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Chris Manning

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## *Setting the scene*

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*Labour market issues in Indonesian development*

Three decades of rapid economic growth under the New Order have fundamentally changed the Indonesian economy and society. Labour markets have also been transformed in a country much of which was a classic case of a labour surplus economy – demonstrably so in Java – in 1965–6. Despite these developments, many observers are disturbed by the low wages, poor working conditions and high rates of informalisation among Indonesian workers compared with those in more advanced East Asian economies. There is a general feeling that in the area of labour the Indonesian government has performed poorly, in contrast to other areas of social and economic life such as education, health and poverty alleviation. The implication is that Indonesia needs to rethink its development priorities and programmes, especially the recent phase of economic liberalisation since the mid 1980s.

This book focuses on issues raised in these debates. First, contrary to popular opinion, it argues that most ordinary workers have made substantial advances in wages, productivity and labour incomes – although the gains have not necessarily narrowed the absolute gap in living standards with higher-paid professionals and managers, or with unskilled workers in neighbouring countries. Second, it seeks to demonstrate why this finding is so different to public perceptions of labour processes. It shows why the benefits to wage workers have not been more visible or pronounced in terms of conventional indicators of labour market outcomes, and why labour outcomes have sometimes differed from those in neighbouring countries.

The book deals with this labour market transformation both in the context of national social and economic developments, and comparative labour market experience in other rapidly growing economies in East Asia. It examines aspects of initial economic circumstances and labour market conditions when Soeharto came to power, drawing attention to the extent to which Indonesia lagged behind many of its neighbours. And it looks at aspects of social and economic change which have influenced labour's gains, and

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Excerpt

[More information](#)

#### 4 *Setting the scene*

losses. The body of the book deals with the labour market response: the movement of workers between jobs, sectors and regions; the delayed and then later accelerated response of agricultural wage rates to rapid economic growth; trends in unemployment and underemployment; industrial relations processes; and the changing role of women in the labour market.

The extent to which growth transforms labour markets has a major influence on both economic efficiency and equity. This is evidenced in markedly different labour market structures and outcomes between and within developing economies. Fluid, responsive and relatively undifferentiated employment and wage structures at one extreme contrast with fractured or segmented labour markets, in which there is a marked contrast in the wages and welfare of 'insiders' and 'outsiders', in terms of access to the prized modern sector jobs at the other.<sup>1</sup> These themes are emphasised in comparisons of labour market experience between regions and over time in Indonesia, and between Indonesia and other East Asian countries.

Labour market change has important implications for social and political structures. These include the extent of participation by vulnerable groups, discrimination by race, region and gender, and the representation of workers in political processes. While workers have been willfully suppressed in some countries, they have also been in the forefront of the democratic reform movement in some countries, such as South Korea during the 1980s.

The obvious point of comparison for a study of Indonesian labour is other rapidly developing countries in East Asia, in particular the NIEs and the larger ASEAN economies.<sup>2</sup> Rates of economic growth, episodes of economic liberalisation and the transition to export orientation have been similar to most of these other economies, notwithstanding some notable differences.

There have been surprisingly few major studies of the interaction between economic growth and labour market outcomes in the rapidly expanding East Asian economies. The mechanisms underlying development success – the roles of the market and the state, international economic integration, and technological change (Krugman's 'inspiration' rather than 'perspiration') – are well documented and have been widely debated in the literature.<sup>3</sup> Much less is known about the causes and

<sup>1</sup> Horton, Kanbur and Mazumdar (1994a), World Bank (1995a), ILO (1995).

<sup>2</sup> China is also an obvious country for comparison. However, owing to its size and complexity of labour market change in a previously centrally controlled economy, greater stress is placed on comparisons with other countries in the region.

<sup>3</sup> See especially Hughes (1988), Amsden (1989), Wade (1990), World Bank (1993) and Krugmann (1994).

*Labour market issues in Indonesian development* 5

consequences of differences in the impact of economic growth on labour markets.<sup>4</sup>

In part, mainstream economists working on East Asia have generally assumed that labour markets respond smoothly to sound economic management and 'getting prices right'. Yet we know this is not always true. Some well-integrated economies, such as Taiwan and Korea, followed quite similar growth paths and shared similarities in the nature of labour market response, such as in the speed of labour transfers from agriculture to manufacturing, and the subsequent wage rises. Nevertheless, even between these two countries, labour processes differed markedly in response to contrasting spatial (and size distribution) patterns of investment, government intervention in wage-setting mechanisms and human capital development. In a large and spatially dispersed economy like Indonesia, the contrasts in labour market processes and outcomes are likely to be even greater.

The analysis of labour institutions and policies in East Asia has largely been left to non-economists. These topics have been relegated to footnotes in mainstream economic analysis, or left to industrial relations specialists.<sup>5</sup> Many of these studies are rich in theory and detail on the political and dimensions of worker organisations and industrial relations. However, they frequently ignore the interaction between labour markets and economic change, which are fundamental to labour welfare and bargaining power as countries modernise.

The main topics of study were selected with Indonesia in mind. But they have much broader relevance. These issues include

- *different paths through which labour markets are transformed* – from initial conditions of extreme poverty and 'labour surplus' – in the process of structural change
- *the role of the labour mobility* (between jobs, sectors and regions) in productivity, wages and incomes growth
- *patterns of labour market adjustment* to changing economic circumstances, and to shifts in economic policy orientation – resource booms, import substitution and export-oriented industrialisation policies
- *the causes and consequences of labour market 'failure'* in the form of high levels of underemployment and urban unemployment, and labour market divisions (segmentation) by gender, region and type of investment

<sup>4</sup> The major references are Pang Eng Fong (1988a), Fields and Wan (1989), Deyo (1989), Ogawa, Williamson and Jones (1993) and Fields (1994).

<sup>5</sup> In recent years there has also been a spate of comparative studies of industrial relations and labour organisation in the region (See for example Frenkel 1993; Deery and Mitchell 1993).

## 6 *Setting the scene*

- *the role of changing labour market institutions and policies* in determining the efficiency and equity of labour markets, in traditional and modern settings – including adjustment of rural labour institutions and the role of trade unions.

Several developing East Asian economies have already undergone a turning point in which wages and labour incomes rose quickly. The NIEs (and, increasingly, Malaysia), are well along the path in a transition towards labour-scarce economies. This is indicated by rapidly rising unskilled real wages and the movement of labour to more skill and capital-intensive industries (Galenson 1992; World Bank 1995b). In contrast, it is debatable whether Indonesia was close to achieving a similar stage in labour market transition in the mid 1990s.

This raises several intriguing questions. For example, have macro-economic processes and policies been less friendly to labour in Indonesia? Or were initial economic and labour market structures less prepared for rapid economic change? Such questions lead to an analysis of the nature of macroeconomic change and policies, and their interaction with micro-economic processes and structures.

### The Indonesian setting: key issues

Indonesia is an engaging case for the study of labour market change in the process of economic development. The diverse sources of economic growth – abundant natural resources, excess labour supply (to the modern sector), high rates of domestic and foreign investment, and strong state support for agriculture and human resources – provide a rich foundation for examining labour market adjustment. Indonesia's unfavourable initial conditions yet sustained high growth rates provide fertile ground for investigating the nature of labour market transformation.

The Indonesian economy has been among the top ten achievers in the developing world since President Soeharto came to power in 1965. Some have labelled the country one of the miracle economic performers of recent decades. Others see it as a nascent New Industrialising Economy (NIE) of Asia – on the verge of becoming a middle tier, industrialised economy in the region.

Economic growth has been accompanied by substantial structural change. Relative to other sectors, the share of GDP produced in agriculture has fallen even quicker than in other fast-growing economies in East Asia.<sup>6</sup>

<sup>6</sup> In the book, the term 'rapidly growing' East Asian economies covers the NIEs of Asia (South Korea, Taiwan, Hong Kong and Singapore), Malaysia and Thailand. Comparisons are also made with the Philippines, but only fleetingly with China, the Indochinese states and Burma.

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Excerpt

[More information](#)*Labour market issues in Indonesian development 7*

Much of the traditional manufacturing sector has been replaced by modern, large-scale industry. The latest technology is visible in the form of extensive communications and infrastructure networks, not only on Java but now extending into most Outer Island regions. Although Jakarta dominates, other major cities show unmistakable signs of affluence – high-rise office buildings and hotels, supermarkets and widespread car ownership (with the concomitant, inevitable traffic jams!). More relevant to the living standards of the masses, the incidence of poverty is estimated to have declined at a rate almost unparalleled in the experience of the developing world (World Bank 1990).

Yet wage rates remain low, a small proportion of workers are employed in non-agricultural or skilled occupations and the ubiquitous informal sector abounds in major cities, just a few minutes walk from the modern centres of business. The contrast is stark if compared with the more advanced, neighbouring economies of East Asia, let alone with Japan or Western Europe. Per-capita incomes and wage rates were around one quarter of those in Malaysia and South Korea and closer to one-tenth of those in Taiwan, Singapore and Hong Kong in the mid 1990s.<sup>7</sup>

These issues are not just of academic significance. Indonesians themselves – particularly the industrial workers – have become increasingly frustrated with the slow rises in real wages and living standards. Recent substantial labour unrest reflects this concern.<sup>8</sup> In the political arena, criticism has been directed at the suppression of labour rights and of the relative standards of living in addition to absolute levels. Much attention has been given to the high incomes of the increasingly visible middle class and employees of wealthy business conglomerates, compared with the US\$1–2 per day wages of ordinary workers.

Analysis highlights unique aspects of the historical and institutional framework in Indonesia over the past 30 years. Four aspects of Indonesia's labour market experience and its challenge distinguish it from several other neighbouring East Asian countries.

First, labour market change in Indonesia – by industry, occupation and region – can be expected to be closer to that in resource rich countries than in many of the countries of East Asia. Owing to an abundance of natural resources – especially oil – the country faces many of the same challenges as countries such as Brazil, Mexico or Nigeria, in areas of macroeconomic management, allocation of resources and the distribution of wealth. Surpluses generated from oil and natural resources enabled Indonesia to

<sup>7</sup> The differences were slightly smaller in purchasing power parity terms.

<sup>8</sup> Labour riots in the Sumatran city of Medan in April 1994 were a culmination of several years of increased labour action from 1991 onwards.

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Excerpt

[More information](#)

## 8 *Setting the scene*

remain less open to international markets than several of its neighbours. Manufacturing was heavily protected for a longer period, following the pattern of South Asian and Latin American countries. One might expect employment structures and growth – including a burgeoning informal sector – to resemble the less equitable patterns often observed in these countries.<sup>9</sup>

Second, with respect to the efficiency and flexibility of labour markets, integration of rural–urban and regional labour markets is an important topic in a far-flung archipelago. One view is that Indonesian labour markets work very well. Labour is regarded as highly mobile geographically and between sectors. An alternative view is that in Indonesia labour markets are imperfect: they are segmented by type of firm, industry and according to relationships between employers and employees.<sup>10</sup> One related issue is the change in labour market structures over time, especially during the period of deregulation since the mid 1980s. This is particularly relevant in the context of similar episodes of liberalisation which have occurred in East Asian economies.

The large size of the Indonesian population and workforce suggests that the labour market challenge might be qualitatively different than for smaller economies. With a population of almost 200 million and a workforce of over 80 million in the mid 1990s, Indonesia is the world's fourth most populous country. Some issues of labour absorption and their impact on welfare in poor countries are related to scale – the size of domestic and international markets, regional diversity and national integration.

It still has to be seen whether (and on what time scale) the larger countries of Asia – China, India, Indonesia, Pakistan and Bangladesh – can emulate the remarkable labour market transformation of the smaller East Asian NIEs. Indonesia has undergone sustained economic growth, and had a more liberalised economy over a longer time period than other large economies in Asia. Its experience should help provide a glimpse of possible outcomes for the other reforming and rapidly growing giants in the region.

A third important area of research deals with the impact of government policies on labour processes and outcomes. Like elsewhere in East Asia, some policies adopted by the New Order government have indirect effects

<sup>9</sup> Tokman (1984), Fields (1994), World Bank (1995b).

<sup>10</sup> Contrasting views regarding the efficiency of labour markets are put forward in two World Bank publications undertaken in the 1970s. The first (World Bank 1985) argued that unskilled labour markets were relatively open and efficient whereas the second (Lluch and Mazumdar 1985) argued that the labour market was highly segmented in both urban and rural areas.



*Labour market issues in Indonesian development* 9

on labour – such as general macroeconomic, stabilisation and investment policies (including allocation of resources to human capital). But other policies have been more directly focussed on labour market outcomes than in neighbouring countries. These include direct employment creation programmes, minimum wages and labour protection policies.

A controversial issue in Indonesia has been the extent to which labour policies (or their absence) have influenced labour outcomes. Some have argued that wage workers, especially females, have been exploited by monopsonistic employers, and that exploitation is due to government inaction and the stifling of independent trade unions. Extensive protection, minimum wages legislation and guarantees of labour freedoms are viewed as central to improving the situation.

Alternatively, it is asserted that greater government intervention in areas such as wage policy can harm nascent export-oriented industrialisation and discourage foreign investment (World Bank 1995a). Some observers of the NIE experience suggest that the absence of government labour market interventions contributes to rapid growth in jobs, and to equity (Fields and Wan 1989).<sup>11</sup> A *laissez-faire* approach in several countries encouraged investment and labour market adjustment to economic change.

A final set of issues relates to labour welfare and equity. The impact of rapid economic growth on the distribution of labour incomes is of interest, given that the initial allocation of assets was skewed and that there has not been any successful programme of land redistribution.<sup>12</sup> Key issues relate to the extent to which gains have been made by landowners and capitalists at the expense of labour, and the factors which have determined these outcomes.

One specific distributional issue in the Indonesian case is the low general education standards at all levels of schooling, and a paucity of skilled labour when economic growth began after 1965. Although school enrolments have grown very fast, it is questionable whether the increased supply of graduates has offset rising demand for skilled and professional labour.<sup>13</sup>

<sup>11</sup> Not all governments in the rapidly growing NIEs refrained from direct involvement in wage determination.

<sup>12</sup> The impact of an unequal distribution of land on employment opportunities and incomes has especially been a topic of debate in discussions on the impact of the green revolution in agriculture (see Hart 1986).

<sup>13</sup> On the demand side, it is likely that development has been more skill intensive in Indonesia than in the NIEs at a similar stage of development, particularly due to the greater importance of resource-based industries in Indonesia. One would thus expect a less equal distribution of wage incomes than in other East Asian countries.

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Excerpt

[More information](#)

## 10 *Setting the scene*

### Plan of the book

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The book is divided into four parts.

Part I emphasises both connections with international labour market challenges and trends, and the importance of Indonesia's special historical and institutional environment. At the same time, particular attention is given to the remarkable demographic, social and economic transformation which has underpinned labour market change.

The main aspects of an emerging labour market transition are documented in part II. Not only has labour moved out of agriculture and into higher productivity sectors at an increasing rate, but wage rates began to rise quite steeply in the 1990s and labour markets became much more integrated across activities and regions. Not surprisingly, the process of labour market transformation has been anything but smooth. Thus I document how changing economic circumstances – the oil boom of the 1970s, the subsequent slowdown in economic growth and manufacturing-led export growth from the late 1980s – had quite contrasting effects on employment structure and wages.

Three key labour market challenges are discussed part III. It is argued that while urban unemployment is a pressing social and political problem, it is mainly related to segmented wage and employment structures rather than slow growth in labour demand relative to supply. Industrial relations are another area of controversy. Here the main issues are the impact of tight controls over the labour movement – mainly for political reasons – and attempts to guarantee worker welfare through other mechanisms, such as minimum-wage legislation. Finally, it is argued that Indonesia shares much in common with other East Asian countries in wage and job discrimination against women. Nevertheless relative to men, women have done remarkably well in capturing a larger share of new modern sector jobs, and play a much more influential role in the more skilled segments of the labour market than some commentators would have us believe.

Overall, I conclude that labour market transformation has made a major contribution to rising living standards in Indonesia over the past 30 years. Given economic fundamentals and policies in the mid 1990s, there are no longer grounds for pessimism – which even the most sanguine observers felt when Soeharto came to power – concerning better job prospects for most Indonesians as the country approaches the twenty-first century. Political reforms stalled in the mid 1990s and there are very genuine concerns about equity and the concentration of economic power and wealth in Jakarta among a small number of elite families. But the