

Indonesia Jobs Report

Towards Better Jobs and Security for All

Executive Summary



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Foreword

Indonesia has enjoyed a demographic dividend over the last forty years. The working population has been growing faster than the population of non-working dependents. This presents a major opportunity for economic growth and poverty reduction, provided that more jobs – and better jobs – are created to employ a workforce, which will grow by an estimated 20 million workers over the next ten years. But this demographic window of opportunity will close over the next decade. Growth in the population of elderly dependents is outpacing the growth of the workforce, placing greater strains on workers' income security. The upcoming years will be critical for Indonesia to boost job creation and make the most of this opportunity.

Today's policy makers in Indonesia face a strategic challenge in identifying which policies and programs will spur the creation of good jobs while, at the same time, ensuring that workers are better protected from risks threatening their income security. Decisions about labor policies are particularly difficult because they can directly affect the well-being of workers, both inside and outside the formal jobs market, and the firms that are the main engines of job growth. Differences between these competing interests have contributed to the current stalemate position that leaves both workers and firms in a "lose-lose" situation.

Sound empirical data will help guide the debate around labor reform. The Indonesia Jobs Report, prepared by the World Bank in cooperation with the Government of Indonesia and local research partners, is the most comprehensive assessment of the country's labor market that has been carried out in the last decade. The report uses the most up-to-date data available to examine the performance of the labor market, changes in the supply of workers, and the effects of labor policies. The findings will help inform future policy directions and contribute towards evidence-based decision making.

Stimulating the growth of better jobs requires a multi-pronged approach. This report recommends much needed reforms of labor policies and programs. Equally important, however, are reforms that accelerate job creation by improving infrastructure and the investment climate, alongside reforms that aim at improving the quality of education. Success will depend on working partnerships between the government, employer associations, labor unions and other civil society groups, with the support of Indonesia's think tanks and international development partners.

We sincerely hope that this report helps reinvigorate policy dialogue about job creation and worker security. Learning from experiences and international best practices, Indonesia will be better prepared to navigate a course towards "win-win" solutions that accelerate the creation of better jobs without sacrificing adequate protection for workers.



Joachim von Amsberg
Country Director, Indonesia
The World Bank

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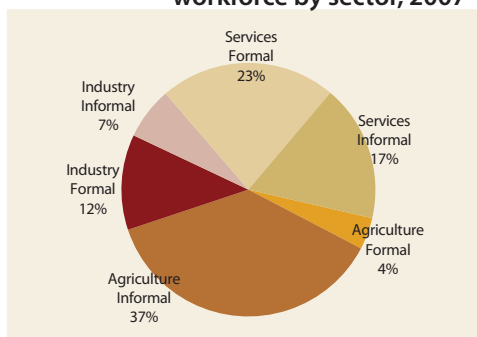
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Introduction

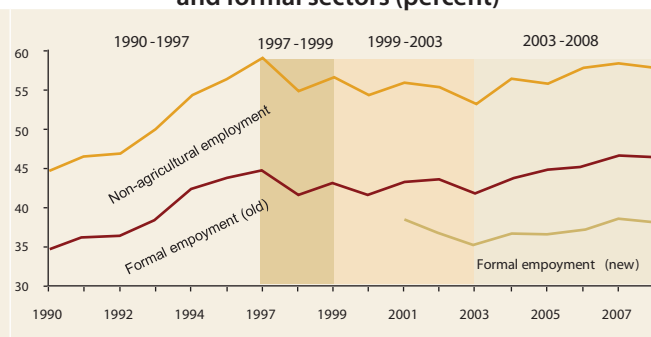
Indonesia has not generated enough good jobs to fully share the benefits of sustained economic growth with workers. Labor is one of the few assets of the poor. If provided with a good job, they have a chance to earn their way out of poverty. Indonesia, however, experienced significant jobless growth from 1999 until 2003, which contributed to the current situation where the majority of the Indonesia's working population of 104.5 million is concentrated in the agricultural and informal sectors (Figure 1).¹ Despite sustained economic growth, the rate of poverty reduction is slower than hoped, partly because there are not enough opportunities for poor workers to move into better jobs in the formal and non-agricultural sectors (Figure 2). Economic shocks can also dampen the pace of job creation and, if serious enough, can threaten to push Indonesia back into jobless growth.

Figure 1: Composition of active workforce by sector, 2007



Source: Sakernas.

Figure 2: Employment shares in non-agricultural and formal sectors (percent)



Source: Sakernas.

¹ National Labor Force Survey (Survei Angkatan Kerja Nasional, Sakernas), February 2009.

Rigid labor regulations have inhibited job creation and are failing to provide protection for workers, especially the most vulnerable. Indonesia's hiring and firing regulations were tightened in 2003 with the passage of the Manpower Law (No. 13/2003), which aimed to improve workers' protection. These policies benefit neither employers nor the majority of workers, trapping both in a lose-lose situation. Rigid regulations hamper job creation, by discouraging investment and productivity, and restrain the ability of employers to downsize in order to stay viable during economic downturns. Contrary to the intention of the law, however, these regulations provide little actual protection for formal, contracted workers. The most vulnerable employees – low wage earners and female workers – are the least likely to benefit from current regulations. Of equal concern, current policies exclude the majority of “outsider” workers, consisting of employees who work without a contract and those employed in the informal sector. They are left entirely unprotected by the current regulations and face dim prospects of finding better jobs. At the same time, there are few active labor programs that are designed to promote job creation and provide opportunities for informal and unemployed workers.

Labor reform attempts have been deadlocked, blocking Indonesia's ability to prepare for the challenges that lay ahead. The debate around reform of the labor law has been vigorous, focusing largely on the controversial hiring and firing regulations. Previous government attempts to improve the flexibility of the labor market by reforming these regulations, once in 2006 and again in 2007, failed. As a result, Indonesia's labor regulations continue to be among the most rigid in the region. The stalemate is constraining Indonesia's ability to accelerate the pace of 'good' job creation and also the pace of poverty reduction.

With a fresh political mandate, the new government has an opportunity to move beyond the current impasse on reforming current labor policy that is hurting both workers and employers. Indonesia's labor policies and programs can be better designed to boost job growth while, at the same time, protect vulnerable workers. The new government has an opportunity to use the next five years to introduce new policies and programs that work to the benefit of both workers and employers, by focusing on the following four priorities.

First, negotiate a grand bargain on regulatory reform. The current stalemate on severance reform is undermining the competitiveness of Indonesia's labor market and offers scant protection for most workers. Work towards a win-win solution by simplifying and decreasing excessively high severance rates while, at the same time, offering unemployment benefits to protect formal workers more effectively. An employment benefit system is a core component of the future National Social Security (NSS) system, which is a key institution in other middle-income countries.

Second, develop a comprehensive skills training strategy to equip workers for better jobs. It is not enough to simply rely on labor regulations to protect workers. Regulations are largely irrelevant for informal workers who make up the majority of the workforce. The government can assist more workers by adopting both formal and informal strategies for skills development. In the formal approach, lifting the freeze on general senior secondary schools will help meet demand. Vocational senior secondary education expansion, in turn, should respond to actual labor market demand rather than quotas. Improve the quality of vocational education to meet the strong demand for educated workers. At the same time, introduce a complementary non-formal skills training strategy to target the majority of the workers in Indonesia who are unable to access formal education.

Third, launch active labor programs that are designed to protect the most vulnerable. Workers often face the brunt of the shocks, as they did during 1997 financial crisis. In the absence of safety nets, workers typically resort to finding work in the informal and agricultural sectors. The threat of the recent global financial crisis has highlighted the need for Indonesia to better prepare for future shocks. Take advantage of

the current stable situation to prepare for future employment and wage shocks by introducing labor safety net programs to protect the most vulnerable workers. Begin with public works, which are an essential safety net that can be effectively used to target poor and low-wage workers.

Finally, invest in research to support evidence-based policy making. Many debates concerning labor market policies and programs are not based on empirical evidence. There is a need to improve the quality and depth of labor policy research to assist the new government in embarking on a reform agenda that is analytically sound and supported by strong evidence. Local think tanks, research facilities and the Central Statistics Agency all play key roles in generating data and carrying out quality labor research to meet the needs of policy makers.



Negotiating a Grand Bargain

Provide more unemployment benefits and agree to lower severance rates

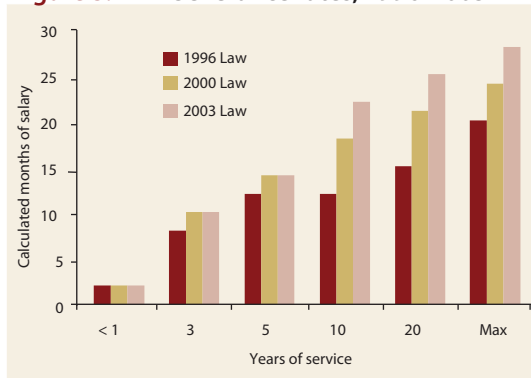
The Manpower Law substantially increased the rigidity of Indonesia's labor regulations. The law increased severance rates for workers with three or more years of service and added a 15 percent gratuity payment (Figure 3). With the increase, severance pay is estimated to be equivalent to a "hiring tax" of approximately one third of a worker's annual wage.² While it made it more difficult for employers to terminate or reallocate employees, the law also restricted the ability for firms to hire temporary employees. The use of fixed-term contracts (FTCs) and outsourcing services was restricted to non-core positions and the maximum length of a temporary contract was reduced from five to three years. The law also introduced some welcome changes. The minimum wage-setting process was improved by reforming the use of price surveys and strengthening the role of local wage councils.

Indonesia's hiring and firing regulations are now among the most rigid in East Asia and the world. In a 2009 cross-country survey comparing labor regulation rigidity, Indonesia ranked 157 out of 181 countries in the world. In comparison with neighboring competitors in the East Asia and Pacific region, Indonesia ranked 23 out of 24 countries.³ No other country in the region has firing costs that are as high as those in Indonesia (Figure 4). While most Asian economies limit the use of FTC work to certain activities and stipulate both the duration of the contract and the conditions for renewal, Indonesia falls into the group of countries with more restrictive regulations governing FTC work, alongside Cambodia, the Philippines, and Vietnam.⁴

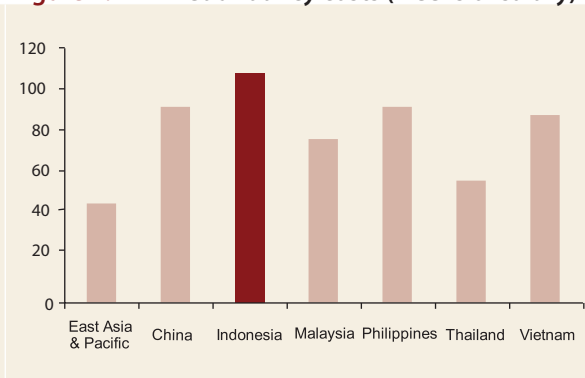
2 Severance pay, based on the Manpower Law, is estimated to be equivalent to a "hiring tax" of about 4.1 monthly wages, up from an average 2 months in 1996 and 3.4 months in 2000. (*Laboratorium Penelitian, Pengabdian Pada Masyarakat dan Pengkajian Ekonomi*, LP3E, Faculty of Economics, Padjadjaran University. "Indonesia's Employment Protection Legislation: Swimming Against the Tide?" 2004. Prepared for GIAT, a USAID/GOI project).

3 World Bank 2009a. *Doing Business*. Note: The report is based on survey findings that quantitatively measure regulations for employing workers across 181 economies. For details see www.doingbusiness.org.

4 Based on country-specific regulations in Asian economies from the ILO (LABORSTA on-line database, 2008) on the duration of temporary contracts and the conditions under which they are permitted.

Figure 3: Severance rates, 1996-2003

Source: UNPAD, 2004.

Figure 4: Redundancy costs (weeks of salary)

Source: Doing Business, 2009.

Developing countries with rigid labor regulations face more difficulties in generating jobs, worsening labor market outcomes for workers. Empirical evidence of the impact of increased rigidity of job creation is not available for Indonesia because data on severance payment and contract status has not been consistently collected. International research, however, consistently finds that developing countries with onerous labor regulations also experience lower rates of investment, productivity and investment in manufacturing.⁵ Rigid labor regulations hamper job growth by limiting the benefits of trade openness and discouraging entrepreneurs from starting new businesses. This has a direct, negative impact on workers. Developing countries with rigid labor regulations are more likely to experience lower (male) participation in the labor force, lower employment rates, and high unemployment rates – especially among women and young people.⁶ A study of 74 countries concluded that if Indonesia maximized the flexibility of its labor regulations, the unemployment rate would decrease by 2.1 percentage points and the youth unemployment rate by 5.8 percentage points.⁷

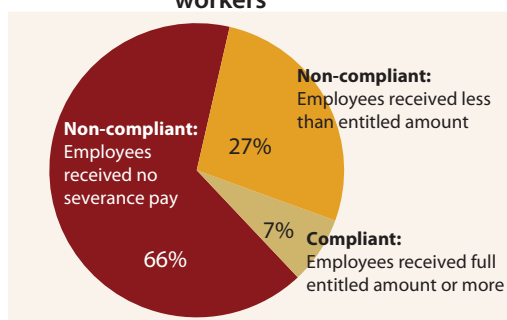
The current stalemate traps workers and employers in a lose-lose situation that constrains job creation and leaves employees inadequately protected. Indonesia's high de jure severance rates deter foreign investment and discourages entrepreneurs from creating new businesses. Complicated rules about severance calculations and the current "post-pay" system introduce additional problems by making it difficult for firms to predict their labor costs. High severance rates not only hurt employers, but employees too. The regulations have not been effective in protecting employees who are terminated and face unemployment. Only 34.4 percent of all eligible employees who separated from a job in the last two years actually received severance pay (Figure 5). Of those employees who actually received severance pay, 78.4 percent collected less than amount to which they were legally entitled. The burden of non-compliance falls disproportionately on the workers who, arguably, need more income protection: women, temporary staff and low-wage employees (Figure 6). Small firms are more likely to avoid compliance because they are too small to form unions and fall under the radar of labor inspectors.

⁵ Djankov, Simeon and Rita Ramalho. 2008.

⁶ Ibid.

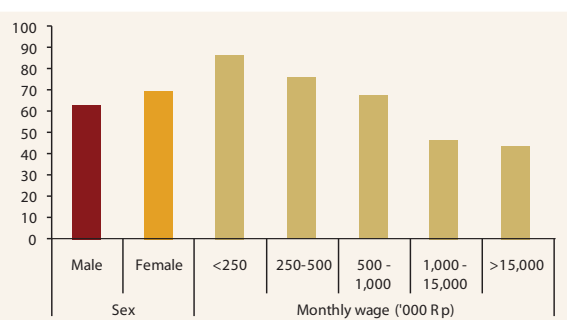
⁷ Feldmann, 2008.

Figure 5: Receipt of severance pay, as reported by terminated workers



Source: Sakernas 2008.

Figure 6: Eligible workers who report not receiving severance pay (percent)



Source: Sakernas 2008.

By negotiating a grand bargain – lowering severance rates in exchange for introducing unemployment benefits – the government can improve labor market flexibility while increasing protection for employees. There is scope to find a win-win solution that works both for employers and employees. First, simplifying severance calculations and adjusting rates downward will bring Indonesia in-line with regional standards, improving labor market flexibility and global competitiveness. At the same time, introducing a complementary unemployment benefit system can improve the level of protection for terminated employees. Shifting towards a monthly contributory approach – where firms make monthly contributions to an account that is managed centrally with government oversight – will improve the predictability of firms' labor costs without influencing their hiring and firing decisions. It will also likely increase the level of compliance by employers, which will help reduce reliance on the Industrial Relations Courts that are backlogged with disputes concerning employment termination.⁸ This will be a relief to both employees and employers who find the dispute resolution process costly and time-consuming.

There are a range of unemployment benefit systems that should be considered and assessed for inclusion in the future National Social Security system. Indonesia is ready to begin following the lead of other middle-income countries that have adopted unemployment benefit systems. There is a range of reform options that can improve the predictability of labor costs and compensate workers for lowered severance rates. The options include a pooled fund from which terminated employees can draw, an individual account severance system, or a flat-benefit unemployment assistance program (Box 1). Each option has its respective advantages and disadvantages, and varies in terms of the level of institutional complexity to manage the program.

The reform process can be kick-started by initiating the necessary analytical homework to identify which option best fits Indonesia. Simulation studies are needed to assess the anticipated impact of the alternative systems and the institutional implications and demands associated with each reform option. Based on the best-suited model, a reform roadmap is needed to lay the foundations for the future system, which should be linked to the future national social security system mandated by the Social Security Law (No. 41/2004).

⁸ Nugroho, 2008.

Box 1: Severance Reform Options

Option One: Severance Fund: Firms make regular severance payments to a pooled fund that is administered by a central government agency or private firm(s). Terminated employees receive severance according to years of service. Individual pooled funds may be created for each firm, or shared among all contributing firms.

Option Two: Individual accounts: Employers and employees regularly deposit contributions into individual accounts managed and disbursed by a central agency. Unemployed contributors draw from their own accounts upon confirmation of unemployment status.

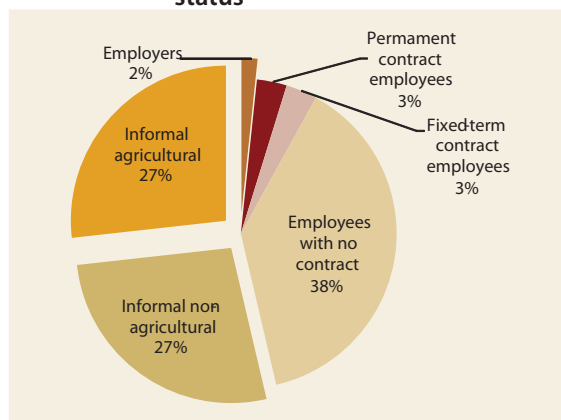
Option Three: Flat-benefit unemployment assistance: Create a fund that eligible workers can draw from when unemployed. Funds are managed and disbursed by an appointed agency, not the employer. Unemployed workers receive a low benefit from a common fund for a specified period of time. Eligibility based on active job search and availability of suitable work. Possibility to make benefits contingent on means-tested family income.

Source: Revenga and Rigolini, 2007, and Vroman, 2007.

Contract-less and informal workers lose the most in the current stalemate; reforms are needed to increase opportunities for them to find better jobs. It is not possible to reach the majority of Indonesia's highly informal workforce by regulatory reform alone. Indonesia's labor market is highly segmented by sector and contract status. Labor regulations mostly benefit employees with a permanent contract (less than 3 percent of the workforce) and unionized employees (11.2 percent of wage employees). Regulations, however, are largely irrelevant for the 92.1 percent of all workers who are either employed without a contract or work in the informal sector (Figure 7).

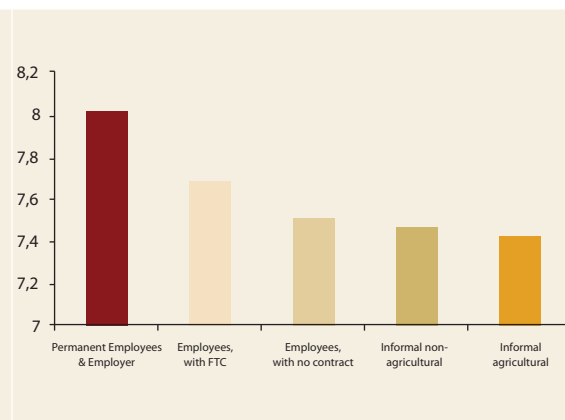
Easing the rigidity of current regulations will benefit these "outside" workers by creating more work opportunities in the formal sector. By finding better jobs in the formal sector, they could expect to earn 20 percent more and are more likely to receive non-wage benefits such as medical coverage (Figure 8). That said, many workers will still remain trapped in the informal sector for the foreseeable future with limited chances of upgrading their employment status. For this reason, regulatory reform alone is not sufficient to improve the prospects for most Indonesian workers. Additional strategies are therefore needed to empower and protect Indonesia's excluded and vulnerable workers.

Figure 7: Segmentation – Distribution of active workforce by employment status



Source: Sakernas 2008.

Figure 8: Comparative monthly wages (log mean), by employment status



Source: IFLS 2007.



Developing a Comprehensive Skills Training Strategy

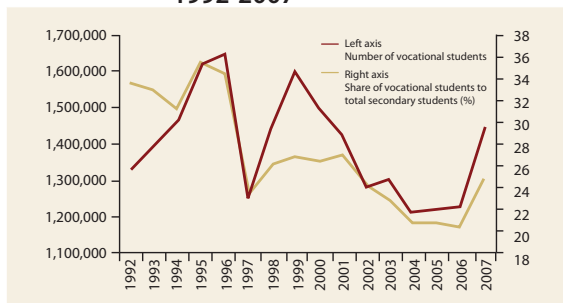
Equip vulnerable workers with the skills they need to succeed in the labor market

The main government strategy to improve workforce skills is through broad expansion of vocational senior secondary schools, both public and private. In 2005, the Ministry of National Education (MoNE) launched its controversial “70:30” policy that aims to have 70 percent of all senior secondary students enrolled in public and private vocational (SMK) schools by 2015.⁹ This is a major increase from the current rate of 46 percent of students enrolled in vocational schools in the 2008-09 school year (Figure 9). The government has three general strategies to achieve their target ratio: freeze construction of new general secondary school (SMA), accelerate the construction of new SMK schools, and convert existing general schools into vocational facilities. The change process has already begun. From 2006-07 until 2008-09, 1,211 additional vocational schools were created while 375 general schools were closed.¹⁰ As a result of the expansion almost 1.2 million more students are now attending SMK schools than there were in 2002-03 (Figures 10). The policy is motivated by the aim to lower youth unemployment rates by providing senior secondary students with job-specific skills.

9 MoNE, 2006a. Note: vocational schools at the senior secondary level are called Sekolah Menengah Kejuruan (SMK). General senior secondary schools are called Sekolah Menengah Atas (SMA). A third school type at the senior secondary level, the Islamic schools (Madrasah Aaliyah), is not included in the analysis for this chapter. However, the number of senior secondary students enrolled in Islamic schools is very small compared to SMK or SMA.

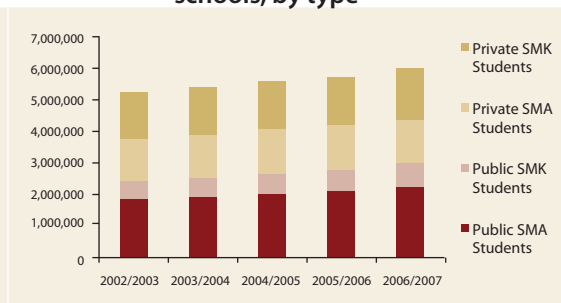
10 MoNE, www.depdiknas.go.id.

Figure 9: Vocational school enrollment, 1992-2007



Source: Newhouse and Suryadarma, 2009 (based on Susenas).

Figure 10: Enrollment in senior secondary schools, by type

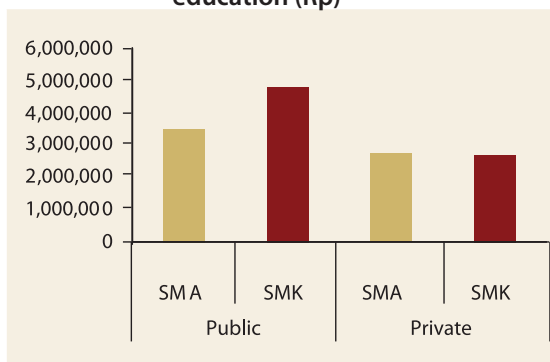


Source: Sakernas and World Bank calculations.

Vocational senior secondary education, however, does not provide clear advantages for graduates in the workforce. Despite the intention of the “70:30” policy, public vocational education does not lower the chances of graduates being unemployed any more than if they graduated from public general schools. It has improved the men’s prospects of finding formal employment, but this advantage has disappeared for the most recent group of graduates. Although female public SMK graduates enjoy a wage premium, this has eroded over time. This development is grimmer for recent male graduates from public SMK who face an increasingly large wage penalty that reached 30 percent in 2000 and 43 percent in 2007.¹¹ Men who are top-scorers in school face steep wage penalties without a public general diploma, and stand to lose the most from the government’s expansion policy. Vocational schools, especially private vocational, play a valuable role in serving low scoring students who can expect wage outcomes similar to those who graduate from SMA.

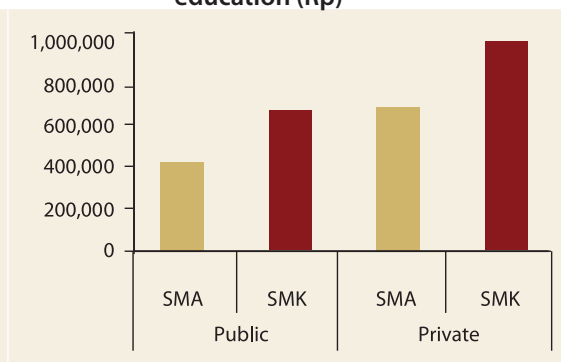
Without clearly improving labor outcomes, the current broad expansion of vocational schools is not cost effective for either the government or parents. Vocational schools are more costly to run and more expensive to attend than general schools. Given that estimated public SMK costs per student are 37 percent higher than for public SMA, the 70:30 policy will require an additional budgetary input of approximately Rp 5 trillion per year once the target is reached (Figure 11). Vocational school is also expensive for parents. “Out-of-pocket” costs for parents are 36.9 percent higher for public SMK than public SMA. Private SMK is 31.4 percent more expensive than private SMA (Figure 12).

Figure 11: Public costs of vocational education (Rp)



Source: Ghozali and World Bank.

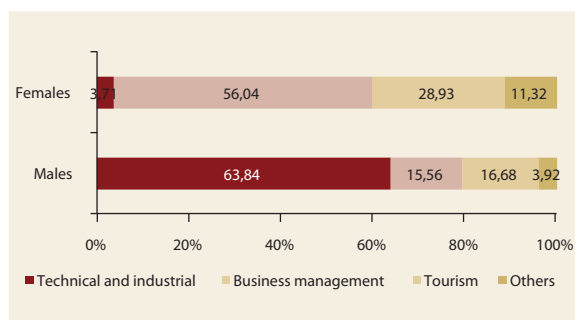
Figure 12: “Out-of-pocket” costs for education (Rp)



Source: Susenas, 2006.

11 Newhouse, David and Daniel Suryadarma, 2009.

Figure 13: Choice of SMK majors, by sex



Source: Susenas 2006.

Figure 14: Workers with SMA or higher, by sector (millions)



Source: Sakernas.

Senior secondary education should expand to meet strong demand for educated workers, taking cues from the labor market to determine the “right mix” of school type. The demand for educated workers remains high even though there are now more educated Indonesian workers than ever before. Access to senior secondary schools needs to be expanded to meet the demands of the workforce and allow more graduates to benefit from high wage premiums for educated workers. Lifting the freeze on public general schools is not only a cost effective way to expand access but it also ensures that academically strong students are in the best position to find well-paying jobs. Although vocational education plays an important role in expanding the pool of educated workers, especially for academically weak students, quotas should not be set to increase enrollment levels. Instead, the supply of SMKs should be flexible so that it can better respond to the needs of employers. Currently, the shift is more towards service-oriented skills than technical and industrial skills, which is benefiting female graduate students who tend to choose majors that are more aligned with the expanding service sector (Figures 13 and 14). Finding the “right mix” in the future requires monitoring the changes in the types of skills that employers demand, and responding with the appropriate educational policies.

Improving the quality of both general and vocational schools can help satisfy the demand for better educated workers. Successes in expanding the pool of more-educated adults have not been matched by a deepening in the quality of education. Indonesia’s educational performance continues to lag behind regional countries. This may be contributing to growing disparities in the wage outcomes between academically stronger and weaker students. To improve the quality of vocational education it will be necessary to create and enforce minimum standards for SMKs, most of which currently fall below national standards. Fostering stronger linkages with employers, ensuring adequate financial resources, and improving teacher quality are also key ingredients in improving vocational education outcomes.¹² Mismatch, although decreasing, continues to be a problem; almost one-quarter of tertiary graduates are employed in jobs outside of their area of expertise. Innovative matching programs, such as those used in model vocational schools and universities, can help graduates successfully transition from school to the workforce.

Complementary skills training are needed as a second-chance for workers who cannot access senior secondary education. Given that only one-quarter of the workforce has completed a senior secondary level of education – low even by regional standards – a skills strategy focusing only on formal education is inadequate. A complementary strategy is needed to build the skills of uneducated workers through non-formal training. Public training centers – *Balai Latihan Kerja* (BLK) – however, are unprepared to meet demand. There are only approximately 162 centers located across the country training a small number of

¹² Wicaksono, 2008.

workers (42,500 people in 2003-04).¹³ Although intended to target job seekers and self-employed workers in small business and agriculture, BLKs largely contract out their services to train workers already employed by client firms. The Ministry of Manpower and Transmigration (Depnaker) assessed BLK conditions in both 2004 and 2006 and found that approximately 60 percent of all the centers are in poor condition, in terms of their facilities, equipment and human resources.¹⁴

There is a need to introduce a well-designed comprehensive national skills training program to improve the labor outcomes of vulnerable workers. There is a gap in providing skills for the unemployed or new entrants to the labor market. International experience shows that training interventions, such as the *Jóvenes* programs in Latin America (Box 2), have been successful in improving labor market outcomes for participants.¹⁵ Rather than simply providing classroom-based learning, these programs offer a broader array of services that include: internships, job search assistance or on-the-job training, and wage subsidies. The curriculum does not only include training in technical skills, but also soft “life” skills that are increasingly in demand from prospective employers in Indonesia.

Box 2: The *Jóvenes* Programs: Best practice in skills training

Jóvenes programs offer poor, young people training in both professional and life skills followed by workplace internships. Based on a pilot in Chile in the early 1990s, this comprehensive approach to training has spread throughout the Latin American region, with each country tailoring the program to their needs. Disadvantaged young people are identified using, for example, out-of-work statistics, socioeconomic data, and poverty mapping. Qualified private firms, NGOs, public institutions and non-formal training agencies provide training on a competitive basis. Providers are required to arrange internships for their trainees and to ascertain what kind of skills local employers need before they can receive any funds for training. In this way, internships provide information on the skills for which there is demand. Intensive life skills training focuses mainly on problem-solving skills, correct workplace behavior, conflict management, job search techniques, and building self-esteem.

Programa *Jóvenes en Acción*. The pilot of Colombia’s version of this program began in May 2001, offering job-training courses for 100,000 unemployed men and women in the two lowest levels of income. The program was implemented in seven cities with a total investment of US\$ 17.6 million. This training program is part of the Social Support Network (Red de Apoyo Social) that also includes emergency public works for income generation and family education and health allowances for poor rural families. Youth between the ages of 18 and 25 receive training allowances and vouchers, which they can use to enroll in a training course of their choice from a list of competitively selected providers. Job training lasts about three months and is followed by a three-month internship in a company or organization. Beneficiaries also receive a food and transportation allowance. The program is administered by a group of government agencies, nonprofit organizations and private companies.

An evaluation of the *Jóvenes en Acción* program has shown impressive results:

- **Higher employment rates:** For women, training increased the probability of employment, days and hours worked, and the probability of having a job with a written contract. The impact was similar but more limited for men.
- **Wage increases:** The most significant impact of the program was the substantial increases in salaries: women’s salaries increased by 35 percent, while men’s salaries increased by 18 percent.
- **Cost-effective:** The program generated a large net gain, especially for women. Even the most conservative of the cost-benefit calculations suggest that the net benefits of the program more than justify its existence and possibly its expansion. The lower bound internal rate of return is 13.5% for women and 4.5% for men.

Source: Attanasio, Orazio, Adriana Kugler and Costas Meghir. 2007.

13 Alisjahbana et al., 2008.

14 Ibid.

15 Puerto and Fares, 2008.

Indonesia needs a new skills training program that is sufficient in scope to reach out to those who do not have access to formal education or public training facilities. A new comprehensive training program can form the second component of a national strategy to equip workers with job relevant skills. This future program, unlike current BLKs, should support vulnerable and disadvantaged workers, especially targeting young, poor and informal workers who would benefit the most from a second-chance. Contracted service providers (private sector and NGO providers) can be used to pilot the program. Depnaker should take the lead in strategic planning and monitoring the performance of the implementing agencies. Supporting private-public partnerships will help to build links with prospective employers and ensure that training providers survey local employers to ascertain the needs of the local labor market. Training alone, however, cannot protect vulnerable workers from the risks that they face. Additional measures are needed to protect them in the event of employment and wage shocks.

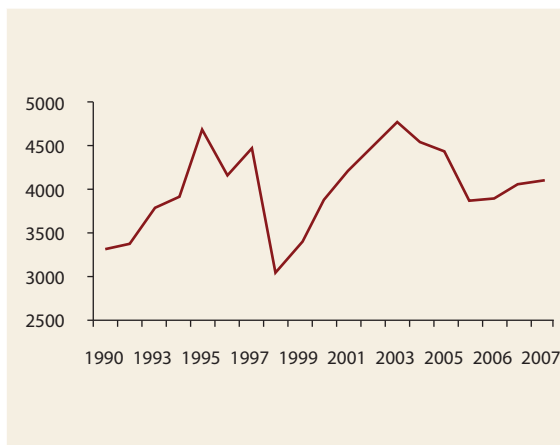


Expanding Labor Safety Nets

Protect vulnerable workers from employment and wage shocks

In the absence of social protection systems for workers, informal and agricultural job markets have served as default safety nets during employment and wage shocks. The 1997 East Asia financial crisis hit Indonesian workers hard. Median real wages fell by 31 percent in one year and many formal sector workers lost their jobs (Figure 15). Stable employment rates masked a massive re-allocation of workers into the informal and agricultural sectors, which acted as safety nets in the absence of government protection systems. This reverse structural transformation was a setback for many workers as well as for Indonesia's development.

Figure 15: Median real wages (Rp)



Source: Sakernas.

Figure 16: Jobless growth - share of non-agricultural jobs (percent)



Source: Sakernas.

The government policy response – rapid minimum wage increases – failed to protect low-wage workers after the crisis and led to increased exclusion of informal workers. Following the 1997 financial crisis and the ensuing democratic transformation, minimum wages in Indonesia rapidly increased to help employees recover from the wage crisis. “Maxi” minimum wages were used as the wage-setting mechanism for unskilled workers and contributed to rising average wages.¹⁶ Minimum wage increases had the unintended consequence of shrinking the availability of formal and non-agricultural jobs (Figure 17). This particularly affected the expanding service sector that became less labor-intensive as wages rapidly increased during the 1999-2003 crisis recovery period. Indonesia was the only country in the region that suffered from jobless growth during this period and failed to expand work opportunities in the formal and non-agricultural sectors (Figure 16).

Policies to increase minimum wages, moreover, failed to provide an effective safety net for low-wage workers. Poor employees benefit the least from minimum wage hikes because they are more likely to work for non-compliant employers, who tend to be small and medium enterprises that fall below the surveillance of labor inspectorates (Figure 18).

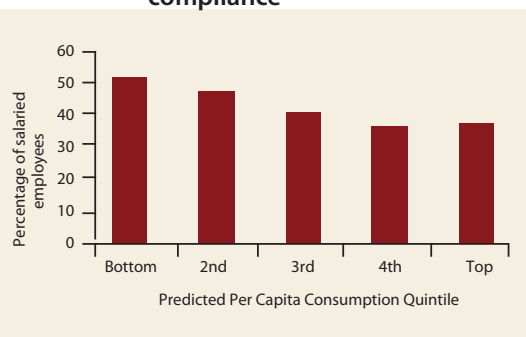
During economic downturns, workers at risk of losing their jobs have few safety nets to fall back on. Although Indonesia has weathered the recent global economic downturn, many questions have been raised about the preparedness of the government to protect laid off workers who depend on stable income to support their families. Severance pay and pension provident funds are not providing effective safeguards for workers who lose their jobs.¹⁷ Nor will increasing minimum wages for workers help workers who have lost their jobs. In fact, raising labor costs during a crisis may cause Indonesia to fall back into jobless growth. In the absence of social protection systems for workers, there is a risk that they will resort to the default safety net of jobs in small-scale agriculture and the informal sector, which pay less and offer less security.

Figure 17: Minimum wages and formal employment



Source: Sakernas 2006 and World Bank.

Figure 18: Minimum wages and non-compliance



Source: Sakernas 2006 and World Bank.

Increasing the frequency and improving the comprehensiveness of labor data can help to detect shocks in-time and accurately pinpoint affected workers. Protecting workers from shocks requires collecting up-to-date information for early detection and pinpointing which regions and households are most affected. Currently, labor force surveys are only conducted semi-annually using a large sample size. The Central Statistics Agency (BPS) can increase the timeliness of data while, at the same time, reduce costs, by adopting a quarterly or continuous survey approach that can provide labor data on a quarterly or monthly basis. There is also a need to expand survey questions to better monitor the extent of vulnerability among

¹⁶ Saget, 2006.

¹⁷ Vroman, 2007.

workers. Local think tanks and research facilities, with technical support and capacity building, can use this data to track changes in the labor market and diagnose how shocks are transmitted to workers to inform the design of response mechanisms. Delays in delivering program responses can be costly to vulnerable workers and their families.

This data can feed into a permanent monitoring system that can detect future shocks, including wage and employment shocks. Emergency safety nets cannot be effective or timely unless there is a monitoring system and a stand-by team responsible for scanning available data (including on-the-ground reports) to detect impending crises. The crisis monitoring and response system serves as a prototype for a future monitoring and response system, which could be established on a sustainable and on-going basis so that future shocks can be monitored and addressed as they occur.

Monitoring information can inform the design of a future emergency response system that governs when and how safety nets for workers will be delivered in anticipation of a range of potential shocks. The system should identify triggers that justify the deployment of temporary assistance through various program channels. Developing this system will require the advance preparation of guidelines that anticipate responses for specific scenarios, including details on recipient identification, size and type (e.g., cash or in-kind transfers, public works) of assistance package, and window-closing conditions. The design of the response system should also clarify how institutions will work together to carry out design, activation, financing and delivery in order to provide assistance as quickly and efficiently as possible.

One of the pillars of a national shock response system should be a public works framework. The framework should govern when, where and how employment generating projects will be delivered in anticipation of a range of potential shocks. This could include the identification of triggers that will launch public works projects or increase allocations for existing labor intensive programs. For example, the National Community Empowerment Program (*Program Nasional Pemberdayaan Masyarakat Mandiri*, PNPM-Mandiri) can channel funds to support labor intensive, locally identified development projects in rural areas where it has been shown to reduce unemployment rates.¹⁸ Additional projects or channels must also be identified to provide temporary assistance to workers when needed in urban areas. At the same time, the response system can maintain a standing-list of on-going and planned infrastructure projects that can quickly absorb workers during shocks in both urban and rural areas.

Learning from past experiences and adhering to international “best practices” will help to ensure that the neediest workers are reached. These best practices include: appointing one single, central institution to be responsible for overall strategic leadership and monitoring the implementation of the program; using systematic geographic targeting in determining program locations; setting wages below the market level for unskilled workers so that workers will self-select themselves into the program;¹⁹ encouraging women’s participation by modifying program design elements; and selecting labor intensive projects that have been identified by communities or supporting infrastructure projects that are already included in development strategies will help to ensure that public works projects are useful and productive.

¹⁸ On average in PNPM-Rural programs areas in comparison to control areas. PSF Progress Report, 2008.

¹⁹ Sumarto et al., 2000.



Supporting Evidence-based Policy Making

Moving forward by filling in the knowledge gaps of the labor market

Build an empirical basis to ground highly charged debates around labor policy. While increasing the frequency of data collection will help policy makers to respond “in-time,” it is also necessary to pay close attention to what kind of data is collected. Sakernas should be designed to collect the data that will help answer the questions that policy makers find most pressing. Resume the severance pay module, for example, to determine the impact of severance pay regulations on labor outcomes for workers. Collecting data on contract status is essential in order to track the degree of segmentation in the labor market which will, in turn, inform which policies and programs are needed to target specific sub-groups of workers. Consider conducting tracer studies to examine the labor market outcomes associated with different education and training experiences.

Rigorously monitor and evaluate current programs and institutions to learn what works and what does not work. Little is known about the performance today’s labor institutions because they have not been carefully monitored or evaluated. Qualitative and quantitative assessments can identify which types of public vocational senior secondary schools and non-formal training centers deliver better results. Monitoring and assessing the performance of the dispute resolution process and the recently established Industrial Relations Courts (IRC) will generate the data necessary to find ways to improve the success rates of pre-court settlement mechanisms and remove the bottlenecks in the IRC in order to improve the speed and cost-effectiveness of coming to a settlement.

Lay the foundation for new directions by piloting and testing new approaches. Much work remains to be done to assess alternative systems to provide unemployment benefits, such as simulations and institutional assessments. Investing in thorough analysis and learning from the experiences of other middle-

income countries to inform the design of future social security mechanisms will avoid costly mistakes. Similarly, test new programs, such as comprehensive skills training programs, by first piloting and testing the approach in select areas before scaling up nationally. For potentially large and fiscally ambitious programs, incorporate randomization into the project design in order to measure impact and cost-effectiveness more accurately. Conduct rigorous impact evaluations of future training programs and public works to determine whether these approaches improve labor market outcomes for workers and are cost-effective.

Strengthen the network of think tanks and research facilities in Indonesia. Policy makers and government agencies responsible for the oversight of labor programs depend on sound analysis to make decisions. This requires the functioning of three inter-related components. First, Depnaker should ensure the public availability of recent labor market data. Second, government agencies need to understand how to ask the right questions and commission research projects that will provide them with answers. Finally, build the technical capacity of researchers, housed in think tanks and university research facilities, to carry out technically sound labor policy research.



Policy Recommendations Summary Matrix

Policy Area	Key Issues & Constraints	Specific Actions	Timeframe & Sequencing
Regulatory Reform	Low de jure severance payments leave most employees unprotected in cases of job termination.	Introduce a complementary unemployment benefit system (pooled severance fund, individual account severance system or flat-benefit unemployment assistance) as part of the National Social Security (NSS) system.	Short-term: Start the reform process by commissioning simulation studies of alternative systems and conducting assessments to determine which system is most suitable for Indonesia's institutional context.
	"Post-pay" system creates unpredictability for employers and decreases the likelihood that terminated workers receive severance pay.	Adopt a monthly contributory approach where firms make monthly severance contributions to an account managed by a third party.	Medium-term: Facilitate multi-party negotiations to reduce severance rates in exchange for implementing the selected unemployment benefit system. Develop a road-map for reform that is linked to NSS reform.
	Complicated rules and high de jure severance rates discourage entrepreneurs from starting new businesses and deter potential foreign investors.	Simplify the rules for determining severance pay and long-service pay. Adjust severance rates downwards so that they fall in-line with regional standards.	

Policy Area	Key Issues & Constraints	Specific Actions	Timeframe & Sequencing
Skills Training	The demand for educated workers remains high, but construction of general senior secondary schools is frozen.	Remove the freeze on construction of general senior secondary schools.	<p>Short-term: Conduct tracer studies on labor market outcomes of students from different types of schools. Research options for non-formal skills training programs. Conduct cross-exchange visits to the <i>Jovenes</i> program in select Latin American countries.</p> <p>Medium-term: Support vocational schools to conduct employer surveys in their regions to identify skills in demand. Pilot and test a new non-formal, comprehensive skills training program in select areas with randomized participants.</p>
	The current target for the expansion of vocational senior secondary schools does not clearly improve labor outcomes and is not cost-effective.	Replace the “70:30” policy with market-driven approach to determine the right mix of vocational and general schools. Develop a strategy to improve the quality of vocational schools and foster stronger linkages with prospective employers.	
	Public training centers are inadequate to meet demand and primarily benefit workers who are already employed.	Introduce a national comprehensive skills training program targeting young, poor and informal workers. Implement the program through private and NGO service providers, with government oversight.	
Safety Nets for Workers	In the absence of up-to-date data, it is difficult to pinpoint regions and groups of workers affected by employment and wage shocks, necessary to inform response programs.	Convert the National Labor Force Survey (Sakernas) to continuous approach, providing quarterly or monthly data while maintaining cost-effectiveness.	<p>Short-term: Determine optimal sample size for a quarterly Sakernas and budgetary implications.</p> <p>Medium-term: Commission a technical team to develop a strategic plan for the creation of a permanent public works program. Include: objectives, design features, delivery mechanisms, institutional arrangements and a step-by-step roadmap.</p>
	There are no safety nets that can be used during employment and wage shocks to effectively protect poor and low-wage workers.	Develop a national public works program targeting the poor who are willing to work, paying below market wages for unskilled workers. Use programs such as PNPM as a mechanism for registering participants and channelling funds for labour-intensive projects.	
Labor Policy Research	Data collected in the national labor force survey (Sakernas) is insufficient to answer pressing policy questions.	Expand data collection linked to key policy questions. Resume the severance pay module in Sakernas and collect data on contract status.	<p>Short-term: Conduct a workshop with Depnaker, BPS and Bappenas to identify labor data needs and propose additions to Sakernas. Develop tools that can be used by researchers to track and analyze labor trends.</p> <p>Medium-term: Develop and support a training program for labor researchers. Provide financial support for a labor policy researchers network</p>
	There is a lack of high-quality labor policy research, especially quantitative studies, to inform policy development.	<p>Ensure timely and public availability of labor market data from the Central Statistics Agency.</p> <p>Build the capacity of government agencies to formulate research questions and commission projects. Enhance the technical capacity of research institutes to conduct quantitative labor policy research.</p>	

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