.2 per cent are never poor over the periods observed. The ‘vulnerable’ population would include the transiently poor implying that the prevalence of vulnerability is larger than the prevalence of poverty per se. It is of some interest to note from the table that income variability (as measured by the standard deviation) is in fact highest for those who are never poor. It is also of some interest to note that the persistently poor and the chronically poor – who form the poorest of the poor in terms of this framework – have average consumption that are 10 to 30 per cent below the poverty line.

Table 2.3 revisits the above poverty categories using SUSENAS-cum-PODES data. It pertains to two years: 1996 and 1999. Both current consumption poverty and vulnerability jumped between the two years. As can be seen, the head count ratio goes up from 15.6 per cent to 27.4%.<sup>28</sup> At the same time, the prevalence of vulnerability went up from 18.1 per cent to 33.7%. This suggests that vulnerability is not only significantly higher than current consumption poverty, but it also went up more sharply than the former with the onset of the 1997 financial crisis.

**Table 2.3: Poverty and vulnerability, Indonesia, 1996-1999**

Poverty category	1996	1999	Change
Transient poor	12.4	17.9	5.5
Chronic poor	3.2	9.5	6.3
Total	15.6	27.4	11.8
Total vulnerable group	18.1	33.7	15.6

Source: Adapted from Suryahadi and Sumarto, 2001, Table 1, p.10.

Table 2.4 presents a simple matrix in which the correspondence between poverty and vulnerability is shown more explicitly. Clearly, there is a great deal of overlap between the proportion in poverty and the proportion that are vulnerable, but the two do not coincide perfectly. Hence, while 78 per cent of the currently poor are

<sup>28</sup> The discerning reader will note that these estimates vary from the CBS estimates presented earlier. This is due to the use of a different poverty line and, to some extent, the merging of two datasets.

vulnerable, 32 percent of the non-poor are also vulnerable.<sup>29</sup> It is the inclusion of the non-poor in vulnerability estimates that explains why in Indonesia, as in many other developing countries, the proportion of the population that faces a non-trivial risk of future poverty is significantly higher than the proportion currently observed to be poor.

**Table 2.4: Poverty and vulnerability, a simple matrix, Indonesia, 1999**

	Non-poor	Poor
Non-vulnerable	64%	22%
Vulnerable	32%	78%

Source: Adapted from Chaudhuri et al (2001), p.1. Note that the prevalence of vulnerability is 45% according to this study. The original data sources are mini-SUSENAS December 1998 and 7,500 households re-interviewed in August 1999.

Some qualifications need to be highlighted as part of concluding the discussion of vulnerability in Indonesia. The data provided here do not directly address the issue of seasonality as a distinct facet of vulnerability. There would be households that would be vulnerable only in bad years (e.g. a bad harvest), and others that are vulnerable irrespective of seasonal effects. Such a subtle distinction is not really captured by the available data suggesting the need for further research along this direction.<sup>30</sup>

### Powerlessness

Recently, attempts have been made in Indonesia as part of a worldwide study that has tried to listen to the ‘voices of the poor’.<sup>31</sup> The purpose is to elicit responses from the poor through small-group discussions. This in turn allows one to obtain perceptual data on direct experiences of poverty.

An important theme that emerges from the above exercise is that the poor in Indonesia, as in many other developing countries, feel

- A strong sense of exclusion from decision-making processes that directly affect their lives
- A strong sense that women have no voice in decision-making processes
- A strong sense of distrust of state institutions.<sup>32</sup>

<sup>29</sup> It is worth noting that different studies generate different estimates of vulnerability. In Pritchett et al (2000), the prevalence of vulnerability varies from 30% to 50%. In Chaudhuri et al (2001) it is 45%. In Sumarto and Suryahadi (2001), it is estimated to be 34%. The differences in the estimates stem from different definitions of vulnerability and use of different data.

<sup>30</sup> See Dercon and Krishnan (2001) for a study of the impact of seasonality on poor households in Ethiopia.

<sup>31</sup> Narayan et al (2000). For Indonesia, the relevant sources are: Consultations with the poor in Indonesia as compiled by Mukherjee (2000) and Bangsal and Sari (2000).

<sup>32</sup> The discussion draws on Mukherjee (2000) as reported in World Bank (2000, pp24-25, 55).

### Exclusion from local decision-making processes

Respondents in poor communities that were surveyed were resigned to the fact that they were excluded from local-level decision-making processes. As one person in East Nusa Tenggara noted:

‘When the Village Development Council calls a meeting, all the decisions about a project or program have already been made...Even an old, aged and blind man ...will be invited along to the meeting, along with rest of the village men. They would all remain silent and listen...’

Elsewhere, someone observes:

‘Those who are able to have influence are only people with high social status, the village officials or the rich’.

### Lack of voice of women in local decision-making processes

Here are some typical observations:

- Women’s groups everywhere confirmed that women are neither invited nor expected to attend village meetings which are often conducted at male-only events and places such as Friday post-prayer meetings...or the Village Forum
- Where women have their community gatherings and activities, they are often there as conduits for implementing development programs or self-help initiatives, with little or no decision-making roles
- ‘When women are invited to the meeting (of the Village Development Council), they are only given the task to prepare and serve the refreshments...’
- Both women and men seem to concur that ‘...community decisions are rights and responsibilities of menfolk. Women’s role is only to accept and implement them’.

### Lack of trust of state institutions

The poor trust an institution that is perceived to be transparent, fair, sticks to commitments made, offers assistance without hidden agendas and believes in the capacities and convictions of the poor. When judged against such criteria, a number of faith-based NGOs were singled out, but none of the state institutions were identified. In particular, rural women consistently excluded village councils and government programs for poverty alleviation as worthy of their trust, and as being open to community influence.

While listening to the ‘voices of the poor’ in Indonesia is, in and of itself, a fascinating exercise and corroborates what has been widely recognised as key attributes of poverty, the challenge lies in translating such perceptual data into meaningful indices that can be readily tracked. Currently, one lacks voice and power indicators that can be readily compared to consumption/income indicators of poverty, capability deprivation and measures of vulnerability. Perhaps greater attention needs to be paid to the design of national household surveys in the future that would routinely incorporate components that seek to elicit information on the civic and political activities of the poor. Certainly, some data that are available in this form



suggest that well over 80 per cent of low-income households in Indonesia do not participate in political and civic activities.

### **3. Poverty and the labour market: the role of employment**

The review of the multiple dimensions of poverty in Indonesia has shown that:

- There was an impressive long-run decline in consumption/income poverty over two decades. This conclusion is valid irrespective of the estimation method used.
- Consumption poverty shot up during the crisis, but it was transient, with the head count ratio tapering off to its pre-crisis level by mid-1999.
- Indicators of capability deprivation exhibit greater stability and were apparently unaffected in any major way by the 1997 financial crisis.
- Vulnerability in Indonesia is more significant than current consumption poverty, and worsened more sharply than the latter during the crisis.
- Perceptual data gleaned from direct experiences of poverty suggest that the poor feel alienated and excluded from local decision-making processes – a phenomenon particularly affecting women – and that they lack trust in state institutions.

The purpose of this section is to explore the extent to which the evolution of consumption poverty (and consumption-based indicators of vulnerability) can be reconciled with developments in the labour market, where such developments are assessed from the perspective of a range of employment indicators. The discussion is reinforced by developing a cross-section profile of the employment /skill and demographic characteristics of the poor. Evidence based on capability deprivation and powerlessness are more difficult to accommodate within the framework of labour market analysis, as they suggest that poverty has deep social, political and institutional roots.

Finally, the section revisits some important debates in the Indonesian context. Do employment adjustments during the crisis represent a high degree of labour market flexibility that, in turn, mitigated the impact of the crisis on consumption poverty? Does the liberalisation-cum-deregulation reform agenda in a context of regional decentralisation that has gained momentum in the wake of the 1997 crisis entail adverse consequences for the employment prospects of ordinary Indonesians?

#### Changes in employment structure: overview and implications for poverty

Drawing on a variation of 'key indicators of the labour market' (KILM) devised by the ILO, a brief account is offered of the following employment indicators in the Indonesian context: (a) labour force participation rate; (b) employment-to-population ratio; (c) status in employment; (d) part-time workers; (e) the size of the urban informal sector; (f) indicators of unemployment and underemployment; (g) the sectoral composition of employment (h) the skill-levels of the work-force.<sup>33</sup> These indicators enable one to develop an understanding of the structure of the Indonesian labour market. This in turn sets the context for appreciating the poverty-employment nexus.

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<sup>33</sup> See Irawan, Ahmed and Islam (2000) for an application of the ILO's KILM framework to Indonesia.

Table 3.1 captures the various ways in which one can track the transformation of the Indonesian labour market over the 1990s. The Indonesian labour force grew from 75 million in 1990 to 96 million in 2000 entailing an average annual growth rate of 2.5 per cent. In terms of absolute numbers, this suggests an addition of two million members to the workforce annually. Hence, the challenge is to ensure that the economy – through a combination of the natural processes of growth and policy interventions – is able to generate at least two million jobs to maintain ‘flow equilibrium’ in the labour market.

**Table 3.1: Overview of the Indonesian labour market, 1990-2000**

	1990	1993	1996	1998	1999	2000
Size of the labour force (mil)	75.4	79.2	88.2	92.7	94.8	95.7
Labour force participation rate (%)	66.4	67.8	66.9	66.9	67.2	67.7
Employment to population ratio	64.7	63.8	63.6	63.3	62.9	63.6
Female labour force (%)	38.8	38.6	38.5	38.8	38.4	38.6
Youth labour force (%)	23.1	22.2	22.3	21.3	21.3	21.6
Urban labour force (%)	25.5	29.5	33.9	36.0	38.1	38.0
Formal employment (%)	28.1	32.1	37.9	35.4	36.9	35.3
Urban informal sector employment (%)	44.2	43.7	42.5	45.7	45.8	44.7
Part-time employment (%)	28.0	29.1	33.3	28.6	27.3	27.9
Female part-time employment (%)	59.8	57.0	57.4	57.7	56.8	57.2
Time-related underemployment rate (%)	8.7	9.0	9.9	8.5	9.1	9.2
Youth unemployment rate (%)	8.0	8.9	15.5	17.1	19.9	17.5
Unemployment rate (%)	2.5	2.8	4.9	5.5	6.4	6.1

Source: Estimated from SAKERNAS, the national labour force surveys, various years. Some indicators also extracted from Puguh, Ahmed and Islam (2000), statistical appendix. Some indicators for 2000 (part-time employment, time-related underemployment, youth unemployment rate, size of the urban informal sector) are estimates based on historical trends. Direct computations of these indicators will require special tabulations based on unpublished SAKERNAS data.

In some respects, one cannot detect a great deal of change in the labour market; in other respects, the changes are evident. Thus, the labour force participation rate – as well as the employment-to-population ratio – remained relatively stable, the former entailing modest fluctuations between 66 and 68 per cent. The gender composition of the workforce was also steady, being around 38 per cent as was the proportion of young workers among the total labour force; it fluctuated between 21 and 23 per cent.

As a contrast to the stable features of the labour market noted above, one observes significant urbanisation and formalisation of the workforce. The relative size of formal sector employment rose from 28 per cent to 38 per cent on the eve of the crisis (1996), while the relative size of the urban labour force increased from 26 per cent to 36 per cent.

These developments are consistent with the sustained decrease in consumption poverty documented in section 2 of this study. A reallocation of labour from low-productivity, low-paid jobs in the rural economy to better-paid employment in the urban and formal economy is one well-known route via which ordinary workers and their dependents can improve their living standards.

As far as different indicators of under-utilisation and ‘casualisation’ of the workforce is concerned, the picture is mixed. Part-time employment remained roughly steady between 1990 and 1993 (28 to 29 per cent) and rose moderately thereafter (33 per cent). The relative size of the urban informal sector hardly changed (gravitating around 45 to 43 per cent). There is also no clear trend of an increase in the proportion of women who worked part-time. Thus, these measures of ‘casualisation’ of the workforce do not show any consistent deterioration in the pre-crisis period. There is little evidence as well that, prior to the crisis, involuntary underemployment (or ‘time-related’ underemployment) was widespread, being around eight to nine per cent. This suggests that the sustained decline in consumption poverty in the rapid-growth Suharto era represented genuine social gains.

What about unemployment and its implications for poverty? In the pre-crisis period, it was below five per cent. The conventional wisdom is that the aggregate unemployment rate is an inappropriate indicator of the state of the Indonesian labour market, given its stage of development. In the absence of a comprehensive unemployment benefits scheme, joblessness for protracted spells is an option that only few can afford. Not surprisingly, the long-term unemployment rate (defined as those unemployed for a year or more) was around one per cent between 1990 and 1996. The available statistics – to be discussed more fully at a later stage – typically suggest that unemployment in Indonesia is largely a voluntary phenomenon, concentrated among educated youth. Certainly, as can be seen, the youth unemployment rate was far above the overall unemployment rate. Nearly, 70 per cent of the unemployed are represented by young members of the workforce.

The current debate on youth unemployment has tried to disentangle ‘choosy youth’ from ‘unwanted youth’.<sup>34</sup> While some commentators suggest that the youth unemployment rate largely reflects a case of young graduates queuing for reasonably

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<sup>34</sup> See Manning and Junankar (1998).

secure public sector jobs,<sup>35</sup> others have warned that not all the unemployed young members of the workforce should be classified as 'choosy youth' coming from reasonably affluent backgrounds. There is a cohort who are the victims of penurious socio-economic circumstances.

Table 3.1 also enables one to focus on the impact of the crisis on the Indonesian labour market. A scrutiny of the information embedded in table 3.1 would suggest that, in terms of some indicators, the impact of the crisis on the labour market was modest and, hence, seemingly at odds with the view that there was a sharp increase in poverty when the crisis was at its worst in 1998. Thus, the unemployment rate rose only moderately (from 4.9 per cent in 1996 to 5.7 per cent in 1998), although there was a more discernible increase in 2000 (over 6 per cent).<sup>36</sup> The incidence of involuntary underemployment actually went down between 1996 and 1998, while the incidence of part-time employment hardly changed. On the other hand, the size of the urban informal sector went up noticeably - from 43 per cent to 46 per cent between 1998 and 1996 and has not yet (that is, by 2000) reverted to the pre-crisis level. At the same time, there has been an alarming increase in the incidence of youth unemployment between 1996 and 1999, probably reflecting constrained job opportunities in the public sector induced by the growth slow-down in the post-crisis period.

A clearer perspective on the impact of the Indonesian crisis on the labour market can be gleaned from table 3.2. The latter exhibits the sectoral composition of the workforce over the 1990s. The employment share of the agricultural sector, after falling on a sustained basis from 55 per cent in 1990 to 43.5 per cent in 1996 (and 41 per cent in 1997), experienced an abrupt reversal: its employment share went up to 45 per cent (approaching the level achieved in 1995). Employment in the manufacturing sector contracted as well: the employment share of the sector declined from 12.6 per cent to 11 per cent between 1996 and 1998. Thus, the impact of the crisis was reflected not through a big jump in unemployment, underemployment or even part-time employment, but in an involuntary shift of the workforce into agricultural activities as well as into the informal economy of the urban sector.

**Table 3.2: Sectoral composition of the workforce (%), Indonesia, 1990-2000**

	1990	1993	1996	1998	1999	2000
Agriculture	55.1	50.0	43.5	45.0	43.2	45.1
(Food crop)	41.6	35.1	26.4	29.9	28.0	28.3
Industry	10.9	11.9	13.5	12.1	13.8	13.5
(Manufact.)	10.2	11.1	12.6	11.3	13.0	13.0
Services	34.0	38.1	43.0	43.0	43.0	41.4
(Trade)	14.8	16.0	18.9	19.2	19.7	20.6
(Non-trade)	19.2	22.2	24.1	23.8	23.3	20.8

Source: See Table 3.1

It remains to be seen to whether some of these sectoral reallocations of labour will be persistent. As the estimates for 1999 show, the changes in the employment share of agriculture have resumed their historical pattern, but estimates for 2000 show that it

<sup>35</sup> Dhanani (2001a).

<sup>36</sup> Preliminary estimates for 2001 suggest that the unemployment rate is 8.1 per cent (Dhanani, 2002, table 2.1, p.3).

has slipped back to 45.1 per cent.<sup>37</sup> On the other hand, manufacturing employment has grown to the point where its employment share has gone up to 13 per cent. It is also noteworthy that by 2000 (table 3.1), the share of formal sector employment has not yet reached its pre-crisis level, suggesting the muted, but lingering, impact of the 1997 crisis on the Indonesian labour market.

A discussion of the Indonesian labour market would be incomplete without some reflection on a key aspect of the employment structure: the extent to which rapid growth in the pre-crisis era was accompanied by a deepening of the skills of the labour force. Table 3.3 enables one to offer a commentary. While recognising that the process skill formation emanates from multiple sources, table 3.3 uses the educational attainment of the workforce as a credible approximation of the skills embodied in the workforce. It is clear that the rapid-growth, pre-crisis era was accompanied by substantial upgrading of the educational profile of Indonesian workers. The proportion of less educated/skill workers (defined as those who have primary education and less) fell from 87 per cent to 79 per cent between 1990 and 1996, with a corresponding increase in the share of the educated/skilled workforce (defined as those with at least secondary education) from 14 per cent to 21 per cent.

These structural changes in the Indonesian labour market juxtaposes rather well with the sustained decline in poverty witnessed during the pre-crisis period. As a subsequent discussion will demonstrate more explicitly, there is a strong correlation between educational attainment and poverty incidence at the household level. Thus, as more Indonesians gained access to the education system, it provided them with an escape-route from impoverishment.

**Table 3.3 Educational attainment of the workforce (%), Indonesia, 1990-2000**

	1990	1993	1996	1998	1999	2000
Less educated/skilled workforce	86.5	83.7	78.8	77.4	76.3	77.8
No schooling	15.0	12.2	9.7	8.6	8.0	7.9
Primary (incomplete)	25.3	23.3	18.9	18.2	17.0	16.1
Primary	36.1	36.8	37.2	36.4	36.0	38.2
Lower secondary	10.1	11.3	13.0	14.2	15.3	15.6
Educated/skilled workforce	13.5	16.3	21.2	22.6	23.7	22.4
Upper secondary	11.5	13.6	17.4	18.4	19.1	17.9
Tertiary	2.0	2.7	3.8	4.2	4.6	4.5

Source: See Table 3.1

<sup>37</sup> Preliminary estimates for 2001 suggest that the employment share of agriculture is 43.8 per cent while the employment share of manufacturing is 13.3 per cent (Dhanani, 2002: table 2.8, p.12).

### Changes in employment elasticity: overview and implications for poverty

An important question pertains to the extent to which the employment-intensity of rapid economic growth, especially in the manufacturing sector, played a role in influencing trends in poverty in the Suharto era. Provided a stable relationship exists between output growth and the job-creation rate – a variation of so-called *Okun's law* observed in industrialised countries – it should be possible to estimate employment elasticity.<sup>38</sup> The latter, as is well known, is a useful summary statistic for computing the employment intensity of economic growth. From the perspective of poverty analysis, what matters is not growth of output per se, but the extent to which it is employment-friendly. Higher employment elasticity translates to the fact that, for any given growth rate, the job creation rate is higher. However, care should be taken in interpreting the normative implication of this proposition. It is possible to have 'excessive' employment creation that is at the expense of growth of productivity. For example, an employment elasticity that exceeds unity means a proliferation of low-productivity jobs. Thus, employment-friendly growth should really mean the expansion of durable and productive work opportunities.

Bearing such analytical caveats in mind, consider table 3.4, which shows employment elasticity in manufacturing for several sub-periods: 1975-80, 1981-85 and 1986-92. Employment elasticity was quite low (0.3) in the 1970s, rose appreciably in the 1980s (0.8) and tapered off a little with the onset of the 1990s (0.7). These estimates are consistent with conventional interpretations of the evolution of the employment-poverty linkage in the Indonesian context. In the 1970s, Indonesia's oil wealth was used to fund public infrastructure and rural development, but the manufacturing sector remained small, inefficient and protected. This constrained its capacity to act as a locomotive for employment creation, although the oil wealth-driven public investment policy of the 1970s did reap some social dividends, given that it heralded the onset of a remarkable decline in mass poverty. As the oil price boom dissipated in the early 1980s, the Suharto government was forced to turn to outward-oriented industrialisation strategy that began in earnest from the mid-1980s. The much higher values of manufacturing employment elasticity in the 1980s support the notion that the manufacturing sector was beginning to play a more significant role in spearheading employment creation by drawing in less-skilled workers from the rural and informal economy to the more formal economy.

Some studies have documented the fact that manufacturing employment elasticity declined appreciably in the latter half of the 1990s, raising the possibility that the capacity of industrialisation to sustain large-scale job creation was becoming constrained. Table 3.5 conveys pertinent information. As can be seen, employment elasticity in the formal sector (represented by large and medium-scale enterprises) was an average of 0.5 for the 1985-1997 period, but fell from 0.8 in the 1985-88 period to 0.3 in the 1993-1997 period. Whether this represents the onset of a durable trend remains to be seen. Table 3.4 also provides useful information on employment elasticities on sub-sectors within manufacturing. For the 1985-1997 period as a whole, the sub-sectors with 'high' employment elasticities (above 0.5) are: garments,

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<sup>38</sup> See Padarino and Vivarelli (1997).

furniture, electrical goods and footwear. It is noteworthy that these are also sub-sectors with a good deal of export-orientation.

Current research on the employment-intensity of economic growth in Indonesia has also reflected on methodological complications entailed in the estimation of employment elasticity. One study has shown that the conventional way of estimating employment elasticity, which is simply an ex-post procedure, may engender unreliable estimates.<sup>39</sup> They seem to fluctuate widely depending on the time periods used. Econometric estimates of employment elasticity using pooled province-level data generate more stable estimates and suggest an employment elasticity of approximately 0.7 for the 1977-1996 period.

**Table 3.4: The evolution of employment elasticity in Indonesian manufacturing**

Period	Employment elasticity in manufacturing
1975-80	0.33
1981-85	0.76
1986-92	0.66

Source: Extracted from Islam, R (2001: table, p4)

**Table 3.5: Sectoral employment elasticities based on medium and large-scale enterprise survey (three-digit ISIC classification), Indonesia, 1985-1997**

Sectors	1985-1988	1988-1993	1993-1997	1985-1997
All medium and large-scale manf	0.8	0.6	0.3	0.5
Food Manf	1.1	0.2	0.2	0.3
Textile	0.7	0.5	0.1	0.4
Garment	0.8	0.5	-0.6	0.7
Furniture	0.8	0.9	0.4	0.8
Electrical goods	-0.2	0.6	0.4	0.6
Transport equip	0.4	0.2	0.4	0.3
Metal	0.4	0.5	0.4	0.5
Footwear	1.3	0.9	1.1	1.0

Source: Islam and Nazara (2000a), table 7, p.18.

### Linking poverty to the employment characteristics of households: a profile

The overview of changes in the Indonesian labour market, as captured in a range of employment indicators, suggest that formalisation and urbanisation of the workforce together with an upgrading of the educational attainment of workers are fully consistent with the sustained declines in poverty in the pre-crisis period. At the same time, there is little evidence that 'casualisation' of the workforce became pronounced, while other indicators, such as the gender composition of the workforce and the relative employment share of young workers remained roughly stable. There is also some evidence that growth under the Suharto regime became more employment-friendly.

The 1997/1998 crises reversed the poverty-reducing structural changes in the Indonesian labour market, with a forced movement of workers into the agricultural sector and into the informal segment of the urban economy. It remains to be seen whether these reversals will turn out to be persistent, with data for 1999 showing a

<sup>39</sup> See Islam and Nazara (2000a). The 'ex-post' procedure really entails dividing observed GDP growth with observed employment growth.

resumption of historical trends, but 2000 indicating otherwise. The unemployment rate has gone up moderately, largely reflecting a high incidence of youth unemployment. Involuntary underemployment was not widespread in the Suharto era. The crisis does not seem to have brought about a lasting worsening in the incidence of underemployment.

The overview of the structural changes in the Indonesian labour market thus sets the context for further analysis of the poverty-employment linkage at the household level. Pertinent information on this issue is displayed in tables 3.6 to 3.8. In table 3.6, one is able to discern the incidence of poverty by main sector of occupation and the relative importance of each sector of occupation in nation-wide poverty. Table 3.7 replicates the estimates, this time from the perspective of the educational level of households. Table 3.8 draws together a wide array of information on the demographic, skill and employment status of poor households and compares it with non-poor households.

The information in the above tables is supplemented by figures 3.1 to 3.4 that depict the employment/skill characteristics of households at different points on the expenditure distribution. More specifically, a 'quintile' approach is used in which the employment/educational attributes of households in different quintiles – poorest 20 per cent to richest 20 per cent – are compared. The figures are undergirded by the plausible assumption that the poorest quintile largely coincides with the population of households officially classified as poor.

The information embedded in the various tables does not hold surprises. The bulk of the Indonesian poor can be found in the agricultural sector. For example, in 1999, the poverty incidence in agriculture was approximately 40 per cent vis-à-vis a poverty rate of only five per cent for household heads who identified finance as their main sector of occupation. Furthermore, 58 per cent of nation-wide poverty can be accounted for by the agricultural sector. Thus, any strategy of poverty reduction in Indonesia will have to recognise the widespread existence of poor households in agricultural activities.

Table 3.7 examines the linkage between poverty incidence and the educational attainment of household heads. There is a strong correlation between the two variables, although one should hasten to add that correlation based on cross-section data do not necessarily imply causality. The bulk of poverty in Indonesia resides among household heads who have attained primary education or less. For example, in 1999, poverty rates varied between 39 per cent and 48 per cent for groups with primary education or less. Such groups in turn accounted for the bulk of nation-wide poverty in Indonesia. At the other extreme, poverty among household heads with tertiary education was two per cent in 1999, while for those with secondary education or more, the incidence varied between five and eight per cent. It thus seems that the upgrading of the Indonesian workforce during the 1990s was an important mechanism in bringing about the impressive decline in poverty prior to the crisis. This also means that ensuring broad access to the education and training system, particularly at the secondary level, is going to remain a major policy goal for the Indonesian government.

Table 3.8 compares the demographic, employment and skill characteristics of poor households with non-poor households. The former have a somewhat larger household



size (4.6 persons vs. 4.0 persons), but there is no evidence that poor households are either substantially younger or older than non-poor households. There is also no clear evidence of ‘feminisation’ of poverty in the sense that a moderate 16 per cent of households headed by females are classified as poor.

In terms of employment status, it appears that informal self-employment is a major characteristic of poverty. Thus, 56 per cent of household heads who were self-employed were classified as poor vis-à-vis 30 per cent of household heads who were classified as employees were regarded as poor. In terms of hours worked per week, there is some difference between poor and non-poor households. Thus, poor households in 1999 worked an average of 33 hours per week compared with non-poor households who worked an average of 36 hours per week.

Table 3.8 shows a discernible gap between poor and non-poor households in the area of education. Mean years of schooling for poor households were 6.0 years in 1999 vis-à-vis 7.4 years for non-poor households.

**Table 3.6: Poverty incidence by main sector of occupation (%), Indonesia, 1996-1999**

	Feb 1996		Feb 1999	
	Poverty incidence (%)	Contribution to total poor (%)	Poverty incidence (%)	Contribution to total poor (%)
Agriculture	26.3	68.6	39.7	58.4
Trade	8.0	8.1	17.6	11.1
Manufacturing	10.7	5.7	22.9	7.7
Civil, social and private services	5.7	5.7	13.1	7.4
Transport and Communication	8.9	3.3	24.0	5.6
Construction	14.0	5.4	29.0	5.5
Receiving transfer	6.6	1.9	15.6	2.65
Mining & quarrying	15.3	1.01	29.8	1.00
Others	13.3	0.10	32.0	0.27
Finance	1.24	0.06	5.23	0.23

Source: Pradhan et al, 2000. Unpublished estimates. Original source is the national socio-economic survey or SUSENAS.

**Table 3.7: Poverty incidence by educational level of household head (%), Indonesia, 1996-1999**

	Feb 1996		Feb 1999	
	Poverty incidence (%)	Contribution to total poor (%)	Poverty incidence (%)	Contribution to total poor (%)
Illiterate and incomplete primary education	31.2	27.7	47.5	19.9
Incomplete primary education but literate	21.6	35.1	36.7	31.8
Completed primary education	15.0	30.2	29.7	35.4
Completed junior secondary education	7.0	4.8	16.9	7.6
Completed senior secondary education	2.4	2.2	8.6	5.1
Completed tertiary education	0.4	0.11	1.98	0.34

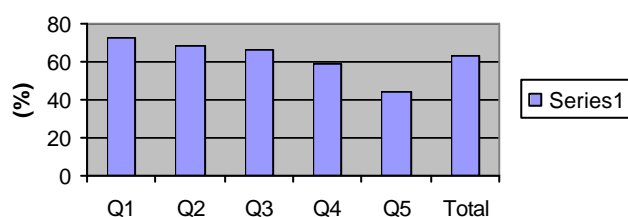
Source: Same as in table 3.6.

**Table 3.8: Demographic, skill and employment status of poor and non-poor households, Indonesia, 1999**

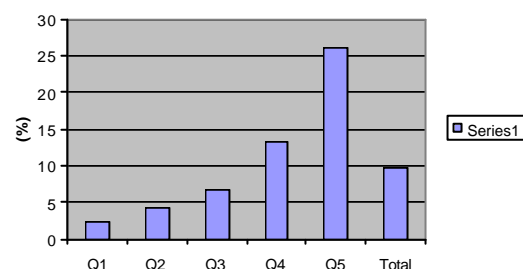
	Poor households (HH)	Non-poor households (HH)
Average family size	4.6	4.0
% Female headed HH	16.3	14.0
Mean age (years) of HH head	44.8	45.6
Mean yrs of schooling	6.0	7.4
% HH head as own-account worker and unpaid family worker (%)	56.8	54.2
% HH head as employee	30.6	34.6
Average hrs worked/week	33.4	35.9

Source: Sutanto and Irawan, 2000. Unpublished estimates. The original data is from SUSENAS.

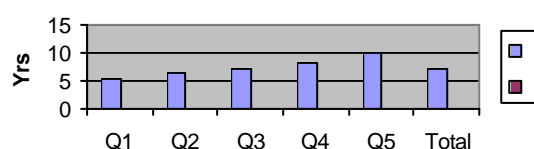
**Figure 3.1: % workforce in informal sector by quintile, Indonesia, 1999**



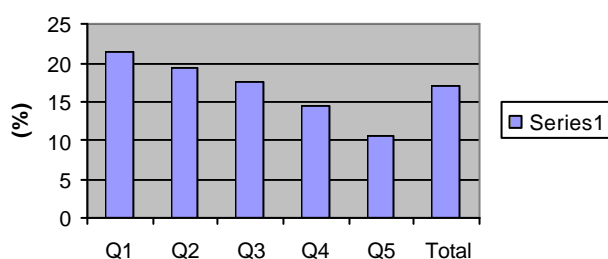
**Figure 3.2: White collar workers by quintile (%), Indonesia, 1999**



**Figure 3.3: Educational attainment (mean yrs of schooling) by quintile, Indonesia, 1999**



**Figure 3.4: Hours worked per week (<20) by quintile, Indonesia, 1999**



Figures 3.1 to 3.4 revisit the linkage between poverty and employment/educational attributes of workers from the standpoint of quintiles of households. They are generated from estimates derived from the 1999 national socio-economic survey (SUSENAS). These estimates were compiled by a Jakarta-based research agency using special tabulations.<sup>40</sup> The figures add to the information embodied in the previous tables in the sense that they enable one to see the relationship between poverty and employment characteristics from the perspective of households at different points on the expenditure distribution. As can be seen, there is a preponderance of the poorest 20 per cent of households in the informal sector (figure 3.1), while the proportion of white-collar workers is rather low for the bottom quintile (figure 3.2). Furthermore, in terms of mean years of schooling, the gap between the bottom quintile and top quintile is quite substantial: the poorest 20 per cent have a little over five years of schooling vis-à-vis ten years for the richest quintile (Figure 3.3). It is noteworthy that the average educational attainment of the poorest 20 per cent is well below the long-held goal of the Indonesian government that all Indonesians should have at least nine years of schooling. Thus, upgrading the educational attainment of poor Indonesians at least to the national standard remains a major policy challenge.

Figure 3.4 shows the distribution of households by quintile in terms of low hours of work per week (less than 20 hours). A discernible pattern emerges: the incidence of low hours of work diminishes as one moves up the richer quintile, this tendency becoming more marked for the top two quintiles. Thus, inadequate hours of work are one attribute of Indonesian poverty.

### Unemployment and poverty

What the above figures and the previously discussed tables do not show is the extent to which unemployment can be related to poverty. Recall from the previous discussion that the conventional wisdom is that unemployment has limited relevance to the understanding of poverty in Indonesia. How much is this contention borne out by the available data?

It is clear from table 3.8 that unemployment in Indonesia is largely concentrated among educated workers. In 1999, secondary school leavers had an unemployment rate of 16 per cent, the highest in the country. This is followed by tertiary graduates who exhibited an unemployment rate of 13 per cent. At the same time, the poverty rate for this group is well below the national average and ranges from 13 per cent (secondary school graduates) to two per cent (tertiary graduates). This experience contrasts sharply with the case of less educated workers encompassing those with primary education or less. The unemployment rate for this cohort varies from five per cent (primary school graduates) to less than one per cent (no schooling). The poverty rates for this group are highest in the country (37 per cent to 48 per cent). Thus, the contention that unemployment has limited relevance in understanding poverty in Indonesia seems to be borne out by the available evidence. In general, the poor cannot afford to stay unemployed for too long and have to seek work of any kind to eke out an existence. It would be useful, as part of future research strategy, to probe more

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<sup>40</sup> See Insan Hitawana Sejahtera (2000). In figures 3.1 to 3.4, Q1 = poorest 20%...Q2=richest 20%.

fully the relationship between poverty and unemployment. For example, it should be possible to undertake a ‘quintile analysis’ by identifying unemployment rates for different quintiles and highlighting the extent to which unemployment is a luxury for richer quintiles, but is unaffordable for poorer quintiles. A more careful scrutiny of unpublished SUSENAS and SAKERNAS data along such directions is worth exploring.

**Table 3.8: Unemployment rate and poverty incidence by educational attainment (%), Indonesia, 1999**

	Unemployment rate (%)	Poverty incidence (%)
No schooling	0.4	47.5
Less than primary	1.5	36.7
Primary	4.8	29.7
Secondary	15.9	13.0
Tertiary	12.7	2.0

Source: based on previous tables in this section

### Employment, labour market flexibility and poverty: revisiting the debate

An important debate that has emerged in the Indonesian context pertains to the role that labour market flexibility has played in the pre-crisis period in facilitating sustained improvements in the living standards of workers and in mitigating the social consequences of the Indonesian crisis. It is important to understand this debate in order to develop a fuller appreciation of the poverty-employment nexus.

Labour market flexibility may be regarded as a synonym for the textbook case of a competitive or neoclassical labour market. The virtue of the latter is that workers are free to adjust the workforce in response to shifting relative wage and employment opportunities, while firms are free to adjust the workforce in response to shifting profit opportunities. In such a framework, collective bargaining driven by trade unions, strongly enforced hiring and firing decisions, unemployment benefits, minimum wages etc are regarded as undesirable institutional arrangements as they constrain the free choice of workers and firms. More importantly, arrangements meant to protect the interests of workers paradoxically hurt employment opportunities by raising the price of labour above what the market will bear.

Despite its appealing simplicity, the analytical construct of labour market flexibility in pre-crisis Indonesia was adapted to the requirements of paternalistic authoritarianism. Thus, the emphasis was on the provision of centrally mandated benefits for workers (especially minimum wages, and later, a formal social security system). This was juxtaposed with a political framework that tightly circumscribed labour rights, while informal systems of social protection through the network of friends and families were seen as playing an adequate and complementary role for workers in the informal economy. The rapid growth of the pre-crisis period and its ability to absorb new entrants to the workforce appeared to justify such a strategy.<sup>41</sup>

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<sup>41</sup> Manning (1998), Wiebe (1996), Mason and Baptist (1996) are prominent examples of studies on Indonesia that work within the analytical tradition of labour market flexibility.

The notion of labour market flexibility re-emerges in post-crisis Indonesia. Some observers argue that such flexibility enabled workers to cope with the crisis with a degree of resilience that ensured that the social impact of the crisis was contained. Had labour markets been rigid, as in the case of a so-called Keynesian labour market, one would have witnessed large-scale unemployment and poverty.<sup>42</sup>

Both the pre-crisis characterisation of the Indonesian labour market and its post-crisis resurrection overlook a number of problems. To start with, some observers, while sympathetic to the notion of labour market flexibility, drew attention to the stresses and strains afflicting the pre-crisis period. Thus one study highlighted the limits of a paternalistic system that offered substantial centrally mandated minimum wage increases in the 1990s to appease workers.<sup>43</sup> The consequence was a threat to employment opportunities and falling international competitiveness – although subsequent evaluations have not reached a clear-cut position on this issue.<sup>44</sup>

Another study highlighted the problems caused by the lack of a credible industrial relations system. The mid-1990s were infamous for a sharp increase in labour unrest.<sup>45</sup> Both these studies argued for the revamping of the industrial relations system and recommended democratic forms of enterprise-level bargaining.

As far the use of the notion of labour market flexibility in explaining the evolution of poverty both during and after the crisis is concerned, one can express reservations about its validity.<sup>46</sup> In a so-called Keynesian labour market, the primary vehicle for a rise in poverty following a demand shock (such as the one induced by the Indonesian crisis) is a rise in unemployment (given that wages are rigid). In a neoclassical labour market operating in a dualistic, developing economy – presumably the Indonesian case – the primary vehicle for a rise in poverty as a consequence of a demand shock is a decline in real wages reflecting a reallocation of labour to low productivity activities. Indeed, employment adjustments during the Indonesian crisis followed this classic pattern (as was discussed previously) and was accompanied by a steep fall in real wages (as will be discussed at a later juncture). Whether the unemployment-driven increase in poverty (the Keynesian case) will be higher than the real wage-driven increase in poverty (the neoclassical case) is ultimately an empirical issue that cannot be determined a priori.

A better way of coming to grips with the understanding of the evolution of poverty during the crisis is to eschew pre-conceived notions of the virtues of labour market flexibility and carefully re-visit the current state of knowledge on what could have happened to the poor. It now appears that the sharp increase in consumption poverty and the plummeting of real wages during the crisis period was a tragic manifestation

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<sup>42</sup> As Manning (2000: 108) observes: “I conclude that labour markets remained highly flexible despite the rapid economic transformation. *I suggest that this flexibility is a key explanation for why unemployment and poverty did not rise more than they did during the crisis*’ (emphasis added). See also Tubagus (2000).

<sup>43</sup> See Aggrawal (1995)

<sup>44</sup> See Islam and Nazara (2000b) for an evaluation of the evidence on the impact of minimum wages on employment in Indonesia. They argue that minimum wage increases in the 1990s were benign in terms of their impact on employment, but SMERU (2001) reaches an alternative conclusion.

<sup>45</sup> See Edwards (1996)

<sup>46</sup> See Dhanani and Islam (2001)

of a collapse in the purchasing power of Indonesians as a result of the ‘inflation shock’ of 1998.

If one combines the 1998 episode with the fact that a significant proportion of Indonesians are clustered around the poverty line, then relatively small shifts in the latter may lead to large changes in the incidence of consumption poverty. However, the sharp rise in poverty (and the steep fall in real wages) during 1998 turned out to be transient as inflation abated (and became deflation for a while), reflecting the restoration of macroeconomic stability. In addition, the government launched a comprehensive, donor-supported, social safety program. Some elements of the program worked well, others did not. On balance, it appears that the social safety net interventions managed to reinforce the resilience of ordinary Indonesians in the face of unprecedented adversity. The evidence suggests that social safety net interventions probably prevented an additional 7-11 per cent of the population from sliding below the poverty line.<sup>47</sup>

It is clear from the preceding discussion that the notion of labour market flexibility, while useful, can only represent the beginning rather than the end of any analysis of the linkage between poverty and the structure of the labour market. The paradigm of labour market flexibility is essentially silent on, or pays insufficient attention to, a range of complex issues. How does one give primacy to employment concerns in macroeconomic management? Should such primacy be given? Are there basic workers’ rights? If so, how does one embed them within the industrial relations system? Is there any role for public deliberation in the formulation of labour market policy? What role is there for the state in dealing with labour market risks, such as sub-optimal employment adjustments and falling real wages, triggered by economic shocks? These issues – or at least some of them – are revisited in the discussion on policy options.

#### The Indonesian reform agenda, regional decentralisation and their implications for employment and poverty

In the aftermath of the 1997 financial crisis, Indonesia’s introduced a series of reform measures. These entail:

- privatisation of some state-owned enterprises
- Deepening of trade liberalisation and economic deregulation, a process initiated in the mid-1980s
- regional autonomy.

These measures were in addition to other IMF-recommended measures to restore macroeconomic stability and rehabilitate the banking and financial sector. What has been the employment impact – both actual and prospective – of these initiatives? Before proceeding to a discussion of the Indonesian case, it would be useful to provide a comparative perspective.

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<sup>47</sup> See Dhanani and Islam (2002) for a thorough review.

One study, entailing a large-scale survey of international experience, suggests the following.<sup>48</sup> First, the job destruction effects from trade liberalisation varied from country to country, being substantial in some and minimal in others. Second, the downsizing of the public sector following a privatisation program has turned out to be most dramatic in the transition economies of East Europe where, in some cases, up to 50 per cent of public sector workers were considered to be redundant. In general, public sector downsizing has meant a loss of earnings and benefits for retrenched workers, this loss being quite significant for those with seniority in the public sector. Women have also experienced bigger losses than men, partly because women are more likely than men to withdraw from the labour force after downsizing. Third, trade liberalisation seems to impose a decline in real wages in the short-run (up to three years), with econometric estimates suggesting a 3.5 per cent decline in real wages for every 10 per cent increase in the foreign trade-to-GDP ratio.

Thus, it would appear that trade liberalisation and privatisation can impose short-run hardships on ordinary workers – and contribute to a worsening of poverty. Fortunately, there are some positive consequences that offset the costs imposed on ordinary workers. As noted, the wage decline is temporary. In addition, an inflow of foreign direct investment can actually raise wages, with every one per cent increase in the foreign direct investment-to-GDP ratio raising wages by 2.5 per cent. It should be noted that the job destruction effects of privatisation often affect privileged workers in the protected sectors and not usually workers hovering near or below the poverty line.

Returning now to the Indonesian case, what conclusions can one draw about the employment implications of its reform agenda? One study has offered a preliminary assessment.<sup>49</sup> Here are the key conclusions.

The privatisation of state-owned enterprise are driven by the twin objectives of raising funds for budgetary support from asset sales and, in the longer term, to turn loss-making enterprises into efficient, privately owned and managed entities. However, none of the sixteen SOEs intended for privatisation in 2001, and employing some 50,000 employees in all, was privatised by the target date.<sup>50</sup>

Can one speculate on the likely employment impact of this program, assuming full implementation at some stage? Based on the premise of over-staffing levels of 15-20 per cent, the employment impact of this program would, at most, have entailed some 7,500 persons in a workforce of 90 million. In any case, most of this would have been achieved through natural attrition and early voluntary retirement.

Trade liberalisation has not led to a decline in manufacturing employment so far. Employment in medium and large-scale manufacturing establishments may have grown a little in 2000 and 2001. Import liberalisation probably had an impact on certain import-competing industries and led to specialisation in other industries. For example, the number of domestic market-oriented radio and audio equipment manufacturers has declined, but the number of producers of loudspeakers has increased. Overall, consumer good imports in dollar terms regained their pre-crisis level by 2000, despite an economy

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<sup>48</sup> Rama (2001)

<sup>49</sup> See Dhanani and Widarti (2001).

<sup>50</sup> Recent media reports suggest a good deal of resistance to the privatisation program by workers of the state-owned enterprises. See, for example, *The Jakarta Post*, 21 March, 2002.

that was only two thirds of its 1996 original size, again in dollar terms. Imports of textiles, clothing, television, radio and audio equipment, and motorcycle parts were either equal to or higher than before the crisis. If these trends continue, the corresponding domestic industries will either suffer or will not fully benefit from the economic recovery underway. At the same time, trade liberalisation offers the opportunity to Indonesian manufacturers to identify and develop market niches in the world market, and thereby create employment in new industries.

Why has manufacturing employment held up in the presence of a trade liberalisation program, even in the short-run? The decline in manufacturing activity was induced by the terrible recession of 1998, but this was soon offset by export production that exceeded pre-crisis levels by 1999, before achieving record levels in 2000 in response to strong demand for electronics and other goods in the US market. Certainly, a substantially undervalued rupiah facilitated this process. Very few large manufacturing establishments faced permanent closure, and some that had halted operation in 1997-98 resumed activity in 1999. As a result, employment in garment and electronic establishments was higher in 1999 than before the crisis.

Unfortunately, these positive developments in the manufacturing sector are now under threat. In 2001, the US economy slowed down considerably and the information and communication technology boom came to end. In addition, the horrific terrorist attacks on September 11 (2001) have reinforced the slowdown of the US economy. These developments have led to a drastic decline in the demand for Indonesian export and to significant lay offs.

The financial restructuring measures, including the closure and mergers of private and public banks, did not, it seems, reduce employment in the banking and financial sector. At the same time, the government's anti-inflation strategy, fashioned within the framework of the IMF's financial assistance package, managed to rein in inflation, which declined from 78 to 2 per cent between 1998 and 1999, before rising again to 9 per cent in 2000. This minimised the further erosion of real wages of low-income employees and self-employed workers and farmers. Since the poor are always disproportionately affected by inflation, the return to a low inflation regime protected them – a point that was highlighted at a previous juncture.

What about the employment impact of decentralisation and regional autonomy? Such developments did not result in civil service redundancies. The government engaged in an administrative reshuffling rather than large-scale downsizing. The transfer of central government employees in January 2001 to local government administrations really involved those who were already located in provincial and district offices. On the other hand, the recruitment freeze, in place since 1995, was continued. As a result, the number of civil servants fell from 4.0 million to 3.9 million, or by 80,000, between 1999 and 2000 due to natural attrition. It is likely that the recruitment freeze has also affected the youth unemployment rate to the extent that it has worsened the 'queuing' process for public sector jobs that is characteristic of youth unemployment in Indonesia.

A significant threat to employment generation in an age of decentralisation stems from revenue-generating levies and taxes on businesses and movement of goods imposed by a number of regional administrations, and their negative impact on



farmers and other producers in distant markets. While the corresponding employment and income losses are difficult to estimate, the uncertainty raised by such ad hoc levies and taxes has already resulted in a freeze in all mining investments in the country, and perhaps of investment in other areas as well. Furthermore, regional administrations have so far proven notoriously unable to handle labour relations reinforcing the image that Indonesia has become a country prone to unrest and industrial strife. It is likely that such an image is dissuading the inflow of foreign direct investment preventing the latter from acting as a vehicle for enhanced employment opportunities and higher wages.

#### **4. Poverty and the labour market: the role of wages<sup>51</sup>**

So far, the discussion of the poverty-labour market nexus focussed primarily on issues in employment. There is, of course, another critical dimension that affects the welfare of workers, namely, the rewards to their labour services in the form of real wages. Accordingly, this section will:

- Review the long-run behaviour of real wages in Indonesia
- Highlight episodes of falling/stagnating real wages, with specific reference to the 1997 financial crisis
- Suggest a framework that can explain the behaviour of real wages in Indonesia and highlight the role that changes in productivity have played in underpinning wage growth
- Explore the relationship between real wages, productivity and poverty at both the sectoral and aggregate level.

##### Trends in nominal and real wages: overview

Nominal earnings of wage employees increased by 15 per cent per annum on average in the 1976-1997 period before the crisis, according to the national labour force surveys (table 4.1). Earnings did not grow evenly during this period however, slowing down to respectively 10 per cent and seven per cent per annum during 1976-78 and 1987-89. During this 21-year period, consumer prices rose by an average of 10 per cent per annum, resulting in real growth in earnings of 5 per cent per annum. During the two lower nominal growth periods, real earnings stagnated in 1976-78, while declining by 2 per cent p.a. during 1986-89.

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<sup>51</sup> This section draws on Dhanani and Islam (2001b). See Papanek (1999) for a seminal study on wages and poverty in pre- and post-crisis Indonesia.

**Table 4.1. Trends in Nominal & Real Earnings, Indonesia, 1976-2000**

	Index (1997 = 100)							Average annual growth rate <sup>1</sup> (Per cent)							Pre-crisis	
	76	78	82	86	89	97	00	76-78	78-82	82-86	86-89	89-97	97-00			
															82-97	76-97
<i>Nominal Earnings</i>																
<u>Indonesia</u>	<u>5</u>	<u>6</u>	<u>16</u>	<u>26</u>	<u>32</u>	<u>100</u>	<u>179</u>	<u>10</u>	<u>27</u>	<u>13</u>	<u>7</u>	<u>15</u>	<u>21</u>	<u>13</u>	<u>15</u>	
Male	-		17	27	33	100	180	-	-	13	7	15	22	13		
Female	-		12	22	28	100	178	-	-	16	8	17	21	15		
Urban	-		20	31	34	100	170	-	-	12	-	15	19	12		
Rural	-		18	32	33	100	183	-	-	16	-	15	22	13		
<i>Urban CPI</i>	<i>14</i>	<i>17</i>	<i>30</i>	<i>41</i>	<i>53</i>	<i>100</i>	<i>203</i> <sup>2</sup>	<i>10</i>	<i>16</i>	<i>8</i>	<i>9</i>	<i>8</i>	<i>27</i> <sup>2</sup>	<i>8</i>	<i>10</i>	
<i>Real Earnings (1997=100)</i>																
<u>Indonesia</u>	<u>37</u>	<u>37</u>	<u>53</u>	<u>64</u>	<u>61</u>	<u>100</u>	<u>88</u>	<u>0</u>	<u>9</u>	<u>5</u>	<u>-2</u>	<u>7</u>	<u>-4</u>	<u>4</u>	<u>5</u>	
Male	-		55	67	63	100	89	-	-	5	-2	6	-4	4		
Female	-		40	54	53	100	88	-	-	8	-1	8	-4	6		
Urban	-		65	74	63	100	84	-	-	3	-	6	-6	3		
Rural	-		58	77	63	100	90	-	-	7	-	6	-4	4		

Source:

Earnings: *Labourer/Employee Situation in Indonesia* (National labour force survey *Sakernas*), annual publication for 1990-2000, CBS. *Indikator Tingkat Hidup Perkerja* [Living standards Indicator], and *Indikator Sosial Wanita* [Women's social indicators], various years, for 1976-1989, CBS. Special tabulations from raw data produced by CBS for 1982 and 1986-89.

Consumer prices: weighed average consumer price index of 43 cities (27 cities before 1994), annual average indices, *Monthly Bulletin*, CBS.

Note:

<sup>a</sup> Growth rates for 1976-78, 1982-86 and 1998-00 are point-to-point compound growth rates. Growth rates for 1986-89 and 1989-97 are average annual growth rates.

The East Asian financial crisis, which began in Indonesia in mid-1997, had a major impact on real earnings. In the first year, consumer prices rose by 100 per cent, while nominal earnings grew by 20 per cent, causing real earnings to decline by over 40 per cent. In the following two years, nominal earnings continue to grow by 20 per cent p.a., while inflation was brought under control, rising by just 5-10 per cent per annum. Real earnings began to climb slowly again to around 90 per cent of their pre-crisis level by 2000.

Published earnings data from the labour force surveys by gender and urban-rural location are available only since 1982. The real earnings of females grew faster than for males in the 1982-97 period before the crisis (six vs. four per cent p.a.). This acceleration took place during 1982-86 and 1989-97. Rural real earnings also grew faster than urban earnings during this period (four vs. three per cent p.a.), particularly during the earlier 1982-86 period. These differential growth rates led to the narrowing of gender and urban-rural earnings, suggesting tighter labour market conditions during these two periods of relatively rapid wage growth.

### Real wage trends by sector

Real earnings of employees grew more rapidly in agriculture and manufacturing than in other sectors before the crisis. They grew by five per cent p.a. in these two sectors compared with four per cent p.a. in utilities, construction and transport and services, three per cent p.a. in trade and just two per cent in mining and finance between 1976 and 1997 (table 4.2). Since earnings in the agricultural and manufacturing sectors were lower than average, while those in mining and finance were higher than average, these differential growth rates lead to the narrowing of earnings differentials observed in the previous section.

**Table 4.2. Real Earnings by Sector, 1976-2000 (Annual average growth rate)  
(Deflated by urban consumer price index)**

	76-78	78-82	82-86	86-89	89-97	97-00	Pre-crisis 76-97
Agriculture	-1	8	4	0	7	-4	5
Mining, quarrying	-19	6	-	-	4	-3	2
Manufacturing	8	7	4	-3	8	-7	5
Utilities	-14	8	-	-	8	-11	4
Construction	0	6	-	-	6	-7	4
Trade, hotel, restaurant	-5	7	2	-1	6	-7	3
Transport	4	4	-	-	5	-5	4
Finance and banking	2	0	-	-	6	-6	2
Services	5	6	0	0	6	-4	4
Other <sup>1</sup>	-	-	-	-3	-	-	-
<u>All sectors</u>	<u>0</u>	<u>2</u>	<u>5</u>	<u>-2</u>	<u>7</u>	<u>-6</u>	<u>5</u>

Source: same as table 4.1.

Note:

<sup>1</sup> Other included mining, construction, transport and finance sectors in one category in the 1986-88 questionnaires. Growth rate is point-to-point compound growth rate.

‘-’: Not available.

In general, real earnings moved in the same direction across sectors, though at different rates, during the sub-periods of rapid growth of 1978-82, 1982-86 and 1989-97. Similarly, the overall decline observed during 1986-89 was shared by most sectors. The exception was the earlier 1976-78 period, which registered real earnings increases in some sectors such as manufacturing, transport, and services, and declines in others such as agriculture and trade.

### Real wage trends by education

The labour force survey data is the only source of information on wages by education level. This data show that the real earnings of employees with primary school education and below rose relatively more rapidly than those with junior and senior secondary education (three per cent vs. one per cent and two per cent respectively), leading to the narrowing of wage differentials by educational level before the crisis noted in the previous section (table 4.8). Their real wages also fell less rapidly during the crisis period 1998-2000. At higher education levels however, the real earnings of diploma and university graduates rose in line with the average during periods of rapid growth, while continuing to grow in the periods of constant overall earnings.

**Table 4.8. Real Earnings by Education Level, 1976-2000 (per cent change p.a.)**

	1976-78	1978-82	1982-86	1986-89	1989-97	1997-00	Pre-crisis 1976-97
No schooling	-	-	-	-	5	-2	-
Did not complete primary <sup>1</sup>	-2	10	3	1	6	-7	5
Primary school	5	4	1	-3	6	-9	3
Junior secondary school	4	2	-1	-5	4	-8	2
Senior secondary, general	8	-1	-2	-4	5	-8	2
Senior secondary, vocational	7	2	1	-2	5	-6	3
Diploma I and II	-		-	1	4	-5	-
Diploma III	-		-	-	5	-7	-
University	7 <sup>3</sup>	-5 <sup>3</sup>	-1 <sup>3</sup>	3	4	-7	2
<u>All levels</u>	<u>0</u>	<u>2</u>	<u>2</u>	<u>-2</u>	<u>7</u>	<u>-6</u>	<u>2</u>

Source: same as table 4.1.

Note: <sup>1</sup> No schooling and did not complete primary school together until 1989. <sup>2</sup> Senior secondary general and vocational together. <sup>3</sup> Diploma and university graduates together. ‘-’: not available.

### Long-run trends in real wages: summary

The long-term trends in real wages over the 1976-2000 period can be summarised as follows. Following a period of relative wage stagnation during most of the 1970s, which was otherwise a period of rapid economic growth, real wages grew by five per cent per annum on average during the 20-year period between 1978 and 1997, and where equally shared by the agricultural and non-agricultural sectors. Real wage improvements took place in all years except the mid-1980s, paradoxically also otherwise known as a period of rapid economic growth. The financial crisis of 1997-98 had a major impact on real earnings. Real wages declined by 40 per cent in the first year, remained at 10 per cent below their pre-crisis level three years later in 2000.

Before the crisis, females and rural areas improved their wages relative to males and urban areas. Workers in the agricultural and manufacturing sectors, where wages were lower than in other sectors, improved their position relative to workers in other sectors. Workers with less than primary education improved their position relative to those with junior and secondary school education. This led to the narrowing of wage differentials. Wage differentials were unaffected by the crisis.

### Understanding the long-run behaviour of real wages in Indonesia: towards a demand-supply framework

Although changes in definitions, questionnaires and coverage over such a long time frame introduce many comparability problems in employment data from different time periods, a careful assessment of the labour force survey data does suggest that the demand for labour grew somewhat more rapidly than its supply to produce the observed real wage increases during most of this period. The key factors responsible for the moderate tightening of the labour market may be summarised as follows.

On the supply side, two important measures were undertaken. First, the nationwide family planning programme launched in the early 1970s succeeded in slowing down the growth of the working age population, from around 4.0 per cent to 2.6 per cent per

year between the late 1970s and the late 1990s. Second, the large-scale school building programme and education campaign led to increased enrolment at double the rate of the working age population. Enrolments were particularly rapid in the late 1970s and first half of the 1980s, averaging respectively 14 per cent and 8 per cent per annum, and at a higher rate for female youth. At its peak, the population attending school increased by 0.7 million children and teenagers per annum during 1978-82, and by 0.5-0.6 million per annum in the 1980s. This resulted in the slower growth rate of the labour force relative to the working age population over this whole period (2.4 vs. 2.8 per cent per annum).

On the demand side, strong and sustained economic growth in labour-intensive sectors, particularly manufacturing and construction, led to a corresponding demand for labour. Non-oil GDP growth averaged 8 per cent per year in this 21-year period, led by the manufacturing and construction sectors, which grew at respectively 13 per cent and 10 per cent per annum. Most other sectors grew by 7-10 per cent per annum, with the exception of the agricultural sector, which averaged just over 3 per cent per year.

The windfall revenues from the first and second oil booms of the mid-1970s and late 1970s were ploughed back into an ambitious public infrastructure programme which included the rehabilitation and construction of new irrigation canals, and the construction of school buildings, roads and health centres, thereby creating substantial demand for construction labour. Agricultural production grew as a direct result of improved rural infrastructure and investment in disseminating the green revolution package of IRRI rice varieties and fertilizer, providing ample demand for rural labour. In addition, strong, sustained and broad-based economic growth, particularly of relatively labour-intensive sectors such as manufacturing, construction and transport, created additional demand for unskilled labour in both urban and rural areas.

Real wages first increased in the late 1970s, when agricultural production grew faster than in earlier periods. This coincided with rapid expansion of the construction sector when some wage employees were drawn away from agriculture, even though the end of the oil boom in 1981-82 led to a sharp drop in construction labour thereafter. After momentarily stagnating due to the further contraction of construction labour in the second half of the 1980s, the demand for wage labour once again picked up in the construction sector which, coupled with continued strong demand for unskilled wage labour in the manufacturing and other sectors, allowed the agricultural sector to gradually reduce its work force during most of the 1990s, leading to sustained real wage increases.

Agricultural and non-agricultural wages moved together, because wage movements in different sectors reinforced each other due to a high degree of labour mobility and integration between sectors. The moderate tightening of the labour market led to narrower wage differentials by gender and education attainment, and between urban and rural areas.

Some observers have highlighted the point that institutional factors have also played a major role in influencing the behaviour of wages in the 1990s.<sup>52</sup> Beginning in 1992, the Suharto regime began an aggressive pursuit of minimum wage policy. Such a

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<sup>52</sup> See SMERU (2001a).

policy stalled for a while during the crisis, but seems to have picked up with renewed vigour since then. Minimum wage increases, it is argued, pushed up average wages as well. Statistically, it has been difficult to substantiate this proposition. While no one doubts that minimum wages have gone up substantially in real terms, the circumstances of pre-crisis Indonesia also need to be taken into account. A general tightening of the labour market led to a real wage boom that in turn provided a conducive environment for minimum wages to be pushed up.

#### The wage-productivity relationship: overview

Table 4.9 offers an overview of the trends in real wages for various sub-periods covering the 1976-2000 and compares them with changes in productivity. For the economy as a whole, real wage growth has kept pace with productivity growth for the 1976-1997 period. Furthermore, periods when productivity growth has been buoyant has also been accompanied by real wage growth, but this has not always been the case. For example, rapid productivity growth in the 1986-89 period stands in stark contrast to the decline in real wages. Considering the fact that this period also coincides with the trade liberalisation-cum-deregulation reform agenda, one could raise doubts about the short-consequences of such an agenda for the welfare of workers. However, by the beginning of the 1990s, and until the eve of the 1997 financial crisis, real wages grew a little above productivity growth. Note that there were other sub-periods (1978-86) in which real wage growth exceeded productivity growth – sometimes by quite substantial margins.

At the sectoral level, one can discern significant variations. Real wages grew at roughly twice the rate of productivity growth in agriculture in the 1976-1997 period, but the converse was the case in manufacturing. In the trade and services sector, real wage growth also exceeded productivity growth during the pre-crisis period.

**Table 4.9: The wage-productivity relationship in Indonesia, 1976-2000 (% change)**

<u>Sector</u>	<u>76-78</u>	<u>78-82</u>	<u>82-86</u>	<u>86-89</u>	<u>89-97</u>	<u>97-00</u>	<u>76-97</u>
All							
GDP/worker	3.8	5	1.9	4.7	5.8	-4.3	4.9
Real wage	0.7	9.1	4.8	-1.7	6.6	-6.1	5
Agr							
GDP/worker	-0.9	4.9	-1.2	0.3	4.4	-2.8	2.4
Real wage	-1	7.9	4	0	6.6	-3.9	4.7
Manf							
GDP/worker	17.3	1.6	13.3	2.7	7.5	-6	7.7
Real wage	8.5	6.8	4.4	-3.1	7.7	-11.1	3.5
Trade							
GDP/worker	0.3	6.2	0.3	5.1	1.3	-6.7	2.5
Real wage	-4.8	7.1	2.3	-0.9	5.6	-7.3	3.3
Services							
GDP/worker	-3.1	5.7	-3	12	-0.5	-1.1	1.7
Real wage	4.5	5.6	0	-0.4	5.9	-3.6	3.7

Source: National Accounts and Labour Force Survey *Sakernas*, CBS

Note: worker by sector: total employment minus family workers.

All sectors employment: 15+. Other sectors, 10+ until 97, 15+ after.

## Wages, productivity and poverty: identifying the linkages

**Table 4.10: Real wages, productivity and poverty: 1976-2000 (% change)**

Sector	76-78	78-82	82-86	86-89	89-97	97-00	76-97
All							
GDP/worker	3.8	5	1.9	4.7	5.8	-4.3	4.9
Real wage	0.7	9.1	4.8	-1.7	6.6	-6.1	5
Poverty	-7	-6	-10	-2	-4	6	-29

Source: As in previous tables in this section

Table 4.10 show the trends in real wages, productivity and poverty. The information is also depicted in figure 4.1.

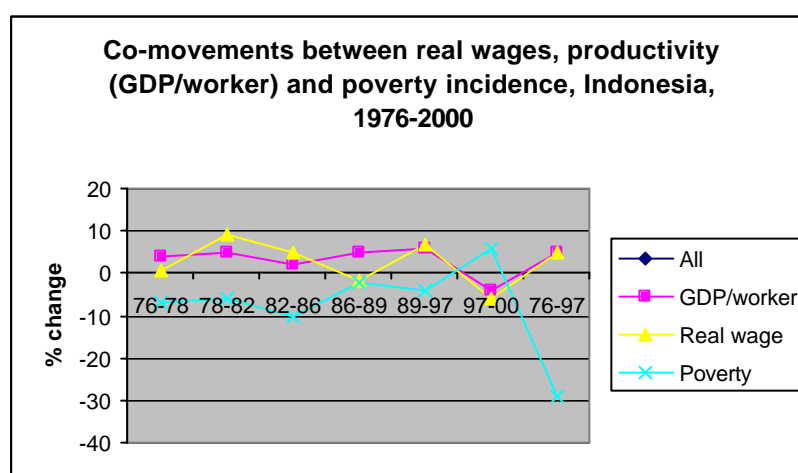


Figure 4.1

Over the pre-crisis period (1976-1997), real wages and productivity have grown at five per cent annually while poverty declined by 29 percentage points. At the same time, in the crisis period and its aftermath (1997-2000), the increase in poverty of six percentage points is accompanied by a collapse in both real wages and productivity. Yet, there are sub-periods during which the linkage between indicators of consumption poverty, real wages and productivity diverge. This is most conspicuous in the 1986-89 period when poverty fell at a steep rate, but real wages actually declined at an annual rate of two per cent. It is also conspicuous in the 1976-78 period when real wages barely grew (at about one per cent), but consumption poverty fell rather steeply. Apart from these anomalous episodes, the co-movements in real wages, productivity and consumption poverty are quite apparent with the substantial declines in poverty being accompanied by rising productivity and real wages and vice versa.

An important study on real wages in Indonesia has also explored the wage-poverty linkage. Pertinent information – derived from that study – is provided in table 4.11. As can be seen, there is, on the whole, a reasonably good correspondence between the movement in real wages for agricultural workers (in Java) and the changes in poverty incidence. The conspicuous exceptions seem to be 1978-80 and 1987-90 when poverty fell even when real wages declined.<sup>53</sup>

<sup>53</sup> Regression analysis using quarterly Indonesian wage data by Papanek (1999) suggest that real wages respond positively to output growth and negatively to inflation.

**Table 4.11: Comparison of changes in poverty and real wages in Indonesia**

	Changes of number of poor based on official poverty line (%)	Agricultural real wages in Java (%)
1976-78	-12.90	4.4
1978-80	-10.4	-1.8
1980-84	-17.3	4.4
1987-90	-9.3	-5.7
1990-1993	-4.8	19.2
1993-1996	-13.1	14.2
1996-1998	52	-33

Source: Adapted from Papanek, 1999, table 2.

The link between poverty and wages at the sectoral/occupational level is exhibited in table 4.12 using data for 1999 and 2000. As can be seen, agriculture, which is the least paid (with wages being 54 per cent of the national average) and also among the least productive sectors, had the highest concentration of poverty and accounted for nearly 60 per cent of the total population in poverty. At the other extreme, finance, in which average wages were 75 per cent above the national average and contained a high incidence of white-collar workers, had the lowest poverty incidence in the country. However, the relationship between wages and poverty at the sectoral level is by no means exact. For example, mining and quarrying has relative wages that are 52 per cent above the national level. Yet, it has a poverty rate (29 per cent) that is higher than the manufacturing sector (23 per cent), which has relative wages that are 7 per cent below the national standard.

**Table 4.12: Relationship between poverty and relative wages by sector of occupation**

	Feb 1999		2000
	Poverty incidence (%)	Contribution to total poor (%)	Relative wage (national =100)
Agriculture	39.7	58.4	54
Trade	17.6	11.1	93
Manufacturing	22.9	7.7	93
Civil, social and private services	13.1	7.4	127
Transport and Communication	24.0	5.6	127
Construction	29.0	5.5	98
Receiving transfer	15.6	2.65	
Mining & quarrying	29.8	1.00	152
Others	32.0	0.27	
Finance	5.23	0.23	175
Electricity, gas and water	14.5	0.17	145

Source: See previous tables in this section.



## 5. Summary of key findings

This paper has navigated a wide and diverse terrain. Hence, it would be useful at this juncture to bring together different strands in the analysis and to highlight the key findings. These findings in turn are guided by the primary goal of studying the linkage between poverty and the structure of the labour market. This has entailed a study of the evolution of employment and wages in pre- and post-crisis Indonesia and the various ways in which such an evolution has influenced the nature and scale of poverty.

### The multiple dimensions of poverty in Indonesia

Reflecting current intellectual trends, the paper highlighted multiple dimensions of Indonesian poverty in both the pre- and post-crisis period. This has involved an empirical synthesis of trends in income/consumption poverty, capability deprivation encompassing the UNDP's 'human poverty index' (HPI), vulnerability and powerlessness. The stylised facts (on which there appears to be a reasonable degree of consensus) are as follows.

- There was an impressive decline in consumption poverty over two decades. The national estimates suggest that poverty fell from per cent in 1976 to 11 per cent by 1996. Alternative estimates generally support this optimistic conclusion, as do estimates of income poverty based on international poverty lines. On the other hand, a generous definition of poverty (\$2-a-day) suggests that approximately 60 per cent of Indonesians still live in penurious circumstances.
- Consumption poverty shot up during the crisis, but it was transient, with the head count ratio tapering off to its pre-crisis level by 1999.
- Indicators of capability deprivation (malnutrition, literacy, access to health services, low life expectancy) suggest that Indonesia made impressive progress that testifies to the genuine social gains embedded in indicators of income/consumption poverty. The value of the HPI fell from 28 to 25 between 1990 and 1996 and was apparently unaffected in any major way by the 1997 financial crisis. Nevertheless, capability deprivation is a significant problem in Indonesia. For example, in 1999, more than 50 per cent of Indonesians did not have access to health services while the incidence of child malnutrition was 30 per cent.
- Vulnerability –the risk of falling into poverty or getting deeper into poverty in the future - in Indonesia is more significant than current consumption poverty. Recent estimates suggest that the incidence of vulnerability is 34 per cent and that it worsened more sharply than consumption poverty during the crisis. Indeed, even those whose expenditure is 20 per cent above the poverty line are vulnerable to an episode of poverty.
- Perceptual data gleaned from direct experiences of poverty suggest that the poor feel alienated and excluded from local decision-making processes – a phenomenon particularly affecting women – and that they lack trust in state institutions.

Thus, the harsh reality is that, despite decades of sustained economic and social gains, Indonesia still has to grapple with the manifold manifestations of poverty and identify cost-effective and credible policy instruments that could lift the many millions who are poor today – and those who are likely to become poor tomorrow – towards a reasonably secure and prosperous future.

#### The poverty –labour market nexus: the role of employment

This paper has argued that a salient aspect of this rethinking on poverty in post-Suharto Indonesia should entail a greater understanding of the interaction between the labour market and those who are poor. At the same time, the limits of this analytical framework need to be recognised. Indicators of powerlessness suggest that poverty has deep-seated social, political and institutional roots. The finding that more than 30 per cent of Indonesians are vulnerable to episodes of poverty suggest that a mere expansion of current employment might ease the pain and suffering of current poverty, but would be inadequate in dealing with the more complex challenge of vulnerability. In order to deal with the latter, appropriate policy interventions would be required to ensure the economic security of at least a third of Indonesians. Such interventions would certainly encompass labour market policies, but cannot be limited to them. Similarly, the challenge of dealing with capability deprivation cannot be kept within the conventional confines of labour market policies. Determined public action in the domain of public health and basic education – rather than a mere expansion of employment - engenders healthy and literate people. They are also transformed into healthy and productive workers who make a contribution to the productive capacity of an economy.

Bearing the above caveats in mind, what can one conclude about the key features of the poverty-labour market nexus in Indonesia? It is clear that developments in the labour market are consistent with the broad finding that there was significant progress in poverty reduction in the pre-crisis period.

There was significant urbanisation and formalisation of the work force in the 1990s. The share of formal sector employment rose from 28 per cent (in 1990) to 38 per cent on the eve of the crisis (1996), while the relative size of the urban labour force increased from 26 per cent to 36 per cent over the same period. At the same time, rapid growth in the pre-crisis era was accompanied by a deepening of skills of the work force. The proportion of less educated/skilled workers (defined as those who have primary education and less) fell from 87 per cent to 79 per cent between 1990 and 1996, with a corresponding increase in the share of the educated/skilled workforce (defined as those with at least secondary education) from 14 per cent to 21 per cent.

These developments are consistent with the sustained decrease in consumption poverty documented in section 2 of this study. A reallocation of labour from low-productivity, low-paid jobs in the rural economy to better-paid employment in the urban and formal economy is one well-known route via which ordinary workers and their dependents can improve their living standards. This is consistent with household-level data that show that the incidence of poverty drops from 40 per cent to 23 per cent as one moves from the agricultural sector to the manufacturing sector.

Furthermore, there is a significant correlation between educational attainment and poverty incidence at the household level. The evidence shows that 87 per cent of Indonesia's poor have primary education or less. Thus, as more Indonesians gained access to the education system during the 1990s, it provided them with an escape-route from impoverishment.

Measures of 'casualisation' of the work-force (in terms of part-time employment and growth of informal sector employment) do not show any consistent deterioration in the pre-crisis period. This is significant because household-level data show that employment in the informal sector is a major attribute of poverty, with 70 per cent of the poorest 20 per cent of households identifying informal sector employment as their major occupation.

There is little evidence as well that, prior to the crisis, involuntary underemployment (or 'time-related' underemployment) was widespread, being around eight to nine per cent. Although the open unemployment rate was low in the pre-crisis period, not much significance should be attached to this statistic. The link between unemployment and poverty is tenuous in the Indonesian case. Household-level data show that unemployment is concentrated among educated graduates. At the same time, the poverty rate for this group is well below the national average and ranges from 13 per cent (secondary school graduates) to two per cent (tertiary graduates).

Another important aspect of the poverty-labour market nexus in Indonesia is the role that the employment-intensity of rapid growth played in the pre-crisis period. Higher employment elasticity translates to the fact that, for any given growth rate, the job creation rate is higher (subject to the important qualification that the value of employment elasticity should not exceed unity). The available evidence suggests that employment elasticity was quite low (0.3) in the 1970s, rose appreciably in the 1980s (0.8) and tapered off a little with the onset of the 1990s (0.7). These estimates are consistent with conventional interpretations of the evolution of the employment-poverty linkage in the Indonesian context. In the 1970s, Indonesia's oil wealth was used to fund public infrastructure and rural development, but the manufacturing sector remained small, inefficient and protected. This constrained its capacity to act as a locomotive for employment creation, although the oil wealth-driven public investment policy of the 1970s did reap some social dividends, given that it heralded the onset of a remarkable decline in mass poverty. As the oil price boom dissipated in the early 1980s, the Suharto government was forced to turn to outward-oriented industrialisation strategy that began in earnest from the mid-1980s. The much higher values of manufacturing employment elasticity in the 1980s support the notion that the manufacturing sector was beginning to play a more significant role in spearheading employment creation by drawing in less-skilled workers from the rural and informal economy to the more formal economy.

#### The poverty-labour market nexus: the role of wages

Real wages grew by five per cent per annum on average during the 20-year period between 1978 and 1997, and were equally shared by the agricultural and non-agricultural sectors. Real wage improvements took place in all years except the mid-1980s, paradoxically also otherwise known as a period of rapid economic growth. Before the crisis, females and rural areas improved their wages relative to males and

urban areas. Workers in the agricultural and manufacturing sectors, where wages were lower than in other sectors, improved their position relative to workers in other sectors. Workers with less than primary education improved their position relative to those with junior and secondary school education. Not surprisingly, these developments meant a narrowing of wage differentials in the pre-crisis period.

For the economy as a whole, real wage growth has kept pace with productivity growth for the 1976-1997 period. Furthermore, periods when productivity growth has been buoyant has also been accompanied by real wage growth, but this has not always been the case. For example, rapid productivity growth in the 1986-89 period stands in stark contrast to the decline in real wages. Considering the fact that this period also coincides with the trade liberalisation-cum-deregulation reform agenda, one could raise doubts about the short-run consequences of such an agenda for the welfare of workers. However, by the beginning of the 1990s, and until the eve of the 1997 financial crisis, real wages grew a little above productivity growth. There were other sub-periods (1978-86) in which real wage growth exceeded productivity growth – sometimes by quite substantial margins.

Over the pre-crisis period (1976-1997), real wages and productivity have grown at five per cent annually while poverty declined by 29 percentage points. Yet, there are sub-periods during which the linkages between indicators of consumption poverty, real wages and productivity diverge. This is most conspicuous in the 1986-89 period when poverty fell at a steep rate, but real wages actually declined at an annual rate of two per cent. It is also conspicuous in the 1976-78 period when real wages barely grew (at about one per cent), but consumption poverty fell rather steeply. Apart from these anomalous episodes, the co-movements in real wages, productivity and consumption poverty are quite apparent with the substantial declines in poverty being accompanied by rising productivity and real wages. Other studies support these findings.

#### The poverty-labour market nexus, the Indonesian crisis and its aftermath

Did the Indonesian crisis of 1997 wipe out all the major gains that were made during the rapid growth era of the Suharto period? It appears that for a while it threatened to do so. As poverty shot up during the peak of the crisis, there was an involuntary reallocation of labour to the agricultural sector and an enlargement in the size of the urban informal sector, thus creating a phase of 'de-industrialisation'. Real wages also collapsed by about 40 per cent. By 1999, however, some form of recovery seems to have taken place. The forced reallocation of labour to the agricultural sector and the urban informal sector has been reversed, but estimates for 2000 suggest a less certain picture. Real wages are now about 10 per cent below their pre-crisis values.

A debate that has emerged under these circumstances is the extent to which employment and wage adjustments during the crisis period reflect the virtues of 'labour market flexibility'. Some see it as a testimony to the resilience and coping mechanisms of ordinary Indonesian workers that tempered the rise in poverty and prevented a 'blow-out' in the unemployment rate. Others suggest that the evolution of poverty during the crisis period were driven by factors that were essentially of a macroeconomic nature and, at least partly, influenced by social protection policy. Thus, the ability of the government to restore macroeconomic stability and rein in the 'inflation shock' of 1998 together with the reasonable effectiveness of some of its social safety net initiatives reversed the

collapse in the purchasing power of ordinary Indonesians and paved the way for a tenuous social recovery. The government benefited from the assistance that it received from the international donor community in the sphere of macroeconomic policy and the design of social safety net schemes.

Considerable interest has also centred on the extent to which the crisis-induced reform agenda of intensified trade liberalisation, deregulation and privatisation may impair employment prospects. At the same time, speculation has emerged on the employment impact of the Indonesian government's ambitious regional decentralisation agenda that was launched in 2001.

A preliminary assessment suggests the employment displacement effects of the trade liberalisation program have so far been benign. This is largely fortuitous. Prior to the growth slow-down of the US – and the World – economy, the 1999-2000 period turned out to be favourable to Indonesia. Buoyed by US export demand and fuelled by a massively depreciated Indonesian Rupiah, domestic firms and its multinational subsidiaries managed to boost export production in sufficient volumes. This sustained employment in the export-oriented sectors and offset the deflation of domestic demand. Now that a worldwide growth slowdown (worsened in turn by the horrific September 11<sup>th</sup> terrorists attacks on the US) has dissipated the 'export boom' of 1999-2000, it remains to be seen how the trade liberalisation agenda will influence future developments in the Indonesian labour market.

The privatisation program has, so far, not been launched. Nevertheless, on the assumption of full implementation at some point and a premise of 15 to 20 per cent overstaffing in the 16 state enterprises designated for privatisation, the overall employment impact is likely to be some 7,500 persons in a workforce of 90 million. In any case, most of this would have been achieved through natural attrition and early voluntary retirement.

The fear of large-scale redundancies of public sector employees as a result of a smaller central government following the implementation of regional decentralisation has not materialised. This is largely because the transfer of central government employees in January 2001 to local government administrations really involved those who were already located in provincial and district offices. On the other hand, the recruitment freeze, in place since 1995, was continued. As a result, the number of civil servants fell by 80,000 between 1999 and 2000 due to natural attrition. It is likely that the recruitment freeze has also affected the youth unemployment rate to the extent that it has worsened the 'queuing' process for public sector jobs that is characteristic of youth unemployment in Indonesia.

A significant threat to employment generation in an age of decentralisation stems from revenue-generating levies and taxes on businesses and movement of goods imposed by a number of regional administrations, and their negative impact on farmers and other producers in distant markets. While the corresponding employment and income losses are difficult to estimate, the uncertainty raised by such ad hoc levies and taxes has already resulted in a freeze in all mining investments in the country, and perhaps of investment in other areas as well. This is likely to have a negative impact on growth and employment.

In sum, this comprehensive account of the interactions between poverty incidence and the labour market suggests that a reasonable degree of consensus has emerged in understanding the multiple ways in which such interactions take place. Important structural changes in the Indonesian labour market – entailing urbanisation, formalisation and skill upgrading of the work-force, rapid real wage growth underpinned by productivity growth - are essential in understanding how they have favourably affected the evolution of poverty in pre-crisis Indonesia. These structural changes were partly the result of the natural processes of sustained rapid growth and partly the product of policy interventions. At the same time, the crisis reversed the poverty-reducing developments in the Indonesian labour market, but by 1999 a tenuous recovery has been in progress. It remains to be seen whether the recovery process will be consolidated. The current reform agenda and the regional decentralisation program appear, until now, to have had a benign impact on employment, but a more comprehensive judgement must await the test of time and the accumulation of more knowledge through further research.

## **6. Discussion of policy options<sup>54</sup>**

Any attempt to develop a policy framework for dealing with issues that directly and indirectly impinge with the evolution of poverty should start with a clear recognition of the key labour market challenges. These are:

- The need to create enough durable jobs annually (at least two million according to current estimates) to absorb new entrants to the work-force and clear the backlog of the unemployed and the underemployed
- The need to empower workers – both in the formal sector and in the informal economy – to cope with the problems of vulnerability to future episodes of poverty that recent studies have highlighted
- The need to develop a credible industrial relations system that can represent the interests of both formal sector and marginalised workers and thus contribute to alleviating the sense of voicelessness and powerlessness of the poor that recent studies have found.

The notion that one can simply rely on the virtues of a flexible labour market to respond to the afore-mentioned challenges is misplaced. The framework of labour market flexibility relies largely on the decentralised interaction of employers and workers to engender improvements in collective welfare. This means an insufficient appreciation of the current labour market challenges that are the product of the weaknesses of the pre-crisis period. Admittedly, the Suharto government was successful in mitigating the incidence of mass poverty through rapid, employment-oriented growth, but it was also conspicuous for its failure to respect labour rights, build up a credible industrial relations system and invest in institutional arrangements to deal with labour market risks. These inadequacies and failures of the past have, in turn, been amplified by the Indonesian crisis.

What are the elements of a policy framework that one could devise for dealing with labour market issues that impinge on the manifold manifestations of poverty in Indonesia? Here are some preliminary thoughts.

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<sup>54</sup> This section draws on Islam (2001).

### The need for the return of rapid and sustainable growth

There has to be a return to reasonably rapid, and sustained, growth. Current forecasts suggest that the growth rate in the short to medium term may not exceed four per cent.<sup>55</sup> This is barely enough to create jobs to cope with the two million entrants to the workforce and by no means enough to cope with the backlog of the unemployed and the underemployed. Based on current estimates of employment elasticity, a growth rate of at least five per cent in the short to medium term appears critical in underpinning any strategy for mitigating the incidence of poverty in post-crisis Indonesia.<sup>56</sup>

The return of growth in post-crisis Indonesia means a re-engagement with the paraphernalia of economic and institutional reforms that the international development community has been urging the government to adopt over the last five years. Such reforms, it is argued, will once again make Indonesia an attractive place to invest (both from the perspective of domestic and foreign investors) and thus rekindle the engine of growth.

At the same time, a mere return of growth will not be enough. In the haste to embrace new investment in manufacturing and mining activities, the government cannot afford to neglect the informal segments of the economy and the agricultural sector where the bulk of the Indonesian poor reside. A strategy of reigniting growth in post-crisis Indonesia needs to be accompanied by appropriate measures that ensure the health and buoyancy of the agricultural sector and that provides ample scope for small and medium-sized business enterprises (SMEs) to play a major role in productive employment opportunities for ordinary Indonesians currently languishing in the informal sector.<sup>57</sup> These initiatives in turn are also likely to improve income distribution and thus reinforce the capacity of the growth-process to reduce poverty. Indeed, cross-country data confirm such an interpretation.<sup>58</sup>

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<sup>55</sup> Asia Recovery Information Centre (2002).

<sup>56</sup> The five per cent figure was highlighted in the 1999 ILO Employment Mission to Indonesia (ILO, 1999a). Note that the required growth rate to absorb new entrants to the labour force is sensitive to the particular value of employment elasticity used. Islam and Nazara (2000a) find that the required growth rate to maintain 'flow' equilibrium in the Indonesian labour market varies from 3.5 per cent to 4.7 per cent.

<sup>57</sup> There is now a sizeable literature on SMEs in Indonesia. For a recent evaluation, see Berry et al (2001). They argue that SMEs fared better than large firms during the crisis, while in the pre-crisis period their productivity grew at rates quite similar to their large counterparts. The authors advocate the creation of a business environment conducive to SMEs and recommend the provision of business development services by the private sector.

<sup>58</sup> See Agenor (2002:7). The study suggests that poverty could decline rapidly with distributionally neutral growth, but it only takes small deviations from such neutrality to wipe out the gains. The study proceeds to use cross-country regressions to show that output growth and real exchange rate depreciations tend to reduce poverty, while illiteracy, income inequality and macroeconomic volatility tend to increase it.

## Reflecting employment concerns in macro-policy

It is difficult to be serious about employment-led recovery from the 1997 financial crisis and its terrible aftermath unless employment concerns are reflected in macroeconomic policy. Indonesian monetary authorities are currently entrusted with the task of reigning in inflation to an agreed target.<sup>59</sup> At the same time, fiscal policy is also severely constrained by the need for 'fiscal consolidation' in order to reign in a crisis-induced explosion of public debt. This has understandably created tensions between an anti-inflation strategy and the need to nurture an employment-friendly recovery.<sup>60</sup>

The medium-term inflation target is of the order of 3-5 per cent.<sup>61</sup> Yet, the central bank also recognises the possible consequences of its actions. Thus, it draws attention to the ...'*policy dilemma* (emphasis in original) in the monetary decision-making process at Bank Indonesia'.<sup>62</sup> In other words, how does it meet the predetermined inflation target without inhibiting the resurgence of growth? Bank Indonesia has not clearly delineated how it intends to resolve the dilemma that it faces. Indeed, some external observers, including a senior ex-IMF official, have expressed concern that a preoccupation with reigning in inflation to a set target could push Bank Indonesia to become too inflation-averse.<sup>63</sup>

Several possible suggestions may be made in dealing with the policy dilemma facing the Indonesian monetary authorities. To start with, the primary goal is the return of full employment driven by broad-based growth. In trying to preserve this fundamental goal, why not aim for a modest benchmark where the monetary authorities try to ensure that the inflation rate stays, on average, below double-digit levels? After all, in pre-crisis Indonesia, widely regarded as a successful case of economic development, the average long-run inflation rate (1969-1996) was around 12 per cent.<sup>64</sup> What are the ex-ante social gains of keeping inflation persistently below five per cent or, conversely, the social costs of allowing inflation to drift above five per cent in the medium term?<sup>65</sup> Unless there are convincing answers to such a basic question,

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<sup>59</sup> The challenges and constraints of implementing 'inflation targeting' in Indonesia are explored in Alamsyah et al (2001).

<sup>60</sup> The government is being urged to run a primary surplus (equal to two per cent of GDP) over the next few years. See World Bank (2000c).

<sup>61</sup> Note, however, that in the latest letter of intent (signed on August 27, 2001) between the Indonesian government and the IMF, the inflation target was set at 9-11 per cent – a recognition that too tight an inflation target is probably not realistic at this stage. See ARIC (2002: 48).

<sup>62</sup> See Bank Indonesia (2000)

<sup>63</sup> The external observer is Paul Krugman, while the ex-IMF official is Hubert Neiss. These comments were made at a seminar organized by *Strategic Intelligence* ('The Second Indonesia Economic Forecast – The Road to Recovery: A Strategic Intelligence Seminar Conference with Professor Paul Krugman', August 29, Grand Hyatt Hotel, Jakarta) and received prominence in the local media (e.g. see *The Jakarta Post*, August 30, 2000). The commentary by Philip Bowring in the *International Herald Tribune* is also worth highlighting. He notes: 'Most of East Asia and Southeast Asia needs some inflation to spur consumer demand, reduce real interest rates and spark a revival in asset prices' ('Asian Economies Should Ride on the Fuel Price Storm', *International Herald Tribune*, September 26, 2000)

<sup>64</sup> Estimates kindly made available to the author by Zulfan Tajoeuddin, Research Associate, UNSFIR, Jakarta, Indonesia.

<sup>65</sup> See Akerlof et al (1996) who suggest that the social costs of moderate inflation have been exaggerated.



inflation targeting in a stringent fashion will cause more problems than they will resolve.

Recasting the current inflation targeting procedure to the more modest approach of avoiding the entrenchment of double digit inflation rates – at least until the recovery is consolidated – is only the first step in incorporating employment concerns in macroeconomic management. A complementary step is to enhance the government's capacity to monitor developments in the labour market. While there is a wealth of short-run data on inflation, even quarterly data on employment does not exist, thus constraining the capacity of the government to regularly monitor the labour market. Yet, generating quarterly data on employment is not too difficult and can be reconstructed out of existing sources.<sup>66</sup>

An approach that attaches primacy to employment concerns should entail clear statements by the government on the rate of job creation that would be consistent with maintaining 'equilibrium' in the labour market (that is, the number of jobs created should absorb the growth of the labour force and make a dent on the current stock of the unemployed and the underemployed). The advantage of integrating employment concerns in macro-policy is that it enables the government to track the employment intensity of economic growth through estimates of employment elasticity. Higher employment elasticity will translate into lower growth rates required to reach threshold employment creation targets (that is, the two million jobs noted above). Several pertinent questions naturally emerge at this stage. What has been the historical behaviour of employment elasticity? How is it going to be influenced by the current reform agenda of further domestic deregulation, trade and FDI liberalisation, and privatisation in the short term and medium term? What will be the likely impact of decentralisation on the employment intensity of economic growth in the short and medium term?<sup>67</sup> Once again, clear policy positions on these issues are not yet evident. However, thorough evaluations by the government of these issues are critical as part of developing a coherent and credible strategy for employment-led recovery.

Assuming that tracking employment elasticity is a legitimate exercise, what scope is there for the government to enhance employment elasticity, thereby reducing the burden on economic growth alone to generate the necessary jobs to absorb new entrants to the labour force? One possibility is to highlight the role that certain sectors/sub-sectors play in employment creation. For example, table 3.5 in this study identified garments, footwear, furniture and electronics as sub-sectors within manufacturing with 'high' employment elasticities (above 0.5 for the 1985-1997 period). It is encouraging that these are also sub-sectors with a significant degree of export-orientation. There is scope in these activities for small and medium-sized enterprises (SMEs) to play an important role in job creation. The government should seek to reduce entry barriers to sectors/sub-sectors with high employment elasticity both by reducing regulatory impediments and restraining the restrictive practices of dominant firms.

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<sup>66</sup> It should be possible to generate quarterly data on employment by combining the national socio-economic survey (SUSENAS) which is held in February of every year and the national labour force survey (SAKERNAS) which is held in August of every year. This will require the use of consistent definitions across both the surveys to underpin labour market data.

<sup>67</sup> The ILO Area office in Jakarta has completed a preliminary study of the short-run employment consequences of the current reform agenda. The results have been reported in section 3 of this study.

ILO studies have consistently argued that there is another direct form of intervention that the government could exercise more assiduously that could influence employment elasticity. This pertains to the proposal that the government ought to consistently incorporate the use of 'labour-based' rather than 'equipment-based' production methods in its public investment policy.<sup>68</sup> The public sector in Indonesia, as in many other developing countries, is a major player in infrastructure investment. One ILO study has shown that labour-based production methods in infrastructure investment in Indonesia can generate as many as 1.2 million durable jobs over four years without compromising standards of quality that one associates with equipment-intensive production techniques. This means that, if general growth-induced employment creation is of the order of two million annually, it has the potential to rise to 2.3 million annually with the adoption of 'labour-based' production methods in public investment policy.<sup>69</sup> This point is of particular importance because infrastructure maintenance and investment will grow significantly as economic recovery takes hold.

#### Access to the education and training system

An important area of poverty-focused policy intervention pertains to the education and training system. It does not fall directly within the domain of labour market policies, but has a major bearing on developments in the labour market. As this study has shown, there is a strong correlation between educational attainment and poverty incidence at the household level. More specifically, the available evidence suggests that 87 per cent of Indonesia's poor have primary education or less. Simply upgrading a household head's education to a junior secondary level is associated with a drop in the poverty rate from 30 per cent to 17 per cent. These are significant figures and suggest that all Indonesians need to have educational attainments at least to a junior secondary level. This is a target that the Indonesian government has recognised. It is also a target that is line with the international community that argues the need for 'education for all'.<sup>70</sup> This in turn highlights a major policy challenge: how to ensure that barriers are not erected against broad-based participation of the poor in the education and training system. Failure to respond to this challenge will engender two long-term problems: Indonesia will be robbed of much-needed human capital; there will be entrenchment of privilege (as the poor can't get in).<sup>71</sup>

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<sup>68</sup> ILO (2000a).

<sup>69</sup> ILO (1999a).

<sup>70</sup> Mingat and Winters (2002) draw attention to the need for 'education for all' by 2015 – this being the goal set by 180 countries at the World Education Forum in Dakar, Senegal in 2000. Such a goal in turn is a continuation of an agenda set by the 1990 World Conference on 'Education For All' held in Thailand.

<sup>71</sup> SMERU (2001b) has released a newsletter in which the difficulties faced by the poor in gaining access to secondary schooling are highlighted. The author, Oey-Mayling Gardiner, maintains that there are two barriers facing the poor (a) insufficient number of state-funded junior secondary schools; (b) exorbitant fees, even in the so-called state-funded sector, that discriminate against the poor. Recent media reports, focusing on the experience of a particular Indonesian district (Banjarnegara), also highlights the rather difficult barriers that ordinary families face in educating their children at a junior secondary level. The drop-out rate for this locality at the junior secondary level is nearly 50 per cent! See *Jakarta Post*, 25 March, 2002.

Some qualifications need to be added as part of concluding this brief discussion on the education and training system and its relevance in fashioning a poverty-reduction strategy. The study of the education-poverty nexus in the Indonesian context relies exclusively on cross-section data at the household. Such evidence provides confirmation of correlation, not causality. Expanding education alone will not solve the multi-faceted nature of poverty! It remains to be said that sustainable poverty reduction entails a complex array of policy interventions. The interaction of investments in education with complementary investments – as in the provision of agricultural extension, the establishment of micro-credit schemes etc – will go a long way towards ensuring that the well-documented social returns to basic education are realised and the conditions of the poor improved.<sup>72</sup> Furthermore, the challenge is to provide high-quality basic education in terms of adequate retention rates, appropriate curricula, well-trained teachers, textbooks and other learning materials and proper physical infrastructure.

### Social protection, vulnerability and labour market risks

A key element of making labour market policies in Indonesia more poverty-focused is the recognition of the fact that at least a third of Indonesians are vulnerable to future episodes of poverty. The 1997 financial crisis has demonstrated how externally driven economic shocks can force millions of Indonesians to move, at least temporarily, into low-paying, low-productivity jobs in the agricultural sector and the informal economy of the urban sector. There is a growing professional opinion that informal systems of social protection (the variety of assistance flowing from private organisations and the informal network of friends and family) are not necessarily efficient and cannot cope effectively with economy-wide shocks (such as the 1997 crisis).<sup>73</sup> Thus, more formal systems of social protection need to be nurtured and strengthened in dealing with labour market risks, particularly those triggered by economic shocks. Two pertinent policy options in this domain are unemployment benefits and public works, although there are many other initiatives (e.g. microfinance) that are also pertinent.

Indonesia could consider the feasibility of setting up an unemployment benefits scheme to cater to the needs of formal sector workers. At the same time, a well-designed public sector scheme could serve as an employment protection scheme for workers in the informal economy and rural areas – the so-called ‘excluded majority’.<sup>74</sup> There are, of course, a number of objections that one could raise against the operation of an unemployment benefits scheme – such as fiscal affordability, administrative complexity, and ‘disincentive effects’ that lure prospective participants to stay voluntarily unemployed in order to access the benefits. Recent research suggests that some of these concerns have been exaggerated.<sup>75</sup> Thus, the so-called ‘disincentive effects’ can be, and have been, mitigated by taking appropriate counter-measures (such as strict eligibility criteria). The fiscal affordability critique has also been questioned by others. A recent ILO study has made a strong plea in favour of

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<sup>72</sup> Studies typically show that the social returns to education in low-income countries are highest at the primary and secondary level. See Mingat and Winters (2002).

<sup>73</sup> See Murdoch (1999)

<sup>74</sup> The literature on social protection in developing countries now focuses on the challenge of dealing with the ‘excluded majority’. See, for example, Beattie (2000), Ginnekan (1999), ESCAP (2000), ILO (2000b) and World Bank (2000b).

<sup>75</sup> See Acemoglu and Shimmer (2000).

introducing unemployment insurance schemes in East Asian economies.<sup>76</sup> Estimates suggest that ‘...an average required contribution rate of between 0.3 to 0.4 per cent of payroll between 1991 to 2000 would have been sufficient to provide all insured job losers over this period, including during the current crisis, with 12 months of benefits’<sup>77</sup>. In the case of Indonesia, the required contribution is 0.44 per cent. Another independent study claims that ‘...most of the Asian economies...should be able to operate (an unemployment insurance programme) with OECD generosity utilising an average payroll tax rate of 1.0 per cent’.<sup>78</sup>

Whatever the future shape of unemployment benefits scheme in Indonesia, it will leave out a large fraction of the workforce in the informal sector, those in self-employment and in rural areas. Hence, discussions of alternative forms of employment protection are necessary. Perhaps the best-known example is public works.

Public works schemes have been quite common in all the Asian economies affected by the 1997 financial crisis. The general conclusion seems to be that they have not been particularly successful in meeting their goals. The employment creation effects were modest and intended beneficiaries often failed to gain access to the potential benefits of the programme.<sup>79</sup>

One factor that undermined the effectiveness of public works as a safety net measure during the Asian crisis is the haste with which the measures had to be put into action. In Indonesia, for example, labour-intensive job creation programmes (or *Padat Karya* – PK - programme) that were terminated in 1994 were quickly resurrected without any careful reflection being given to an overall strategy. Numerous ministries and levels of government were involved causing serious coordination problems. The public works projects were also characterised by a low wage bill and the absence – or at least insufficient participation – of women.

A more recent evaluation of the PK programme that compared it with other interventions in the social safety net domain – such as the rice subsidy programme – however offers a more subtle conclusion. It draws attention to the fact that a social safety net programme can be targeted primarily to the ‘permanently poor’, but it can also be judged on the basis of its ability to target beneficiaries who suffer the ‘most shock’ during a systemic crisis, irrespective of their pre-crisis status. Using survey data, the study concludes that the worst hit were 300 per cent more likely to participate in the PK programme, while the worst hit were only 58 per cent more likely to participate in the rice subsidy programme. Nevertheless, the study concludes that when other dimensions of programme design are considered (such as administrative complexity, waste and malfeasance etc), it is likely that the cost per

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<sup>76</sup> Lee (1998: chapter 4).

<sup>77</sup> Lee (1998: 83). The calculations assume that the coverage of the scheme would be the same as existing social security provisions and would provide 12 months benefit at a replacement rate of 50 per cent of previous earnings.

<sup>78</sup> Vroman (1999:37)

<sup>79</sup> Direct employment creation programmes typically generate temporary employment equivalent to less than 1 per cent of the workforce. See Jorgensen and Domelan (1999:16). Lee (1988: 55) estimates that if one includes all social expenditures directed towards employment creation, then their effects may be summarized as follows: seven per cent of the unemployed in Thailand; 10 per cent of the unemployed in Indonesia; 24 per cent of the unemployed in Korea.

dollar of benefits delivered to poor beneficiaries would be significantly higher for the PK programme than for the rice subsidy programme.<sup>80</sup>

The government has recognised the problems plaguing the PK programmes and has issued new guidelines in an effort to rectify them. It has explicitly recognised the need to increase the participation of women workers, to have sustainable infrastructure development and to have community and civil society involvement. Nevertheless, the government still conceptualises the PK programme as a key instrument for providing short-term unemployment relief and assumes that they will be phased out once sustainable economic recovery takes place.<sup>81</sup> The government should seek inspiration from international evidence, which shows that well-designed public works schemes can be an important part of the tool-kit of long-term social protection policies in developing countries.<sup>82</sup>

### Dealing with voicelessness and powerlessness as dimensions of Indonesian poverty: the role of social dialogue and labour rights

The problems of voicelessness and powerlessness have been shown to be important dimensions of contemporary Indonesian poverty. This demonstrates that poverty has deep-seated institutional roots, suggesting in turn that a focus on labour market policies alone would be inadequate in dealing with the plight of the poor. Nevertheless, much can be accomplished by paying attention to the building of appropriate labour market institutions that provides 'voice' and representation for ordinary workers.

Perceptions about growing labour unrest in Indonesia have understandably caused considerable concern among both domestic and international investors.<sup>83</sup> This in turn is likely to have a negative impact on investment, hinder employment prospects and adversely affect the incidence of poverty. One appropriate instrument for dealing with labour unrest is 'social dialogue' or consensus building through deliberation and negotiation between employers and workers. The notion of social dialogue has built on the ILO's time-honoured principle of tripartism entailing the participation of the government, employers and worker organisations. This principle might have to be creatively adapted to respond to the constraint, opportunities and challenges that confront the promotion of social dialogue in Indonesia. How should one proceed?

To start with, the cause of social dialogue should be championed by the strategic ministries rather than just the ministry dealing with labour affairs.<sup>84</sup> Employers associations need to be more committed to the cause of social dialogue and more coherent and united in terms of their agenda. Perhaps one of the biggest challenges facing the development of social dialogue in Indonesia is that the trade union

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<sup>80</sup> See Sumarto et al (1999).

<sup>81</sup> See Parikesit and Hudayana (1999).

<sup>82</sup> See Ravallion (1998), Subbarao et al (1997).

<sup>83</sup> A 2001 survey by the Japan Bank for International Cooperation (JIBC) notes that Indonesia continues to fall further behind China and Thailand in the competition for Japanese investment and it could be overtaken by Vietnam and India in this decade. The JIBC has urged the Indonesian government to take immediate steps to improve its investment climate. It is noteworthy that Japan is the largest source of private direct foreign investment for Indonesia. See *Jakarta Post*, 22 March, 2002.

<sup>84</sup> See Campbell (1999) who emphasises this point in his account of the Asian experience with social dialogue in the post-crisis era.

movement is still at a nascent stage both in terms of its capacity and degree of representation. A good deal of work will need to be done on various fronts to bring about a cordial industrial relations climate through a culture of dialogue and discussion.

One should also recognise the structural constraints operating on a putative trade union movement. This reflects the current stage of Indonesia's development in which own-account workers and the informal sector represent more than 40 per cent of the workforce. How does one develop credible 'voice' representation for this excluded group? This is where trade unions could work creatively with non-workplace civil society organisations with a credible record of representing the poor.<sup>85</sup> Linking the trade union movement to emerging pro-poor associations could turn out to be a promising route for a broad-based coalition that embeds 'voice' representation for the poor and the vulnerable in Indonesia.

Changing the nature and scope of dialogue partners may also invigorate the nature of the social dialogue itself. There is always the risk that social dialogue could become a residual forum for managing the consequences of particular policy actions or even as a supplement to bread-and-butter issues that form the substance of collective bargaining mechanisms. To be effective, social dialogue ought to become a forward-looking forum that can set the agenda for future labour market issues.

It would be fair to maintain that Indonesia faces the dual challenge of moving up the technology ladder while simultaneously trying to deal with standard labour market risks of fluctuating real wages, unemployment and underemployment that confront a typical developing economy. Technological and industrial transformation means the revisiting of constraints and problems afflicting the education and training system, while dealing with labour market risks entail a focus on the governance of social protection. A broad-based coalition of employers, worker organisations and public intellectuals may represent a promising development in providing the intellectual energy to facilitate Indonesia's transition to a more dynamic and yet fair society.

No process of social dialogue can be effective and durable if it does not build on a labour rights-driven industrial relations system. There is now a consensus in the international community that the recognition of basic worker rights is the foundation on which labour market institutions have to be built. The Indonesian government has made a promising start in this direction by ratifying all the core ILO conventions that pertain to the 'fundamental principles and rights at work'.<sup>86</sup> It has thus acquired the enviable distinction of being the only country in the East Asian region to accomplish such a task.<sup>87</sup> Nevertheless, ratification is only the beginning. The next challenge is the sustained realisation of basic worker rights for all Indonesians. Only then would social dialogue work, labour unrest mitigated and the problem of powerlessness that afflict the poor at least partially addressed.

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<sup>85</sup> The ILO area office in Jakarta supports a project in which innovative attempts are being made to develop 'voice' representation for the informal and unorganised sector. It is too early to say how effective this project is likely to be, but it is certainly a start in the right direction.

<sup>86</sup> These are: freedom of association, right to organise and bargain collectively, the prohibition of forced and child labour, elimination of discrimination of employment.

<sup>87</sup> See ILO (1999b).

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