Pathways to Middle-Class Jobs in Indonesia

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## Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>Bappenas</td>
<td>Ministry of National Development Planning (Kementerian Perencanaan Pembangunan Nasional)</td>
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<td>BPJS</td>
<td>Badan Penyelenggara Jaminan Sosial</td>
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<td>BPS</td>
<td>National Statistical Agency (Badan Pusat Statistik)</td>
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<td>ERIA</td>
<td>Economic Research Institute for ASEAN and East Asia</td>
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<td>FDI</td>
<td>Foreign direct investment</td>
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<td>GVC</td>
<td>Global value chain</td>
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<td>HHE</td>
<td>Household enterprise</td>
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<tr>
<td>ICT</td>
<td>Information communication technology</td>
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<tr>
<td>Manufacturing Survey</td>
<td>Survey of Medium-Sized and Large Manufacturing Firms (Survei Industri Besar/Sedang)</td>
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<td>MSMEs</td>
<td>Micro, small, and medium enterprises</td>
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<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<tr>
<td>OJK</td>
<td>Financial Services Authority (Otoritas Jasa Keuangan)</td>
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<tr>
<td>PIAAC</td>
<td>Programme for the International Assessment of Adult Competencies</td>
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<tr>
<td>Sakernas</td>
<td>National Labor Force Survey (Survei Angkatan Kerja Nasional)</td>
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<td>SMEs</td>
<td>Small and medium enterprises</td>
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<tr>
<td>SNI</td>
<td>National product standards</td>
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<tr>
<td>STEM</td>
<td>Science, technology, engineering, and mathematics</td>
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<tr>
<td>TVET</td>
<td>Technical and vocational education and training</td>
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<tr>
<td>UNDP</td>
<td>United Nations Development Programme</td>
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<tr>
<td>UNICEF</td>
<td>United Nations Children’s Fund</td>
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“Our dream, our ambition is that by 2045, after one century of Indonesian independence, Indonesia should, Insya Allah [God willing], have escaped the middle-income trap,” President Joko Widodo declared in the opening lines of his inaugural address in October 2019. Indonesia is on its way, with single-digit poverty rates and economic growth averaging 5 percent annually between 1990 and 2018. However, nearly half (47 percent) of Indonesians are stuck just below the middle-class threshold and belong to an “aspiring middle class.” They are neither poor, nor highly vulnerable to becoming poor, but have not reached a level or stability of consumption associated with middle-class status. Indonesia’s jobs situation may be preventing the country from making rapid progress toward realizing its dream.

Jobs have contributed to both growth and poverty reduction. Indonesia created an average of 2 million new jobs each year in the past decade. These take many forms, such as 40-hours-a-week Jakarta office jobs, food stalls run by families, online motorcycle taxi drivers, and subsistence farmers in Papua. In 2018, there were approximately 124 million working youth and adults in Indonesia, the employment rate had reached a two-decade record high, with 67.2 percent of youth and adults in the labor force, and the unemployment rate was at a two-decade low of 5.3 percent.

Despite these encouraging signs, Indonesia is not creating the middle-class jobs needed to fuel a middle-class country. Among the 85 million income earners, only 13 million earn enough to allow a family of four to purchase a middle-class way of life. Further, only 3.5 million wage employees earn above the threshold for middle-class earnings, enjoy full social benefits, such as health insurance and severance pay, and hold an indefinite-term employment contract.

This report posits that Indonesia is currently a story of growth in low-productivity jobs. Jobs are being created, and they fuel the economy, but productivity growth is insufficient to unlock the backlog of people aspiring, but unable, to move up to the middle class. This report explores the factors holding back productivity growth and thus the creation of middle-class jobs, and offers policy levers that could unlock the barriers.

The quest for better jobs is at the top of the government’s policy agenda, and is perhaps even more crucial in 2021, as Indonesia and the world manage the economic fallout of the COVID-19 pandemic. This report provides guidance to help Indonesia “build back better” in the post-COVID-19 recovery phase, and reinvent itself as a middle-income country.

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1 World Bank 2019a
2 Wage employees, casual workers, and the self-employed.
3 The National Labor Force Survey (Survei Angkatan Kerja Nasional; Sakernas) data does not report income for the 15 million unpaid workers or profits earned by the 24 million employers with permanent and/or temporary workers.
Introduction

Since the 1990s, Indonesia has enjoyed Asia-level economic growth rates and a rapid decline in poverty rates. Economic growth averaged 5 percent between 1990 and 2018, in spite of a significant dip during the Asian financial crisis of 1997 and 1998 (Figure O.1). At the same time, poverty fell significantly. While 49 percent of the population was classified as poor or vulnerable to falling into poverty in 1990, by 2018 this had dropped to 30 percent. Nearly half (47 percent) of Indonesians belong to an aspiring middle class. They are neither poor nor highly vulnerable to becoming poor, but have also not reached the level and stability of consumption associated with middle-class status.

4 Using a national poverty line from the National Socioeconomic Survey (Survei Sosial Ekonomi Nasional; Susenas).
5 This report uses the definition of “middle class” found in World Bank (2019a):
A middle-class household has less than 10 percent probability of falling into poverty and vulnerability. The definition is quantified by monthly household consumption at around 3.5–17 times the poverty line. This is equivalent to Rp5,628,124–Rp27,336,602 monthly in 2018 prices.
Jobs have made significant contributions to both economic growth and poverty reduction. Jobs—a job is defined, for the purposes of this report, as any income-earning activity that is not illegal—are the nexus of the production process and the worker (Box O.1). In 2018, there were more than 120 million jobs in Indonesia. The increased number of jobs in the period 2000–17, following the Asian financial crisis, boosted annual GDP per capita growth by 0.5 percentage points (annual GDP per capita growth was 3.9 percent). More importantly, when workers and capital come together in a particularly complementary way, labor productivity can increase and lead to even more economic growth. As in other East Asian countries, increases in labor productivity have been the main driver of economic growth in Indonesia. A decomposition of the sources of growth between 2000 and 2017 shows that increases in value added per worker (labor productivity) contributed as much as 88 percent of Indonesia’s 3.9 percent GDP per capita growth, or 3.5 percentage points per year. Jobs are also the primary source of income for the majority of Indonesians. In spite of some economic volatility, for example the global financial crisis, Indonesia created an average of 2 million jobs each year in the past decade. The employment rate reached a two-decade record high in 2018, with 63 percent of youth and adults working, while the unemployment rate was at a 20-year low of 5.4 percent (Figure O.2).

Jobs come in many forms and some are more conducive to poverty reduction or economic growth than others. For example, a full-time employee who works a standard 40-hour week, collects social benefits, and earns wages commensurate with middle-class consumption patterns is likely to have a job that contributes to both economic growth and poverty reduction. A self-employed individual who, together with family members, runs a successful microbusiness also holds a job. The job may be aligned with poverty reduction, but perhaps not with economic growth. A worker in the gig economy who is not covered by social benefits and has irregular earnings also holds a job, but this job may not help them move into the middle class and may also not contribute to overall economic growth. A middle-class job—defined in this report as a job paying an income that allows the worker’s family to consume a middle-class way of life—can also take many forms. It may be in the formal sector (jobs and firms enrolled in government registries) or the informal sector, it may be located in an urban or a rural area, it may be...

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6 See Figure 3.12 in Chapter 3 of the Technical Report
7 The incomes of the top-income percentiles come largely from nonlabor income, that is, profits and returns on capital. The incomes of the lowest-income percentiles come largely from nonlabor income, that is, cash-transfer programs and social assistance.
8 Employment was 65.6 percent if restricted to adults aged 15–64.
within a large firm or a microbusiness, and it may operate in any economic sector. The main criterion is that it provides a middle-class standard of living. Box O.1 provides the definition of a middle-class job used in this report.

Box O.1 Definition of a Middle-Class Job

For the purposes of this report, a job is defined as any income-earning activity that is not illegal. Thus, a job may be as simple as the work a full-time employee carries out in a factory for a salary, or as complex as a portfolio of income-earning activities carried out by a rural household in a variety of sectors at different times of the year.

A middle-class job is defined as a job that pays a level of wages and gives a certain level of job satisfaction, benefits, and security commensurate with the expectations of a middle-class population. A middle-class job may be a wage job where a firm remunerates a worker in cash (wages or salary of at least the value of the middle-class consumption basket) or in kind (for example, payments for publicly provided social benefits, social insurance, paid leave) in line with a legally binding employment contract. A job may also be self-employment, with the worker earning sufficient profit to enjoy an income and purchase social benefits commensurate with a middle-class life.

To facilitate the empirical analysis, this report uses a simple definition of a middle-class job that can be quantified using data from the National Labor Force Survey (Survei Angkatan Kerja Nasional; Sakernas). Namely, the report defines a middle-class job as one paying at or above a middle-class income, equivalent to Rp3,752,000 monthly (at 2018 prices). This definition necessarily limits our analysis of middle-class jobs to 68.6 percent of all jobs. The Sakernas does not include information on profits earned by employers with workers and it does not impute wages of unpaid workers (whose remuneration likely comes from pooled household income). Indonesia’s Economic Census 2016 does not include job-specific information. Thus, while the analysis of jobs as a whole covers the universe of jobs in Indonesia—approximately 124 million in 2018—the analysis of middle-class jobs covers the 85 million jobs worked by paid employees and the self-employed.

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**a** Following Brummund, Mann, and Rodríguez-Castelan (2016).

**b** The threshold for middle-class consumption is approximately 3.5 times the poverty line per capita. Since some household members do not earn income, a middle-class wage needs to be sufficient to lift the whole household above the middle-class consumption line. Thus, assuming one full-time adult worker and one part-time adult worker (since only half of Indonesian women work) in the household and two dependent nonworkers, the middle-class earnings would be equivalent to (3.5*poverty line)/1.5, or Rp3,752,000 per month in 2018. This is a flat amount applied to all income earners. This assumption does not allow for variation based on household size or composition since there is no information about household characteristics of workers in Sakernas.

**c** The Sakernas does not include information on social insurance and benefits, or contract status enjoyed by the self-employed (23.6 million), casual workers (22.2 million), employers (23.8 million), or the unpaid (15 million). In total, these are equivalent to two-thirds of all jobs. If variables for wages, social insurance and benefits, and contract status were included in the definition of middle class, all these workers would be excluded from the sample because the data are missing. Instead, the detail on social insurance, social benefits, and contract status was sacrificed in order to retain in the sample the self-employed and casual workers.

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Overview
Indonesia is not a story of jobless growth, but insufficient middle-class jobs are being created to fuel a middle-class country. In his inaugural speech, President Joko Widodo stated his ambition that Indonesia would be a high-income country by 2045. Indeed, Indonesia is moving in the right direction: The middle class expanded from 7 to 23 percent of the population between 2002 and 2018. However, Indonesia has not been as successful at moving its workforce up the jobs ladder as neighboring countries. Thailand, the Philippines, China, and Vietnam have seen much faster growth in middle-class jobs. Indonesia’s failure to create sufficient middle-class jobs has resulted in a backlog of Indonesians who aspire to move up to the middle class, but are unable to do so.

The difficulty in creating middle-class jobs is particularly worrisome given that the tailwind of favorable demography will wane over the coming decade as the population begins rapidly to age. For the past five years, economic growth has been partly driven by a young population supplying increasing amounts of labor to the economy. However, this demographic dividend window is beginning to close. Projections suggest that the working-age population as a share of the total population will have peaked by 2025 or 2030, after which the dependency ratio will begin to increase. Indonesia has not benefited as much from the demographic dividend as other Asian countries that have undergone a similar demographic transition. This closing window of favorable demography means that labor productivity, which is aligned with middle-class jobs, will have to become an even more prominent driver of future economic growth.

The COVID-19 pandemic may further delay Indonesia’s quest for middle-class jobs. This report was begun a few months before the first Covid-19 case in Indonesia was officially announced (on March 2, 2020) and was completed as the virus continued to disrupt Indonesia’s economy, as well as economies worldwide. The total impacts of the pandemic on jobs may be deeper than those of the Asian financial crisis, since the pandemic is affecting across the board both the demand and supply sides of the market. Someone who has lost their job, left education, or closed their small firm will struggle to recover. Further, the COVID-19 situation continues to evolve, making it difficult to fully understand the impacts. While this report focuses primarily on the medium- and long-term horizon, it also provides reflections on how the COVID-19 disruption may be leveraged to enable Indonesia to build back better by introducing structural changes with long-term benefits for middle-class jobs.

9 The dependency ratio is the share of the population who are not of working age (aged 0-14, and 65 and above) relative to the economically active population.
Box O.2 A Transition Interrupted

The COVID-19 pandemic is expected to continue to have deep impacts on the economy. Indeed, after several years of strong growth, Indonesia’s GDP fell 2.1 percent in 2020, although this was a smaller downturn than in other countries in the East Asia Pacific region, except China and Vietnam. This partly reflects good policy choices, less restrictive containment measures, and the diversified structure of the economy. Indonesia’s GDP decline related to COVID-19 was much smaller than the 13-percent decline it experienced in the Asian financial crisis of 1997 and 1998. However, the pandemic is expected to continue to manifest itself through several channels and thus to continue to have deep and widespread negative effects.

First, the crisis triggered by COVID-19 is a broad-based economic crisis. Some industries, such as mining, plantations, tourism, and some labor-intensive manufacturing industries, have been affected by the external shock, with demand drying up. Other industries, such as trade, transport, and hotels and restaurants have been affected by domestic restrictions on movement. Most sectors have been somewhat or severely affected by global and domestic measures to contain the virus. The handful that have not been so affected include those providing certain medical goods and services, e-commerce, and less contact-intensive activities such as finance, education, communications, and telecommunications. Firms across the board are feeling the impacts, and this includes firms operating in sectors in which middle-class jobs are clustered.

Second, sectors in which mostly urban microbusinesses trade, including offline low-end food and beverages and motorcycle ride-hailing transportation, have been severely hit. These enterprises have little inventory or savings, and limited access to financing. With social distancing measures, many have failed. Providing financial support to these urban businesses is difficult since a large share of the self-employed, of daily-wage workers, digital gig workers, and microenterprise owners operate under the radar. The COVID-19 government assistance programs that are aimed at formal workers and firms have limited effect on these informal workers and enterprises. Consequently, the government introduced COVID-19 assistance programs aimed at informal workers and firms; programs include direct cash transfers for ultra-microenterprises and microenterprises (Banpres Produktif Usaha Mikro) and credit restructuring programs, including for drivers working via ride-hailing apps. While these sectors—self-employment, jobs paying daily wages, digital gig workers, and microenterprises—are not a significant source of middle-class jobs, the COVID-19 crisis may slow the

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a For example, Indonesia is less dependent on the sectors that were hit hardest by the pandemic, including tourism. Indonesia is also less integrated into the global production network compared to its regional peers. See, for example, Ing and Kimura (2017).

b Much of the comparison in this report with the Asian financial crisis is based on an understanding of transmission channels. Quantitative analysis has not yet been carried out.

c They are not in government systems such as tax or social security.

d For example, tax measures or exemptions from making social security payments.
progress of workers holding these roles in moving up to middle-class status. The pandemic has also reduced demand for waged jobs in the formal sector and increased the number of unpaid family and casual jobs.

Third, small and medium enterprises (SMEs), especially young SMEs, continue to be at risk. These firms have lower levels of capital and little access to the financing that could help them through a period of shutdown. Indeed, among medium-sized and large manufacturing firms, it was the smaller firms that disappeared during the Asian financial crisis and never recovered at scale, limiting the dynamism and job-creation potential of young innovators over the past few decades. If SMEs fail in large numbers again, progress to middle-class jobs may also stall. Based on a representative firm-level survey conducted in June and October 2020, smaller firms have indeed been hit harder in terms of average year-on-year change in monthly sales.

Fourth, net job destruction and declining family incomes leave potentially long-lasting impacts, particularly for youth (aged 15–24). Many have had to mix school with work, which has disrupted their learning. Between August 2019 and August 2020, 300,000 jobs were destroyed (in net terms), compared to 2.47 million jobs created (in net terms) between August 2018 and August 2019, and about 2 million jobs created every year on average in the decade from 2008 to 2018. The pandemic has impacted the 7 million new graduates (including university and high-school graduates)—part of the so-called “Generation COVID-19”—who are ready to enter the labor force. Youth were delayed in entering the labor force; in 2020, about 300,000 fewer youth entered the labor force compared to 2019. Not only has the pandemic caused increased numbers of youth to take on work alongside their schooling, there has also been an increase in youth idleness (those not in employment, education, or training). The increase in employment rates among youth was especially concentrated among those of high-school age (15–18 years old), who are likely to be working as unpaid family workers. This pattern holds even for youth working full time (at least 20 hours a week): the increase was especially concentrated among those of high-school age. The effects are similar for boys and girls. This may mean interrupted learning (combining schooling with full-time work) for these children of high-school age. Moreover, graduates starting work in 2020 earned less than their older cohort.

A somewhat extensive literature finds that entering the labor force during economic downturn comes with several issues: it is harder to find a job and this becomes a vicious circle, partly because people lose skills when they are not working; consequently, it leads to many years of lower wages.

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\*World Bank 2020c
\*World Bank 2020d
\*Pradana, Hadiwidjaja, and Posadas 2021
\*Halim, Hambali, and Purnamasari. Forthcoming
Job losses and falling household incomes could also affect human capital investment in children. Fifth, women have been entering the labor force for the first time as “added workers,” meaning that they are taking on (low-quality) jobs to help compensate for the reduced income or job loss experienced by another member of the household. By August 2020, around 5.1 million workers had lost their jobs (both temporarily and permanently) due to COVID-19, while another 24 million (one in five employed workers) had experienced a reduction in working hours (and presumably, income). Previous economic crises have shown that other family members begin to work to compensate for lost income. By August 2020, six months after the pandemic hit Indonesia, the crisis had led to negative net employment impacts for men of all ages, but positive net employment impacts for women, except those in the early childbearing years (19–29 years old). This indicates that women with caring responsibilities may have some constraints on their ability to engage in labor market work. Both men and women with children aged under five were less likely to be employed compared to their counterparts without children aged under five, but the gap is much larger for women. The increase in the employment of women is proportionate to the decrease in the share of women outside of the labor force and to the increase in the share of women working who had no prior job experience. In other words, women entered employment for the first time as added workers. Evidence also suggests that these female added workers took up low-quality jobs. The question now is whether these low-quality jobs could be a stepping-stone that will allow these women to permanently enter the labor force, a longer-term change.

Sixth, with a large number of firms in distress, many laid off workers. Workers and firms will need to go through a massive rematching process. However, Indonesia does not have the labor market information or matching tools to facilitate this. This may cause labor market frictions, delay the process of reemployment, and prolong the recovery in jobs.

By August 2020, the share of middle-class jobs had declined by about 5.2 percentage points compared to August 2019. This trend, if not reversed, threatens the gains Indonesia has made in the last 30 years of structural transformation toward better-quality jobs. However, this crisis may open new opportunities for accelerated transformation in some areas, especially when combined with digital adoption, innovation, and training (upskilling and reskilling) in digitally enabled sectors such as e-commerce.
Notably, the report does not include agricultural jobs, but instead refers the reader to the recent publication *No One Left Behind: A Multilevel Approach to Tackling Rural Poverty in Indonesia* (World Bank 2020e).

The highest levels of government recognize the importance of middle-class jobs for Indonesia and have given unprecedented attention to policy reform to this end. President Widodo’s inaugural speech also addressed elements of the jobs puzzle: the need to develop a “workforce that is hard-working, dynamic, skilled . . .” and for Indonesia to transform economically to become “a competitive and modern manufacturing and service-based economy that has high added value for the prosperity of the nation . . . for all Indonesian people.” He asked policymakers to prioritize legislative reforms to enable this vision, which will be even more crucial in the post-COVID-19 context.

While the policy making for better jobs is rapidly advancing, the empirical foundations needed to inform policy development are incomplete. Indonesia is home to a large intellectual community that is exploring the many facets of job creation. However, jobs are, by nature, a multisectoral challenge and levers in one sector may have complementary or conflicting effects on other sectors. Thus, effective and efficient policy to shift Indonesia away from an equilibrium based on low-quality jobs and toward one based on middle-class jobs must be built on a holistic, multisectoral foundation that identifies the commonalities and makes conscious choices about trade-offs.

This Overview presents a cross-sectoral narrative about the current jobs situation and the policy framework that is needed to spur the creation of middle-class jobs toward a middle-class Indonesia. It draws from sector-specific empirical analysis of the macroeconomy, and of firms and workers; the empirical analysis is presented in a companion technical report. The Overview is intended to give a broad picture of the challenge of creating middle-class jobs, identify potential policy priorities, and map out initial actions to move a complex agenda. The preparation of the report overlapped with the COVID-19 crisis. While it refers to the economic crisis caused by the pandemic, it primarily looks toward a post-COVID-19 period of rebuilding better.¹⁰
Interrupted Structural Transformation and the Decade of Hollowing Out

Indonesian labor markets still need further structural transformation to create higher-productivity jobs that offer higher earnings. Since the 1980s, Indonesia has undergone two periods of structural transformation, both of which have had significant impact on jobs. The first wave of structural transformation took place in the 1980s and 1990s, until it was brought to a halt by the Asian financial crisis. Over that period, Indonesia experienced a shift of workers out of agricultural jobs and high poverty and into higher-productivity jobs—especially in manufacturing as Indonesia was industrializing—with greater earnings. The second wave, which occurred after the Asian financial crisis, was characterized by a continued flow of workers out of agriculture, but into services with low levels of value added, with few productivity gains and lower wage gains than seen during the pre-Asian financial crisis transition to manufacturing.
The structural transformation of the 1980s and 1990s portended a middle-class Indonesia by 2018. In this period, Indonesia industrialized rapidly by growing its manufacturing exports. Indonesia was able to attract investment in labor-intensive industries such as textiles and food by bringing in broad reforms designed to create a business-friendly climate—such reforms included measures to build financial openness—in conjunction with a large labor surplus. Manufacturing, other nonmanufacturing industries, and services contributed equally to growth in value added between 1990 and 1997 (Figure O.3). By 1996, manufacturing exports accounted for half of the total value of exports. Manufacturing employment boomed (Figure O.4), reaching 18 percent of all employment in 1999. These trends, which marked the first phase of structural transformation, came to an abrupt halt with the Asian financial crisis of 1997 and 1998.

After the Asian financial crisis, Indonesia’s economy shifted to a natural resource–based growth model, and the low-value service sector became the single largest source of economic and job growth. Economic growth rates in all sectors fell relative to the high rates registered in the 1990s, but remained at a respectable 6 percent between 2000 and 2008. The pivot to resource-driven and non-labor-intensive (and noninclusive) growth was not conducive to continued growth in the quality of jobs. By 2000, the share of total employment attributable to manufacturing jobs had fallen to 13 percent. With few backward or forward links between the commodities sector and local economies, and rapid urbanization, low value-added services grew to fill the gap, becoming the single largest source of job growth. Although nonagricultural jobs proved more lucrative than agricultural jobs, the crowding of people into low-productivity service roles led to income gains that were insufficient to shift workers out of vulnerability and economic insecurity and into the middle class. The disconnect between the sectors, firms, and occupations in which value is created, and those in which most people make a living, held back Indonesia’s development potential and its path toward middle-class jobs.

The return to a dependence on exported natural resources resulted from several factors, including the negative impact of the Asian financial crisis (1997–98) which hurt manufacturing, the dominance of China in low-cost, labor-intensive manufacturing, the global increase in demand for (and prices of) commodities in abundance in Indonesia, in particular coal and palm oil, a sharp appreciation in the real effective exchange rate, which hurt manufacturing competitiveness, and weaknesses in the business environment including insufficient infrastructure, low skills, an unfavorable regulatory framework for foreign direct investment (FDI), and “big-bang” decentralization that caused many regulatory uncertainties at the local level and further limited Indonesia’s competitiveness (see also World Bank [2014]).

Interrupted Structural Transformation and the Decade of Hollowing Out

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As the commodity boom came to a halt post 2012, Indonesia entered a period of insufficient productivity growth and thus a slower path toward middle-class jobs. Growth rates in nonmanufacturing industries and services fell, and manufacturing growth slowly began to pick up in an economy crowded with low-value services (also called low value-added services) and a small number of very large and very old firms. “Structural Transformation 3.0” thus began with the resumption of manufacturing employment. The share of total employment attributed to the manufacturing sector had reached 15 percent by 2018, but remained below levels registered before the crisis of 1997 and 1998. Labor productivity in manufacturing increased at a slower rate than in the agriculture and low-value service sectors (see Figure O.5 in section 3). The Asian financial crisis killed off many younger and smaller firms among medium-sized and large manufacturing firms and the business environment immediately following the crisis deterred new firms from entering. As a result, large and old manufacturing plants played the dominant role in the recovery from the crisis. Firm dynamism mostly came from old plants as they expanded (jobs created) or contracted (jobs destroyed) their workforce, rather than from new plants (jobs created) or closing plants (jobs destroyed). Labor productivity growth in industry was mostly driven by productivity increases within firms rather than dynamic reallocation of workers from less- to more-productive firms. By 2018, two in three workers were employed in sectors with comparatively low levels of labor productivity. In other words, Indonesia’s jobs challenge was not “jobless” growth; it was “insufficient productivity” growth.
Low Job Quality in Indonesia

Relative to comparators—and competitors—in Asia, such as Malaysia, Vietnam, Thailand, and the Philippines, Indonesia’s labor productivity is low and has fallen in major sectors over time. Although value added per worker—a proxy for labor productivity—increased as much from 2010 to 2018 as it did from 2000 to 2010, the sources of labor productivity growth shifted. More specifically, growth of value added increased in agriculture, where jobs were destroyed, but fell in nonagricultural sectors, in particular manufacturing and services with high levels of value added (high value-added services) (Figure O.5). The productivity levels of Indonesian workers put them at a disadvantage relative to regional competitors. For example, value added per worker in Indonesia in finishing, spinning, and weaving textiles is half the value added per worker in Vietnam and one-quarter of that in Thailand (Figure O.6).
Low growth of labor productivity is harming Indonesia's international competitiveness. Even though market wages in Indonesia are below those of Thailand, for example, low productivity means that unit labor costs\(^{12}\) are higher in Indonesia than Thailand. Moreover, unit labor costs have continued to increase more rapidly in Indonesia than in comparator economies, even though the increase in labor costs per hour in Indonesia has been low compared to these other economies (Figure O.7). Thus, the loss in competitiveness may have had less to do with growth in labor costs and more to do with losses in labor productivity. More research is needed to confirm this.

12 Unit labor cost is defined as labor compensation (or wage) per one unit of production. An increase in labor compensation (wages) will increase the unit labor cost, while an increase in labor productivity will reduce the unit labor cost.
Today’s jobs are clustered in low value-added occupations and sectors. Two-thirds of jobs fall into three occupational categories: sales and services, including shop and stall salespeople and restaurant workers (24.7 percent); agriculture, livestock, forestry, and fisheries (22.5 percent); and elementary occupations such as low-skill agricultural work, street vending, cleaning, and message delivery (18 percent). These are Indonesia’s lowest-paid occupations and they have the lowest productivity levels in the Indonesian economy. Elementary occupations are also the fastest-growing occupational category. Broken down by sector, the largest economic sectors by employment are agriculture and wholesale and retail trade, with manufacturing coming in a close third. Half of the growth in jobs during 2007–18 has been in low-end, low-wage services, namely wholesale and retail trade, accommodation, food and beverages, and other services. On a positive note, manufacturing employment—which tends to be more productive and have higher wages than jobs in low-value services—has shown signs of recovery since 2015.

Most jobs in Indonesia are not covered by a work contract, do not pay a middle-class wage, and do not offer social benefits. In 2019, 38.2 percent of all workers owned their own business, with over half (25 million) reporting that they were self-employed and the majority of the remainder hiring only temporary employees. Most of these businesses were in low-value sectors, including (in decreasing order by share) informal retail trade of food and beverages, food stalls, and motorcycle ride-hailing transportation. By definition, a self-employed worker does not have a work contract or receive social benefits. Among the self-employed, only 9 percent earned at least a middle-class income. Among the 49 million wage employees in the Indonesian labor force in 2018, 22.7 percent had a permanent contract, 21.1 percent earned at least a middle-class income, and 15.8 percent received full social benefits. Only 7 percent had all three, meaning they earned at least a middle-class income, had a permanent contract, and received full social benefits.

14 Sakernas does not provide earnings information for employers who are not self-employed.
15 See Figure 5.25 in Chapter 5 of the Technical Report.
Jobs in the formal sector and those held by wage employees are more aligned with middle-class earnings than are informal jobs or self-employment, though all job types can be a pathway to middle-class status. Between 2011 and 2018, two-thirds of the increase in the share of middle-class jobs was contributed by wage employment alone; the remaining one-third was contributed by casual jobs and self-employment, except self-employment in the agriculture sector. Formal-sector employment contributed almost three-quarters of the increase in the share of middle-class jobs, with formal employment in industry and services alone contributing almost two-thirds. Indeed, wage employment in industry is the job type-industry combination most aligned with an increase in middle-class jobs.

To achieve economically secure jobs and higher incomes, it is recommended that Indonesia move toward a productivity-driven growth model that creates value added and jobs, and that facilitates movement of workers into more-productive jobs, within and between firms and sectors. This requires a three-pronged strategy. First, Indonesia could support productivity enhancements in all sectors, including the low-productivity sectors that house the majority of jobs. Second, Indonesia could advance the structural transformation process by enabling firms and workers to shift toward high-value manufacturing and services. Third, Indonesia could support a workforce transformation to prepare a highly capable workforce for and integrate it into productive jobs. Section 4 of this Overview discusses the first and second strategies, while Section 5 addresses the third.
Most labor productivity growth during 2000–17 came from within sectors rather than from movements between sectors. Efficiency gains within the main sectors—agriculture, industry, and services—accounted for 2.5 percentage points of labor productivity growth per annum, or about two-thirds of total labor productivity growth per annum. In terms of absolute growth, the contribution of within-sector productivity growth to growth in overall labor productivity aligns Indonesia with Asian comparators (except China) (Figure 0.8). Indonesia differs from its comparators in that it shows limited productivity growth emerging from movement between sectors, namely structural transformation. The total contribution of structural change to Indonesia’s labor productivity growth, 0.9 percentage points, was smaller than in Vietnam (2.2 percentage points), Thailand (1.3 percentage points), and China (1.1 percentage points)—all countries that have, in the recent past, experienced a faster expansion in the middle class than Indonesia.

16 See Chapter 3 of the Technical Report
The within-firm effect captures the impact of productivity growth within individual plants on aggregate productivity in the economy. A positive within-firm effect means that individual productivity of the plants is increasing, which may be driven by their capacity to innovate, by increased efficiency, or by overcoming credit constraints, for example.

Between-firm effect (static reallocation): The between-firm effect captures the impact of the reallocation of employment across plants. A positive between-firm effect means that aggregate productivity rises because workers are moving to plants displaying higher-than-average productivity or that workers are leaving plants displaying lower-than-average productivity.

Cross-firm effect (dynamic reallocation): The cross-firm effect captures the impact of reallocation of employment into plants exhibiting growing productivity. A positive cross-firm effect means that aggregate productivity is increasing because workers are moving to plants displaying higher-than-average productivity growth or workers are leaving plants displaying lower-than-average productivity growth.

The entry effect is the sum of the differences between each entering plant’s productivity and the average productivity in the sector prior to that plant’s entry, weighted by the market share of each entering plant. A positive (negative) entry effect results if the entrants are more (less) productive than the average incumbents.

Average annual labor productivity growth among medium-sized and large manufacturing businesses was mostly driven by the within-firm effect between 2000 and 2015, in part due to muted firm dynamism, with very few between- and cross-firm effects, although the entry effect is still indispensable. Overall, average annual labor productivity growth between 2000 and 2015 was low, less than 1 percent (0.54 percent). Around 0.32 percentage points of average annual labor productivity growth in this period came from the within-firm effect, while 0.23 percentage points came from the entry effect. Only 0.04 percentage points came from the between-firm effect, while the cross-firm effect contributed negatively to labor productivity growth. Evidence suggests that allocative efficiency (indicated by the positive correlation between productivity and firm size) is declining in terms of labor productivity, but increasing in terms of total factor productivity and unchanged in terms of capital productivity.
Two fundamental strategies can pull firms and workers back onto a productivity growth path. First, productivity growth can be fostered within large sectors that have low levels of value added, namely agriculture and low value-added services (Figure O.9). While it may be attractive to focus a jobs strategy on the development of high value-added jobs, this will have limited success in the short term. Low value-added farming and activities in trade, accommodation and food services, and personal services account for the majority of Indonesia’s employment. These jobs require a skill level that is commensurate with the skills possessed by a majority of the working-age population; the sectors are also a significant source of jobs for both women and men. Though jobs in these sectors are low wage, they were instrumental in drawing people out of poverty and, to a lesser extent, into the middle class during 2011–18. Further increasing the productivity of these jobs—including those in agriculture—from the current low base is essential if economic insecurity is to be reduced.

Second, employment growth should be fostered in more-productive and better-paying jobs, firms, and sectors, namely in manufacturing and high value-added services. Workers should be helped to move into these firms and sectors. Not all sectors, firms within sectors, or jobs within firms offer the same job quality. Some have the technologies, market share, and organizational management that lead to labor productivity growth and profit sharing with workers. Others are locked in a low-level equilibrium that is inherent to their sector or firm type (Figure O.9). A concerted effort to nurture and grow these sectors, firms, and jobs will yield long-term gains and eventually draw workers out of low-skill jobs. Potential poles of growth in job productivity are manufacturing and high value-added services sectors, dynamic and outward-oriented domestic and foreign (manufacturing) firms, and the workers who will transform them.

Figure O.9 More and Even Better Jobs: Structural Transformation 3.0
Relative productivity and share of employment 2018, and directions for the future

Source: World Bank staff calculations using data from the BPS and Sakernas. Relative productivity = sector share of value added/sector share of employment.

Note: Dark green arrows represent the shift in employment; light green arrows represent the shift in productivity. The BPS is Indonesia’s National Statistical Agency (Badan Pusat Statistik). Sakernas is the National Labor Force Survey (Survei Angkatan Kerja Nasional).

20 For example, jobs in wholesale and retail trade, and restaurants and hotels were responsible for a quarter of the increase in middle-class jobs between 2011 and 2018.
4.1 In the Short Run, Manufacturing Offers Viable Opportunities for Quality Job Growth; Indonesia Nurtures Higher-Value Sectors for the Long Run

*Indonesia's nonmanufacturing industries*[^1] are unlikely to be sources of productivity-driven job creation. In spite of their significant contribution to value added (21 percent of the total), they are capital intensive and have limited capacity to absorb labor (mining and utilities). The construction sector may be able to create jobs as investment in infrastructure increases, but it provides very few jobs with middle-class income levels or indeed with any other aspects of middle-class jobs, such as worker protection. The construction sector is also male-dominated and unlikely to create jobs for women.

The manufacturing sector is a good candidate for creating productivity-driven middle-class jobs in the short run. Manufacturers, especially the medium-sized and large, provide comparatively "good" jobs in Indonesia as they offer wage employment and higher wages than agriculture or low value-added services. Unlike the high value-added service sector, however, most manufacturing jobs require a skill level that is aligned with that of the Indonesian workforce, namely a lower-secondary education. The manufacturing sector is a viable source of quality jobs for women, who currently make up 45 percent of the sector’s workforce.[^2] In spite of the manufacturing sector’s slow rebound in the post-2010 period, it was the primary contributor to the increase in the share of middle-class jobs during 2011–18.

Higher value-added service sectors such as information communication technology (ICT) or finance have the potential to grow and create modern and highly paid jobs, but the overall effect will be limited over the medium term. While jobs in high value-added services (and utilities) grew quickly in the decade from 2008 to 2018, also indicating further job prospects in the long term, these sectors employ an educated workforce and cannot be counted on to absorb a major share of today’s workers, most of whom have low skill levels. Moreover, growth started from a low base, so high growth rates mask the small number of total jobs in these sectors. In fact, financial services, real estate, business services, and ICT do not account for a major share of employment even in high-income countries, though they may account for significant shares of GDP in some. Public administration, defense, and education are the sectors with the largest number of middle-class jobs if social benefits and contract status are taken into account, but the supply of these jobs is limited and not subject to

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[^1]: In this context, "industry" means manufacturing, mining, construction, and utilities.
[^2]: World Bank staff calculations using data from Sakernas.
market forces. Thus, investments in high value-added service sectors should be encouraged in the short run, but with the understanding that returns will not be immediately observed.

**Household enterprises (HHEs) can be sources of middle-class jobs.** In 2018, about 22 million owners of HHEs reported that they were self-employed. These small and often family-run businesses can take many forms: pushcarts selling food such as fried rice, online motorcycle taxis, local laundries, small motorcycle repair shops, or even a physician’s private practice. Women are more likely than men to be HHE owners in urban areas. The majority of HHE owners started out because they wanted to run their own businesses (62 percent), were motivated by a desire to be independent (44 percent), were seeking work-life balance (24 percent), or wanted higher earnings than those offered by wage employment (18 percent). Only one-fifth of HHE owners started a business because they could not obtain a salaried job. About 9 percent of self-employed HHE owners report earnings above the cutoff for middle-class wages, as compared to 15 percent of all income earners. Although the average earnings of self-employed HHE owners are on par with casual employees—partly due to the lower level of education of self-employed HHE owners as compared to wage employees—the range of earnings is much broader than that of wage employees. In other words, there are self-employed HHE owners who earn more (and less) than employees of any type, lifting some above the middle-class earnings cutoff and leaving others far below it.

However, this path toward middle-class jobs is constrained by the low productivity of most HHE. The owners of HHEs face constraints to increasing their productivity and thus to increasing their earnings: limited education, limited use of good business practices, limited experience as an entrepreneur, and limited use of the internet. Owners of HHEs highlight further factors that also constrain their productivity: the high price of rent, lack of access to loans or credit, excessive offline competition, and lack of skills/knowledge.
4.2 Dynamic Firms with an Outward Orientation Create Jobs and Create Middle-Class Jobs: A Case Study of Medium-Sized and Large Manufacturing Firms

*Medium-sized and large manufacturing firms that export more of their products tend to offer higher wages, a reflection of higher productivity.* Higher export growth is associated with higher labor productivity growth. Moreover, firms do share productivity gains with workers. Across plants, a 10 percent increase in labor productivity (real value added per worker) is correlated with real wages that are 2.14 percent higher than in firms with no increase in labor productivity. Domestic firms share more of their profits with their workers than do foreign-owned firms, offering wages that are 2.1 percent higher for a 10 percent increase in productivity as compared to a 1.3 percent wage premium paid by the more productive foreign firms. More broadly, wages track firm productivity, with a correlation of 0.68.

*Contrary to assumption, in the manufacturing sector higher productivity and greater export shares are associated with higher employment.* On average, higher labor productivity does not come at the expense of jobs in Indonesia’s medium-sized and large manufacturing firms. The positive association between labor productivity and employment growth can be explained through lower production costs (especially unit labor costs), greater competitiveness (ability to undercut a competitor’s price), and market expansion. The more productive firms are also using their productivity gains to expand the workforce rather than cut jobs. In other words, the expansion effects have dominated substitution effects.

*Labor productivity and real wages tend to be higher in heavy or capital-intensive manufacturing subsectors, but employment is lower.* Manufacturing subsectors with both low productivity (Figure 0.10) and low wages (Figure 0.11), such as apparel, textiles, and food and beverages, have high shares of employment, while subsectors with high productivity and high wages, such as chemicals, motor vehicles, and other transport equipment have low shares of employment. This suggests a trade-off between employment and labor productivity at the industry (subsectoral) level, while at the micro, firm level, employment growth and labor productivity growth go hand in hand. This could be due to the fact that the heavy or capital-intensive manufacturing subsectors are still

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28 See Chapter 4 of the Technical Report. The discussion is limited to medium-sized and large manufacturing firms since there are no robust data available for other sectors.

29 The authors use definitions of productivity growth at the plant level from David and Haltiwanger (1992 and 1996). See Figure 4.24 in Chapter 4 of the Technical Report.

30 See Figure 4.15 in Chapter 4 of the Technical Report.
relatively small (in terms of employment share), compared to the light or labor-intensive manufacturing subsectors, and could still potentially grow.

**Manufacturing subsectors that are the biggest employers pay sub-middle-class wages.** Some large firms operating in heavy, high technology, or capital-intensive subsectors, such as other transport equipment, pay middle-class wages on average. Large firms in other heavy or high technology or capital-intensive subsectors, namely computers, electronics, optical, base metals, electrical, motor vehicles, and chemicals, pay the next highest average (nominal) wages. Labor-intensive sectors that provide the most employment in industry, including food and beverages, tobacco, textiles and textile products, and footwear pay wages that are much lower than the middle-class population’s expenditure cutoff on average.

**Moreover, Indonesian manufacturing plants are aging as, in the period immediately following the Asian financial crisis, fewer plants opened and few young plants survived.** The Asian financial crisis seemed to deter new firms from starting up, while destroying younger and smaller firms. By the time the crisis had passed, larger firms dominated manufacturing, and many were also old. Smaller firms (fewer than 50 employees) and firms younger than 10 years old were more likely to exit during the Asian financial crisis than older and larger firms. During the Asian financial crisis and the global financial crisis of 2008, firm start-ups slowed significantly. Hiring by new firms was already low even before the Asian financial crisis. Although there has been a surge in the number of young firms, and somewhat in hiring, since 2013, the number remains below the pre-1993 level on average. All of this was exacerbated by the aging of manufacturing plants, which had started even before the Asian financial crisis. Post Asian financial crisis, firm dynamism was mostly coming from surviving plants with most jobs created and destroyed within surviving plants, rather than from new plants (job creation) or plants closing permanently (job destruction). Perhaps more worrisome, though, is the lack of dynamism in the firm sector, which may be a sign of market capture or a lack of competition, and which allows firms with low levels of productivity to survive, hinders innovation, and negatively affects the prospects for upgrading jobs or creating higher-quality jobs.

**Figure O.10 Employment Declines as Productivity Increases**

*Share of employment versus productivity (relative to the apparel sector)*

(Source: Manufacturing Survey 2015; World Bank staff calculations)

**Figure O.11 Employment Declines as Wages Increase**

*Share of employment versus real wage (relative to the apparel sector)*

(Source: Manufacturing Survey 2015; World Bank staff calculations)
4.3 Foreign Manufacturing Firms Consistently Create Higher-Quality Jobs, Especially for Women\textsuperscript{31}

Medium-sized and large manufacturing plants that are foreign owned tend to generate more jobs, and pay higher wages on average. Foreign-owned firms add labor at twice the rate of domestically owned firms (an average of 10 workers per year, compared to 5 workers in domestically owned firms). Further, 30 percent of foreign firms pay middle-class (average) wages compared to 16 percent of domestically owned manufacturing firms. That said, the higher wages and employment are attributable to the higher labor productivity of foreign firms. Controlling for labor productivity, foreign firms pay similar wages and have similar employment growth patterns as domestically owned manufacturing firms.

Manufacturing foreign direct investment (FDI) is associated with a skill premium, with the wage premium increasing for more-skilled workers. However, this skill premium is only significant in low-skill manufacturing sectors. If broken down by gender, only women, especially those working in low-skill sectors, earn a wage premium.

Foreign-owned plants contribute directly and indirectly to employment. Vertical technology or productivity spillovers can occur through links with domestic suppliers and customers. Horizontal spillovers (to competitors) occur through demonstration or imitation effects and through the increased competition that can spur innovation. These technology spillovers are far from automatic, however, and depend on the strength of links, the types of firms, and domestic absorptive capacity, for example. District-level analysis of the local effects of manufacturing FDI in the period 2007–15 shows that when a foreign-owned manufacturing firm establishes itself in a district, total employment in the district increases by 0.4 percent. Extrapolating to the national level, manufacturing FDI may have created some 4.6 million additional jobs between 2007 and 2015, of which two-thirds were in the manufacturing sector itself. Manufacturing FDI can accelerate structural transformation in Indonesia by changing the employment and output structure and affecting employment and productivity broadly in the economy.

\textsuperscript{31} See Chapter 3 and Chapter 4 of the Technical Report.
4.4 The Difficult Transition to Sectors and Firms that Create Middle-Class Jobs

Structural transformation needs workers to accompany the sector and industry growth, but labor does not flow seamlessly. Better job matches can be a pathway to middle-class jobs. Skills mismatches between old and new sectors, poor information flows about new job opportunities, the psychological costs of leaving a job, the opportunity cost of severance pay that is tied to job tenure, the absence of job-search support—for example, unemployment insurance—following voluntary redundancy, and the monetary costs of changing jobs all impede a worker’s movement up the job ladder. The most recent estimates available use data from 2007 to calculate labor mobility costs in Indonesia; they are estimated to be 2.8 times the average annual wage, among the highest in a 47-country study.32

The factors that contribute to high labor mobility costs are exacerbated in Indonesia where skill levels are low, information about vacancies is primarily derived through social networks, and internal migration is limited relative to movements in neighboring countries. As a result, labor mobility is lower than optimal. While skills gaps are an important constraint to labor mobility, transitions are also low between sectors with similar (and low-to-medium) skill requirements.

Indonesian jobseekers rely on limited information sources, likely resulting in poor job matches. Nearly 90 percent of jobseekers turn to family or friends for information about job vacancies. Less than 40 percent use other methods, such as responding to job advertisements in print or electronic media, directly contacting firms to find out about job opportunities, or registering in a job-search service. Women are particularly likely to use informal job-search methods. Skills mismatch—meaning that people are not in the right job for their skill set—is on the rise. In 2016, 1 percent of urban workers with at least a Bachelor’s degree or equivalent who had left a job in the past year reported that they did so because they felt that the job was not commensurate with their skills; by 2018, this had increased to 5 percent.33

32 Calì, Hidayat, and Hollweg 2018
33 Sakernas August 2016-18; World Bank staff calculations
Labor legislation could be improved to play a larger role in improving job quality. International literature shows that well-designed minimum wage policies can lift the wages of the poorest and, in some cases, have (muted) spillover effects on workers who earn higher wages. However, Indonesia’s minimum wages do not uniformly increase the wages earned by the poorest, with 43 percent of employees earning below the minimum wage of the province in which they work. Similarly, well-designed labor legislation such as paid maternity and paternity leave, limits on work hours, protection from unfair dismissal, and equal rights in the workplace can protect workers on the job without causing harm to firms. The policy challenge is finding the balance between setting a minimum wage that is well defined and understood by workers, but not so high that firms want to evade, and labor legislation that protects workers while not overburdening firms. The Omnibus Law on Job Creation (Law No. 11/2020) is introducing new processes for setting minimum wages and is modifying other labor legislation in an effort to strike a better balance between worker protection and labor market flexibility.

34 Cunningham 2007; Del Carpio and Pabón 2014
35 Hohberg and Lay 2015; Alatas and Cameron 2008; Harrison and Scone 2010; Chun and Khor 2010
36 An additional challenge is to improve compliance; see Weber and Kudo (2020).
Building a Middle-Class Workforce

Most workers in today’s workforce in Indonesia are not equipped to hold a middle-class job. Middle-class jobs tend to be in occupations requiring higher skill levels—managers, professionals, and high-level technicians and associates in manufacturing and services industries—and strong cognitive, interpersonal, and digital skills, as well as knowledge in science, technology, engineering, and mathematics (STEM), and business administration. However, 57 percent of the labor force has a lower-secondary education (nine years of school) or less. This is on par with middle-income East Asian countries, but Indonesia’s labor force has acquired fewer skills relevant to the labor market than its educational level might suggest. An Indonesian child entering the education system today can expect to complete 12.4 years of schooling, but will only learn the equivalent of 7.8 years due to the poor quality of many Indonesian primary and secondary schools, as well as limited availability of early childhood education.  

38 Interpersonal skill is the ability to manage people and relationships in order to successfully perform a range of tasks.  
39 Human Capital Project 2020
Standardized tests of adult skills conducted in 2014 and 2015 rank Indonesia last among OECD and middle-income countries; Indonesia's best performers score worse than the average performer in the OECD workforce. The wage premium for each additional year of education is 6.7 percent in Indonesia, compared to 10.4 percent for East Asia and 10 percent for Vietnam. Nearly 14 percent of firms interviewed in the Doing Business 2015 survey in Indonesia report that “workforce education” is a major or severe obstacle to doing business, as compared to 8.4 percent of employers in the Philippines and 2.5 percent in Thailand. There is a particularly severe shortage of the skills needed for more-skilled occupations, including managerial roles.

The clustering of middle-class jobs in urban areas is partly due to educational attainment and agglomeration effects. A one-year increase in the average education level in Indonesia leads to a 10 percent increase in high-skill wages and a 2 percent increase in low-skill wages in urban areas, but not in rural zones. This wage premium is driven by the direct effect of skills on productivity and by the indirect effects of worker proximity, as workers learn from each other. For example, a doubling of population density results in a 10 to 13 percent increase in productivity in urban Indonesia, which translates to higher wages. Increased density does not affect rural productivity. So even though urban jobs are mostly in low value-added services, the impacts of education and agglomeration result in higher productivity and wages than in less densely populated rural zones. There are few noticeable job spillovers from urban to rural areas.

Perhaps more worrisome is that Indonesia does not have the systems in place to help the large existing workforce acquire the skills that a structurally transformed, more-productive Indonesia will need. The workforce development system is insufficiently advanced. Indonesia’s training system has more than 45,000 institutions providing technical and vocational education and training (TVET). They are managed by dozens of ministries and levels of government, and serve millions of students each year. Some good practices are in place, but the complex system is not conducive to efficiently providing training in the skills that are demanded by the labor market, particularly in an environment in which the skills profile of jobs is rapidly evolving. The government has started to identify critical occupations and the fastest-growing jobs, but these labor market trends are not yet shaping the publicly managed training sector. Efforts to develop quality-assurance mechanisms are in motion, but the quality control system is still fragmented, duplicative, and incomplete. Both the education and training systems are largely divorced from the business sector, which further exacerbates the
mismatch between education and training services and good jobs. Businesses do little to fill the gap; 13 percent of Indonesia's businesses provide training to their workers, as compared to 32 percent in the East Asia and Pacific regions. And, when training is provided, it is primarily in firm-specific technologies rather than broader and more mobile skills.

Certain groups face particular barriers, but they may also have a comparative advantage that could help them leapfrog to middle-class jobs. Women's low participation in the labor force, their crowding into traditionally female sectors or occupations, and the gender wage gap all mean that women's incomes are less likely to reach the middle-class threshold. Only half of working-age women hold a job, as compared to 80 percent of men. Women earn 75 percent of the wage of comparable men, as compared to 88 percent in Vietnam. Thus, women hold a smaller share of middle-class jobs (28.6 percent) than predicted given their share of the income-earning workforce (35 percent). Childcare and domestic duties, as well as social norms that undervalue women's work, lead to the overrepresentation of women in lower-paid occupations and as urban HHE owners and unpaid workers. However, women may be trading off higher wages for family-friendly social benefits. Women earning middle-class wages also have a higher share of social benefits than do middle-class men. And women hold higher-skilled occupations within "feminized" sectors, namely services, with median wages exceeding those of men in high-value services.

Middle-class jobs accrue to those with work experience in occupations requiring higher skill levels. Youth earn 32 percent less than adults, on average, which explains why they hold 6.4 percent of middle-class jobs but 14.4 percent of all jobs. Unfortunately for youth, job experience is the primary factor for accessing a middle-class job, but in the short run, youth can improve their chances by developing field-specific skills, as well as broader cognitive and interpersonal skills, and focusing their job search on white-collar jobs as semi-professionals or technicians and associates. This will increase their earnings in the short run and pave their way to middle-class jobs as they acquire experience.

In short, even if the structural transformation toward more productive sectors and firms happens, the workforce will not be ready to meet the demands that will arise. Labor productivity would be low, thus dragging down total productivity and profits. This points toward the need for an upskilling and reskilling policy agenda in the short run to meet emerging demand from industry around labor.
Indonesia’s economy has failed to deliver the jobs and wages needed to achieve the country’s middle-class aspirations. This is partly due to a disrupted structural transformation that resulted in the entrenchment of large and old firms, the growth of low value-added jobs, and a low-skill labor force. To get Indonesia back on track, barring extreme long-term setbacks from the COVID-19 crisis, this report proposes a three-pronged strategy (Figure O.12). The general policy areas are presented here and in Annex Table; full details are provided in Chapter 6 of the Technical Report. The government has already started to implement comprehensive policy interventions to close gaps in infrastructure, human capital, and financial services; these should continue as they are the foundations of the three pathways to middle-class jobs.


47 To create middle-class jobs, Indonesia needs an efficient financial sector that is less costly, faster, safer, and more transparent. It must mobilize domestic savings and allocate them across time and space to the more productive sectors, firms, and workers. An efficient financial sector also enables firms and households to cope with economic uncertainties by hedging, pooling, sharing, and pricing risks, which helps savers and investors to make better decisions in terms of allocating their money and financial assets. The financial sector in Indonesia still, however, faces many challenges that could impede the allocative efficiency of resources to the most productive uses.
Figure O.12 Three-Pronged Strategy for Moving Toward Middle-Class Jobs

- Accelerate across-the-board productivity growth
- Build a middle-class workforce
- Transition workers to jobs-friendly sectors and firms

Source: World Bank
Reform Strategy 1: Accelerate Across-the-Board Productivity Growth

Government policies could aim to promote productivity growth across the board, which means productivity enhancements in all sectors, firms, and jobs. The basic goal is to unleash competition and innovation to weed out firms with low levels of productivity and begin to grow more productive firms in every sector. The transition to high-value jobs will take time and, even then, low-value jobs will always exist. In the meantime, policy can help firms to be more productive and, with that, pay higher wages through broad-based labor productivity growth. This reform strategy will also require a concerted effort to support productivity growth in small and medium enterprises (SMEs) and HHEs, sectors that house a large share of jobs, but where many operate with a low level of productivity. Three sets of actions can accelerate across-the-board productivity growth.

First, to avoid a repeat of the lack of firm creation that characterized the lost decade after the Asian financial crisis, Indonesia could unlock new firm entry and growth to create competition and innovation that spur productivity in the private sector. The private sector accounted for 86.8 percent of all jobs in 2019 in Indonesia and reducing impediments for private sector firms to enter and grow will be key to robust employment growth. However, to create quality jobs and expand Indonesia’s middle class, Indonesia could do more. Integrating firms into global value chains (GVCs) and leveling the playing field between domestic versus foreign firms, and small versus large firms will also be key to ensuring firm dynamism and robust job creation in the private sector. A more predictable regulatory framework is needed to enable firms to enter and grow.48

Four areas of policy intervention are critical for unlocking new firm entry and growth, creating competition and innovation, spurring productivity, and creating middle-class jobs in the private sector.49

(i) Indonesia could improve FDI policies, increase access to inputs, markets, and foreign talent to fill roles for which there is a shortage of domestic candidates, and better integrate firms into GVCs. The government has issued one of the most ambitious investment and trade reforms in decades (see Box O.3). Remaining items on the reform agenda include: (a) reducing the list of sectors reserved for Indonesian micro, small, and medium enterprises (MSMEs) and turning burdensome minimum local content requirements across various sectors into positive incentives to use local
supply; (b) eliminating the Expatriate Manpower Utilization/Placement Plan as a precondition for the employment of an expatriate in a high-skill occupation where there is a shortage of domestic candidates; and (c) addressing nontariff barriers to access to inputs of production—such barriers include preshipment inspections, restrictions on the port of entry of goods, and a requirement for ministerial letters of recommendation. The government is also recommended to continue to pursue ambitious preferential trade agreements to lock in domestic reform and attract investment by finalizing the EU Comprehensive Economic Partnership Agreement.

(ii) Indonesia could increase the capacity of domestic firms and workers to benefit from the technology spillovers of FDI by: (a) increasing the quality of human capital of domestic workers (see Reform Strategy 3); (b) promoting links among firms; (c) providing incentives and advocacy to promote firm-based training programs; (d) building business networks; (e) establishing institutional partnerships, especially between domestic and foreign-owned firms; and (f) providing information services, including on the quality standards required by multinational corporations. These recommendations could increase both absorptive and adaptive capacity among local firms and workers.

(iii) Indonesia could support firms with a more predictable regulatory framework by: (a) introducing a regulatory oversight body to reduce regulatory uncertainty; (b) over the longer term, introducing into the regulatory process compulsory public consultation that follows international best practice, and providing incentives for local governments to streamline the process of business licensing; and (c) consolidating and targeting policy instruments that better assist firms to innovate, thereby spurring productivity growth and new product development.

(iv) Indonesia could strengthen its competition regulatory framework by: (a) strengthening the technical capacity of the Commission for the Supervision of Business Competition (Komisi Pengawas Persaingan Usaha; KPPU) to enforce competition laws and advocate pro-competition policies; (b) revisiting the existing Competition Law (No. 5/1999) to improve the ability of Indonesia’s competition framework to identify and sanction anticompetitive behavior; and (c) mainstreaming competition considerations into the policy-making process to ensure that regulations do not unduly restrict competition.
Second, Indonesia could improve the productivity of SMEs to help other firms play a more prominent role in the creation of middle-class jobs, rather than only relying on large and old firms. Any SME that is characterized by low productivity and innovation, partly the result of ineffective government policies, cannot be a source of middle-class jobs. The government has issued a range of policies to improve productivity growth in SMEs, including policies designed to make business registration cheaper and faster, and policies relating to technology transfer and e-commerce, access to market, exports, and financial assistance. However, SME policies continue to take a welfare approach, instead of a competition, efficiency, and productivity approach. They also contain excessive protectionism, for example, reserving certain business sectors for SMEs, and other programs that shield SMEs from competition.51

The report identifies five priority policy areas of intervention that would improve the productivity of Indonesia’s SMEs, helping them to grow and become better creators of middle-class jobs:

(i) Indonesia could develop specific measures and strategies to assimilate SMEs into GVCs, including the integration of smallholders into agriculture value chains and home-based workers into manufacturing and services GVCs.52 Priority policy reform areas are: (a) addressing information gaps in order that SMEs understand the quality standards they must meet to supply to multinationals or their tier-three, or higher, suppliers; (b) supporting SMEs to meet these quality standards and ensure they deliver on time; (c) providing tax incentives for multinationals that invest in upgrading local suppliers through training, mentoring, or staff secondment;53 (d) reducing the transaction costs for SMEs using free trade agreements, simplifying Certificate of Origin procedures, and making each Certificate of Origin free of charge.54

(ii) Indonesia could promote the incremental introduction of innovative activities to boost productivity. Reforms could focus on a mix of policy instruments that may include: (a) technology extension and diffusion programs; (b) early-stage infrastructure and advisory services; (c) inducements; (d) vouchers for collaboration; and (e) direct grants for business innovation (with embedded advisory services).55

(iii) Indonesia could close the digital infrastructure divide and ensure affordable, reliable, and ubiquitous high-speed broadband internet access (fixed and mobile 4G) by: (a) reforming spectrum management and infrastructure sharing that will stimulate further private investment; and (b) targeting public-private partnerships to close internet access gaps.
Indonesia could expand access to financial services. Priority policy reform areas are: (a) preparing a roadmap with a view to leveling the playing field for delivery of financial services; (b) strengthening financial sector infrastructure such as credit registries and secured transactions; and (c) promoting the use of dedicated liquidity and risk-sharing facilities (especially relevant in the aftermath of COVID-19).

**Third, Indonesia could target support to increase the productivity of HHEs, the source of a large share of jobs.** Household enterprises, which account for more than 98 percent of microenterprises, are significantly different to SMEs in many respects. Specific policy reforms for HHEs should focus less on growth and more on increasing productivity, and hence income, marginally and incrementally without requiring a significant amount of additional resources (for example, time, workers, capital, or finance).

Policy interventions in three areas can improve the marginal productivity of HHEs:

(i) Indonesia could improve basic business skills of HHE owners through training and education. At least three skill sets need to be improved: financial literacy, management, and entrepreneurship. Strategies to improve the business skills of HHE owners and workers should be perceived in a short- or medium-term horizon and are: (a) creating short training modules on simplified rule-of-thumb business skills, combined with training in personal initiative (soft skills), business competition, and innovation; (b) providing information to HHEs about the benefits of training and possible routes to acquiring it; and (c) in the medium term, synchronizing and integrating government training and support programs across ministries and bodies.

(ii) Indonesia could create inclusive ecosystems for HHEs. Priority policy reform areas to create inclusive and more secure ecosystems for HHEs are: (a) encouraging the owners of HHEs to join the social security system, Badan Penyelenggara Jaminan Sosial (BPJS) Ketenagakerjaan, for nonwage workers by providing tailored information on the benefits of doing so; (b) providing government contributions to ease entry into and sustain participation in the program; (c) promoting the benefits of becoming a legal entity by bundling legal registration with other government support programs; and (d) improving the delivery of support programs, and broadening and facilitating HHE access to them, independently of their participation in social assistance programs.
Box O.3 Creating Better and More Jobs: Recent Reforms to Investment, Access to Skilled Foreign Workers in Shortage, and Manufacturing Inputs

Until recently, Indonesia had some of the tightest restrictions on foreign direct investment (FDI) among middle-income countries, which has weighed down on the creation of middle-class jobs. These restrictions on FDI have been compounded by restrictions on the hiring of foreign high-skill workers to occupations for which Indonesia has a shortage of domestic workers, and high costs for sourcing manufacturing inputs from global markets.

The government has sought to address some of these issues by implementing one of the most ambitious investment and trade reform programs in decades. The key reform was a presidential regulation on investment, which reduced the number of business activities subject to at least one investment restriction from 813 to 260. This liberalization of investment, particularly FDI, moves Indonesia from having one of the most restrictive FDI regulatory regimes in the region to having one of the most open. According to World Bank estimates, this liberalization may generate between US$4.1 billion and US$6.0 billion in additional foreign and domestic investment in the liberalized sectors. The investment flows would translate into an estimated increase in GDP growth of between 0.12 and 0.17 percentage points, raise productivity, employment, and wages, and ensure lower prices and/or better-quality products and services for consumers.

To facilitate a more adequate supply of high-skill professionals in shortage to meet the needs of the labor market, the government also passed Government Regulation No. 34/2021 on Foreign Workers. This complements a regulation issued by the Minister of Manpower in 2019 in two ways. First, it removed the requirement for an employer to have an Expatriate Manpower Utilization/Placement Plan in order to employ an expatriate worker for a number of positions. Second, it has eliminated the requirement for an employer to obtain a written license (an Expatriate Manpower Employment License) from the Minister of Manpower or an appointed official to employ an expatriate worker. This is the most ambitious set of reforms on work permits for foreigners that Indonesia has enacted in

(iii) Indonesia could improve product competitiveness. Specific policy reforms to improve product competitiveness are: (a) promoting on-the-job training and apprenticeships; (b) providing shared factories or machines that can be used by HHEs; and (c) supporting product standardization and modernization of HHEs.

While this review does not explore factors that constrain productivity in the agricultural sector, the recommendations for nonfarm HHEs are also relevant for the farm sector.

Source: This box is largely drawn from World Bank 2021.

a The comparison of the number of business activities subject to investment restrictions in the older regulation (Presidential Regulation No. 44/2016) versus the new is not straightforward as the business activities in the older regulation are defined using different levels of aggregation.

b This 2019 regulation has more than trebled the number of occupations in which high-skilled expatriate workers (managerial, professional, technical) may be employed. It also allows the minister to permit expatriate employment on a case-by-case basis for positions that are not specified in the regulation. Previously, specific permission was needed from the relevant ministries.
recent decades. It is likely to provide more certainty to the approval process, eliminate the discretion of sectoral ministries, and expand the range of skills gaps that firms can fill through global markets. The immediate expected outcome is that a higher share of high-skill jobs in shortage in Indonesia will be covered by expatriates.

To facilitate access to manufacturing inputs, the government reduced the cost of compliance with national product standards (SNI) by removing compulsory SNI certification for steel, stove, and wire products used by producers. This was carried out in Minster of Industry Regulation No. 35/2019, which revoked 14 individual regulations. The inputs covered by the 14 Ministry of Industry regulations revoked by the reform are worth about US$3.9 billion, or 3.5 percent of total intermediate imports in 2019. This is equivalent to almost 10 percent of the intermediate imports the SNI certification is applied to. This exemption should not affect the safety of production processes using these inputs as the products do not present high risks for users. By lowering the costs and increasing the certainty of supply of key inputs, this reform is expected to increase the competitiveness of producers, particularly in manufacturing. It is expected to reduce producers’ fixed costs of switching inputs, thereby facilitating innovation, which is currently limited among firms in Indonesia.

For producers the exemptions are granted automatically. For general importers, further consideration is required before an exemption is granted.
6.2 Reform Strategy 2: Structural Transformation 3.0: Transition to Sectors and Firms That Create Good-Quality Jobs

Indonesia's continued dependence on commodities and nontradable sectors and its inward-looking economic policies have not created enough jobs in higher-productivity sectors, leaving many workers "stuck" in low-productivity, low-wage work. Workers can earn higher wages when the productivity of current jobs increases (Reform Strategy 1), or when they shift from lower-productivity jobs, firms, or sectors such as traditional agriculture or low value-added services to higher-productivity jobs, firms, or sectors such as manufacturing, health, education, finance and other business sectors, and ICT. So far, Indonesia’s growth model has failed to deliver a significant transition of workers from lower- to higher-productivity sectors and activities, and structural transformation has contributed insufficiently to labor productivity growth. With a more skilled workforce and the adoption of the policies in Reform Strategy 1, the economy will naturally create more jobs in higher-productivity sectors. But Indonesia can accelerate the transition from lower- to higher-productivity jobs with policies to increase labor demand in sectors that can deliver middle-class jobs. Such policies include prioritizing sectors such as ICT, finance, health, education, and manufacturing for investment promotion efforts, as well as relieving infrastructure bottlenecks.

First, Indonesia could prioritize its investment promotion strategies to draw FDI to sectors and projects (including infrastructure projects) that are amenable to the creation of middle-class jobs. Indonesia could provide information to firms to reduce information asymmetries, including increasing awareness about potential investment projects, and identifying (and overcoming) potential barriers such as market failures or the existence of externalities. Tax incentives are often considered in this context, but they are an inferior instrument, especially in Indonesia, which already collects less tax than most of its peers and, as a result, has a revenue base that is insufficient to sustainably fund the public services, such as infrastructure, that attract high-quality investment. The strategic roadmap of Indonesia’s Investment Coordinating Board (Badan Koordinasi Penanaman Modal; BKPM) lays out several prioritization strategies, which are broadly focused on sectors that create middle-class jobs, sectors such as tourism, high value-added agriculture, manufacturing, health, education, finance, and ICT. However, there is room to introduce a middle-class jobs creation lens to the criteria of prioritization strategy in investment promotion. Moreover, since structural transformation must go hand in hand...
with infrastructure development, to which the government has a strong commitment, infrastructure development could be prioritized, but viewed from the perspective of creating middle-class jobs.

To further strengthen the government’s prioritization strategy in investment promotion, policy interventions could focus on:

(i) Revisiting the current strategic roadmap of the BKPM (including the goals on infrastructure development) and reworking it through a framework of creating middle-class jobs, both on the demand and supply sides. This reworking should use a global best-practice framework for prioritization of investment, such as the OECD Policy Framework for Investment.

(ii) Revisiting how prioritization is being implemented, for example, assessing whether there is a need for a BKPM unit dedicated to priority sectors, projects, countries, or investors, and also assessing the types of services provided to priority sectors, projects, countries, and investors (including addressing investor grievances), and assessing human resources and budgets allocated to priority sectors, projects, countries, and investors. Indonesia could evaluate in the medium term whether the prioritization strategy has achieved the intended results, that is, whether it has created more middle-class jobs.

(iii) Applying a lens of middle-class jobs creation when selecting sectors and enterprises to target with policy interventions. Policy interventions on SMEs and HHEs could target sectors and enterprises that have greater potential to create middle-class jobs.

Second, Indonesia could close information gaps to help workers transition to higher-quality jobs. When new firms enter (exit), new jobs are advertised and/or new sectors emerge (disappear). Information has to be available to allow workers to relocate. If productivity gains are to be achieved, new firms must enter, more productive firms must outcompete less productive firms, and labor must be able to move into more productive sectors, firms, and jobs.
Indonesia could have policies to help workers move to better jobs. These include:

(i) Upgrading KarirHub and the overall labor market information system by: (a) including private job portals and public portals providing services for job search and career development within the system; and (b) building out the labor market information system in the short run with real-time information. This can be achieved by developing artificial intelligence to trawl sites and pull information to the platform, fielding surveys to collect information on how people prepare for and search for jobs, and analyzing and curating information to identify both critical and high-growth occupations.

(ii) Providing relocation support for hard-to-fill vacancies by: (a) ensuring the system provides information on nationwide job vacancies; and (b) providing stipends to support relocation (travel, housing, and other social services) for workers who are moving to fill critical roles.

(iii) Continuing to develop the Job Loss Guarantee Program (Jaminan Kehilangan Pekerjaan; JKP) to support the transition of workers up the job ladder by: (a) allowing current workers to opt in (or out) of the JKP (during the initial implementation phases, while mandating all newly hired workers into the system); (b) working with social partners to define the program parameters—including financing mechanisms—and to implement a communications campaign about the benefits of the reform for workers and firms; (c) developing a strong monitoring system to avoid misuse of the program; and (d) establishing strong links with the entirety of the ecosystem around the labor market information system.

64 See also World Bank and Bappenas (2020) and World Bank and CMEA (2020).
6.3 Reform Strategy 3: Build a Middle-Class Workforce

The final reform area is to build a workforce that has the necessary skills to take on the more productive jobs created through Reform Strategies 1 and 2. This will require changes to the education system to better prepare today’s youth for modern jobs. But, perhaps more challenging, it will also require innovations to upskill the current adult labor force so that productive investment is attracted to Indonesia, and the upskilled labor force will be able to meet the demands of these new jobs. It will also require innovations so that Indonesia benefits more from potential technology transfers and spillovers of FDI from multinationals. Additional support to crowd in women and youth is increasingly necessary as the share of the working-age population in the total population begins to decline. These issues lead to three areas of potential policy interventions.

First, Indonesia could facilitate learning. The skills imparted by the existing secondary school curriculum and training programs do not meet market demands. This is partly due to a mismatch between the curriculum and the demands of the labor market, but also due to a lack of access to education and training. Results-based training can both expand access to and enhance the job relevance of teaching materials. In addition to improving the general education system, Indonesia could:

(i) Implement targeted incentives for students at risk of dropping out of secondary school. This will require the risk factors for at-risk populations to be mapped at the local level and interventions designed accordingly. It will also require reform of the curriculum and the delivery mechanism for Paket C (an upper-secondary-school diploma equivalency program for those aged over 18 who are unable to gain a diploma through traditional schooling) through greater use of distance learning to facilitate participation by the target audience, primarily adults.

(ii) Support the development of and access to online distance learning in short TVET courses by accrediting online training courses and including a database of accredited online training courses on KarirHub, as well as providing training vouchers for vulnerable groups or those seeking training in critical occupations.

(iii) Modernize the curricula and introduce new pedagogical methods to develop nonroutine interpersonal, analytical, and digital skills. Interventions must be tailored to the age (from preschool through adult education) and context of the learners.
(iv) Improve the quality of the training system by prioritizing the development of quality-assurance mechanisms and more effectively engaging the enterprise sector. Regarding quality-assurance mechanisms, Indonesia could place a higher priority on the development of strictly defined and enforced competency frameworks and accreditation standards. In the long run, it will be necessary to develop a centralized monitoring and evaluation system in which all training institutes report input, output, and (eventually) outcome data. It will also be necessary to establish a National Vocational Skills Steering Committee to make funding and other systemwide decisions based on quality data. Regarding the enterprise sector, Indonesia could amend Ministry of Finance Regulation 128/2019 to subsidize results-based worker training in firms. Public resources can be used to incentivize exchanges of staff between industry and institutions providing TVET by financing TVET instructors to undertake internships in firms and subsidizing the wages of industry experts to allow them to take time out from their firm to teach in TVET institutions.

Second, Indonesia could provide tailored support to particular groups. The above measures would benefit all learners, but some groups have additional constraints that limit their success. The factors underlying the significantly lower wages earned by women compared to men are difficult to identify, but there is some indication that women tend to study and work in lower-paying social and other services. They are also overrepresented in urban self-employment. Women tend to search for jobs less than men and use more informal means. The conflict between work and home leads to suboptimal work decisions. Youth also experience a significant wage gap relative to older adults, which is primarily attributable to their lack of experience. Both women and youth would benefit from tailored support, as well as shifting social norms, including:

(i) Fine-tuning of the labor market information system and training programs to include gender- and age-relevant information, such as nonstandard fields of study for women, as well as auxiliary services such as childcare or student loans. Face-to-face information interventions for girls in secondary school should also be included. In terms of training, Indonesia could earmark a portion of training vouchers to women and youth to enable them to participate in courses that teach business practices and the technology needed for engaging in the gig economy. Indonesia could also incorporate business development training into entrepreneurship support programs for women.
Expanding women’s access to social benefits through their jobs. Indonesia could use legislation to facilitate the formal employment of women: securing women’s jobs during pregnancy, maternity leave, or in the period following her return to work are vital. Indonesia can also establish grievance procedures to report violations of the Labor Law, which guarantees social benefits to workers.

Amending the Labor Law to set national norms for women’s access to the labor market, including a robust definition of “equal pay for equal work” (see Box O.4), a robust definition of sexual harassment, clarification of the nature of unacceptable workplace interactions, and expanded paternity benefit of 30 days.

Indonesia could coordinate the reforms to build a middle-class workforce (as laid out in Reform Strategy 3) with reforms to unlock new firm entry and growth (as laid out in Reform Strategy 1), especially reforms designed to attract FDI. This will avoid any mismatch between the demand and supply sides of middle-class jobs. Singapore is an example of a country that regularly maps short- to long-term economic investment and the demand it creates for certain skills or types of worker. It uses the data to upskill or reskill current workers through updated educational and training curricula.

The Omnibus Law on Job Creation (Omnibus Law) aims to boost competitiveness, including through significant reforms to Labor Law 13 of 2003. The government aims, with the reforms, to improve labor market flexibility, while maintaining worker protection by modernizing existing labor institutions to better align with modern labor markets. The goal is to make Indonesia more attractive to investors, thereby potentially creating more good jobs, and also to improve the currently low level of compliance with labor regulations. As is standard practice in Indonesia, the Omnibus Law was followed by a series of government regulations on the reforms. Reforms have been made to areas including:

**Fixed-term contracts (articles 56–61):** The Omnibus Law modifies work agreements, particularly fixed-term contracts. Most notably it stipulates that fixed-term contracts cannot be (automatically) transformed into permanent work. The implementing regulation, Government Regulation No. 35/2021, allows for a longer duration of fixed-term contracts (the maximum length of a fixed-term contract has been increased from three to five years) and introduces compensation for termination that is proportional to the length of the employment relationship.
### Employment agencies for temporary or outsourced staff (articles 64–66): The Omnibus Law makes these employment agencies responsible for providing the same benefits to its workers as those provided by firms to their permanent workers. These agencies must be licensed by the Ministry of Manpower. The previous restriction that limited outsourcing to noncore business processes has been eliminated.

### Working time (articles 78 and 79): The Omnibus Law expands overtime to a maximum of 4 hours per day (1 additional hour) and 18 hours per week (4 additional hours). It also removes regulations on extended leave and other types of leave, instead allowing this to be agreed by the worker and the company, or the union and the company. Government Regulation No. 35/2021 provides further details on how to calculate overtime wages and other overtime provisions.

### Minimum wage (article 88): Micro and small firms are exempt from compliance with the minimum wage if they rely on traditional resources and do not operate in high-technology or in capital-intensive businesses (definitions will be introduced in implementing ministerial regulations). Instead, Government Regulation No. 36/2021 stipulates that the employer needs to pay above a subfloor equivalent of 50 percent of average public consumption and 25 percent above the provincial poverty line. The minimum wage formula has been modified—sectoral minimum wages have been eliminated, as have provincial wage councils—with the objective of pacing minimum wage growth in regions where minimum wages are already high, and decreasing wage inequality across regions where the ratio of minimum wage to median wage is low. Government Regulation No. 36/2021 introduces a formula for district minimum wages, and a more complex formula for provincial minimum wages that depends on economic growth, inflation, purchasing power parity, manpower absorption level, average consumption per capita, average number of household members who work in the region, and median wages.

### Wage policy (articles 88 and 88B): The Omnibus Law introduces equal wages for equal pay, legislation that is commonly used by countries to address gender wage gaps. The Omnibus Law introduces a minimum hourly wage, further regulated in Government Regulation No. 36/2021.
Significant analytical work is needed to further refine the proposed policy responses. The policies presented here are drawn from in-depth Indonesia studies on some topics and global literature on others. However, there is a notable shortage of deep-dive empirical studies on high value-added services sectors (and the services sector more generally), agricultural jobs, how worker protection laws do (or do not) contribute to middle-class jobs, HHEs, and the effects of global megatrends including digital development, among many others.

**Contract termination and severance (articles 150–90):** The Omnibus Law eliminates the health and housing allowance component of compensation pay, which had accounted for 15 percent of total severance pay and service pay. Government Regulation No. 35/2021 reduces the reward pay for termination of short-tenure employment (for example, the requirement to pay two months’ wages for up to three years of work has been removed). It also adopts the concept of notice of termination, similar to countries throughout much of Asia and common law jurisdictions, such that an employer can unilaterally issue a written notice of termination with reason at least 14 working days prior to the planned termination date. If the employee accepts the termination, the employer must report the termination to the local labor office.
Policy Reforms to Build Back Better

Shifting a substantial part of the economic development agenda in order to reach the challenging goal of more middle-class jobs is ambitious. The broad range of policy areas that need reform are presented here and are testament to this ambition. However, the proposed policies only brush the surface; they are necessary, but far from sufficient. Implementing the agenda is a national task that must take place across a broad range of ministries, levels of government, in the private sector, and among citizens themselves.
Moreover, more often than not, in a country as diverse and decentralized as Indonesia, there is no one answer on the “how to” of implementing reforms. For example, a reform may be more easily implemented in some sectors or regions than in others. Hence, discussion of each of the above policy recommendations needs to be further disaggregated into subsets of “how to.” Reformers must also take into account institutional and political constraints, as reforms do not happen in a vacuum. This means that reforms must be endogenous to secure political will and support. Given this, the policy recommendations would benefit from more elaborated discussions on how to achieve some quick wins that could act as stepping-stones to gaining political support and credibility, especially for reforms that will only show results in the longer term.

Indonesia has shown that it can take on the challenge of implementing a multifaceted reform agenda for jobs. It is one of few countries that has approached the jobs agenda from a holistic perspective, engaged stakeholders across the spectrum, and placed job creation at the center of its legislative agenda (see Box O.3 and Box O.4). The accountability structure and implementation monitoring will be critical and, perhaps, even more of a challenge than the preparation of the necessary legislation.

The recent economic disruption caused by the COVID-19 crisis threatens Indonesia’s progress toward more productive, middle-class jobs. The Asian financial crisis had such an effect. But with careful planning to build back better, the disruption can be an opportunity to systematically and strategically map out a recovery agenda that focuses on productivity and good jobs. This Overview proposes areas for initial reforms.

Indonesia has its eye on becoming a high-income country. The message from the highest level is that jobs are a fundamental part of realizing this vision.
### Reform Strategy 1: Accelerate Across-the-Board Productivity Growth

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<th>Policy Reform Areas</th>
<th>Selected Policy Actions</th>
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<td>Unlock new firm entry and growth to create competition and innovation that spur productivity in the private sector.</td>
<td>Improve foreign direct investment (FDI) policies, increase access to inputs, markets, and foreign talent for occupations where there is a shortage of domestic workers, and integrate firms with global value chains (GVCs) by: (i) reducing the list of sectors reserved for Indonesian micro, small, and medium enterprises (MSMEs) and turning burdensome minimum local content requirements across various sectors into positive incentives to use local supply; (ii) eliminating the Expatriate Manpower Utilization/Placement Plan as a precondition for employment of expatriates in high-skill occupations for which there is a shortage of domestic workers; (iii) reviewing, reducing, and streamlining nontariff measures including measures around product certification, preshipment inspections, and requirements for ministerial letters of recommendation; (iv) pursuing ambitious preferential trade agreements to lock in domestic reform, and attract investment by finalizing the EU Comprehensive Economic Partnership Agreement.</td>
<td>Office of the President; Coordinating Ministry of Economic Affairs (Kementerian Koordinator Bidang Perekonomian; CMEA); Ministry of Finance; Investment Coordinating Board (Badan Koordinasi Penanaman Modal; BKPM); Ministry of Trade; Ministry of Industry; Ministry of Manpower; Ministry of Cooperatives and SMEs; Ministry of Foreign Affairs; Ministry of Law and Human Rights; Directorate General of Immigration</td>
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<td>Increase the capacity of domestic firms and workers to benefit from the technology spillovers of FDI by: (i) increasing the human capital of domestic workers (see Reform Strategy 3); (ii) promoting links between firms; (iii) providing incentives and advocacy to promote firm-based training programs; (iv) building business networks; (v) establishing institutional partnerships, especially between domestic and foreign-owned firms; and (vi) providing information services covering, for example, the quality requirements of multinationals.</td>
<td>Ministry of Trade; BKPM; Ministry of Research and Technology; Ministry of Industry</td>
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<td>Support firms with a more predictable regulatory framework by: (i) introducing a regulatory oversight body; (ii) introducing compulsory public consultation procedures; and (iii) consolidating and targeting policy instruments that better assist firms to innovate.</td>
<td>Office of the President; Cabinet Secretariat; Ministry of National Development Planning; Ministry of Law and Human Rights</td>
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<td>Strengthen the competition regulatory framework by: (i) strengthening the technical capacity of the Commission for the Supervision of Business Competition (Komisi Pengawas Persaingan Usaha; KPPU); (ii) revisiting the existing Competition Law (No. 5/1999); (iii) mainstreaming competition considerations in the policy-making process.</td>
<td>CMEA; KPPU</td>
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<td>Improve productivity of small and medium enterprises (SMEs) to help them grow and become better creators of middle-class jobs.</td>
<td>Develop specific measures and strategies to assimilate SMEs into GVCs. Smallholders should be integrated into agriculture value chains and home-based workers into manufacturing and services GVCs by: (i) addressing information gaps between SMEs and multinational corporations regarding quality standards; (ii) supporting SMEs to meet these quality standards; (iii) providing tax incentives for multinationals that invest in the upgrading of local suppliers; and (iv) lowering transaction costs for SMEs using free trade agreements.</td>
<td>CMEA; Ministry of Industry; Ministry of Cooperatives and SMEs; Ministry of Trade</td>
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<td>Promote incremental increases in innovative activities to boost productivity with a mix of policy instruments including: (i) technology extension and diffusion programs; (ii) early-stage infrastructure and advisory services; (iii) inducement incentives; (iv) vouchers for collaboration; and (v) direct grants for business innovation.</td>
<td>Ministry of Research and Technology; Ministry of Cooperatives and SMEs; Ministry of Trade</td>
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<td>Close the digital infrastructure divide and ensure affordable, reliable, and ubiquitous high-speed broadband internet access (fixed-broadband and 4G) by: (i) reforming spectrum management and infrastructure sharing to stimulate further private investment; and (ii) closing remaining gaps in internet access through targeted public-private partnerships.</td>
<td>Ministry of Information and Communications Technology, in collaboration with telecoms/internet service providers (private sector); Ministry of Public Works; Ministry of State-Owned Enterprises</td>
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<td>Expand access to financial services by: (i) preparing a roadmap targeting a leveling of the playing field for the delivery of financial services; (ii) strengthening financial sector infrastructure such as credit registries and infrastructure related to secured transactions; and (iii) promoting the use of dedicated liquidity and risk-sharing facilities.</td>
<td>Bank Indonesia; Financial Services Authority (Otoritas Jasa Keuangan, OJK); Ministry of Finance; financial intermediaries</td>
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<td>Target support to increase productivity in household enterprises (HHEs), which house a large share of jobs.</td>
<td>Increase basic business skills through training and education by: (i) creating short training programs with simplified rule-of-thumb modules in business skills combined with personal initiative (soft skills) training and innovation training; (ii) providing information to HHEs about the benefits of training and possible routes to enrolling in training; (iii) in the medium term, synchronizing and integrating government training and support programs across ministries and bodies.</td>
<td>Ministry of Cooperatives and SMEs; Ministry of Manpower; Ministry of Education; OJK</td>
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<td>Create inclusive ecosystems for HHEs by: (i) encouraging HHE owners to join the social security system Badan Penyelenggara Jaminan Sosial (BPJS) Ketenagakerjaan for nonwage workers by providing tailored information on the benefits of doing so; (ii) providing government contributions to ease entry into and sustain participation in the program; (iii) promoting the benefits of becoming a legal entity by bundling legal registration with other government support programs; and (iv) improving the delivery of support programs, and broadening and facilitating HHE access to them, independently of their participation in social assistance programs.</td>
<td>CMEA; BPJS Ketenagakerjaan; Ministry of Manpower; Ministry of Finance; Ministry of Social Affairs; Ministry of Cooperatives and SMEs</td>
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<td>Improve product competitiveness by: (i) promoting on-the-job training and apprenticeships; (ii) providing shared factories or machines that can be used by HHEs; (iii) supporting product standardization and modernization of HHEs.</td>
<td>Ministry of Cooperatives and SMEs; Ministry of Manpower; technical ministries, including Ministry of Agriculture and Ministry of Industry; National Standardization Body of Indonesia (Badan Standardisasi Nasional)</td>
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### Reform Strategy 2: Transition to Sectors and Firms That Create Good-Quality Jobs

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<td>Prioritize investment promotion strategies to attract FDI to sectors or projects (including infrastructure projects) that are amenable to the creation of middle-class jobs.</td>
<td>Prioritize investment promotion strategies to draw FDI to sectors and projects (including infrastructure projects) that are amenable to the creation of middle-class jobs by (i) revisiting the current strategic roadmap of the BKPM (including the goals for infrastructure development) and applying a lens of middle-class jobs creation using a global best-practice framework, such as the OECD Policy Framework for Investment, when considering which investment to prioritize; also, (ii) revisiting how prioritization is implemented and evaluating in the medium term whether the prioritization strategy has achieved the intended result of more middle-class jobs. Also, to the extent that reforms in the SME and HHE sectors are not sector-blind, select sectors and enterprises to target with policy interventions by considering their potential for creating middle-class jobs.</td>
<td>CME; BKPM; Ministry of Finance; Ministry of Trade; Ministry of Cooperatives and SMEs; Ministry of Manpower</td>
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<td>Close information gaps to help workers transition to higher-quality jobs.</td>
<td>Upgrade KarirHub and the overall labor market information system by: (i) including private jobs portals and public portals providing services for job search and career development within the system; and (ii) populating the labor market information system platform with real-time information.</td>
<td>Ministry of Manpower; Ministry of Social Welfare; Ministry of Education</td>
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<td>Provide relocation support for hard-to-fill vacancies by: (i) ensuring the labor market information system provides information on nationwide (and not just local) information on job vacancies across Indonesia; and (ii) providing stipends to support relocation (travel, housing, and other social services) for workers who are relocating to fill critical occupations.</td>
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<td>Continue to develop the Job Loss Guarantee Program (Jaminan Kehilangan Pekerjaan; JKP) to support workers’ transitions up the job ladder by: (i) allowing current workers to opt in (or out) of the program while mandating all newly hired workers to join the system; (ii) working with social partners to define the program parameters—including financing mechanisms—and to implement a communications campaign about the benefits of the reform for workers and firms; (iii) developing a strong monitoring system to avoid misuse of the program; and (iv) establishing strong links with the rest of the labor market information ecosystem.</td>
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<td>Policy Reform Areas</td>
<td>Selected Policy Actions</td>
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<td><strong>Facilitate learning.</strong></td>
<td>1. Provide support to at-risk students to encourage them to complete secondary school by: (i) mapping risk factors for at-risk populations and designing interventions accordingly, and (ii) expanding the reach of and modifying the service delivery mechanism of the Paket C diploma equivalency program.</td>
<td>Ministry of Education, Culture and Higher Education (Directorate of Community Education and Special Education), local education authorities (Dinas Pendidikan)</td>
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<td>2. Support the development of short technical and vocational education and training (TVET) courses for adult workers and also support their access to these courses by: (i) accrediting web-based training courses; (ii) providing training vouchers for adult learners in critical occupations or skills; and (iii) developing a database of accredited online training courses.</td>
<td>Ministry of Manpower; Ministry of Information, Communication and Technology; Ministry of Education, Culture and Higher Education; National Agency for Professional Certification (Badan Nasional Sertifikasi Profesi); National Accreditation Committee (Komite Akreditasi Nasional)</td>
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<td>3. Teach nonroutine interpersonal, analytical, and digital skills to students and adult learners through revised curricula and pedagogical methods.</td>
<td>Ministry of Education, Culture and Higher Education; Ministry of Manpower; Ministry of Information, Communication and Technology</td>
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<td>4. Enhance the quality of TVET programs by: (i) prioritizing the development of the competency framework and the process for accrediting institutions and programs; (ii) developing a centralized monitoring and evaluation system for TVET; (iii) establishing a National Vocational Skills Steering Committee; and (iv) more effectively engaging the enterprise sector by amending Regulation 128/2019 to subsidize results-based worker training, and earmarking public resources to incentivize exchanges of staff between industry and institutions providing TVET.</td>
<td>Coordinating Ministry of Human Development and Cultural Affairs; CMEA; Ministry of Finance; Ministry of Education, Culture and Higher Education; Ministry of Manpower, National Agency for Professional Certification; National Accreditation Committee</td>
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<td><strong>Provide tailored support to particular groups.</strong></td>
<td>1. Fine-tune the labor market information system and training programs to address factors that limit the success of women and youth in acquiring middle-class jobs by: (i) including gender- and age-relevant information in the labor market information system; (ii) earmarking a portion of training vouchers for women and youth to participate in courses that teach business practices and the technology needed for engaging in the gig economy; and (iii) incorporating business development training into entrepreneurship support programs for women.</td>
<td>Ministry of Manpower; Ministry of Education, Culture and Higher Education; and technical ministries</td>
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<td>2. Expand women’s access to social benefits through their jobs by: (i) modifying the Labor Law to protect against dismissal or disciplinary measures during pregnancy or maternity leave; and (ii) establishing a grievance procedure process related to firm payment of social benefits.</td>
<td>CMEA; Ministry of Manpower; Ministry of National Development Planning, Healthcare and Social Security Agency (BPJS)</td>
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<td>3. Enact legislation to set national norms for women’s access to the labor market by: (i) clearly defining the “equal pay for equal work” language in the Labor Law; (ii) introducing an article that defines sexual harassment; and (iii) extending paternity benefits to 30 days.</td>
<td>Ministry of Manpower; Ministry of Women’s Empowerment and Child Protection</td>
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References


References


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