

# THE MINIMUM WAGE DEBATE IN DECENTRALIZED INDONESIA

*The power of unions and local government*

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## **AKATIGA - Social Analysis Center**

AKATIGA is a non-profit research institute that was founded in 1991, by a group of social science researchers at Institut Teknologi Bandung and Bogor Agricultural University. Through various activities, AKATIGA helps the marginalized in expanding their access to resources and policy-making processes, especially in areas such as labor, small business, agriculture, community development, budgetary policy, and public services. AKATIGA provides input and recommendations based on the results of research to drive policy change. The process is done through advocacy and strengthening networks of marginalized groups, civil society, government, the media, and international institutions.



# INDONESIA



6.3

Unemployment Rate



38.1

GINI



36.5

Wage and salaried  
workers, total (% of  
total employed)



11461

GDP per person  
employed  
(constant 1990 PPP \$)



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## Introduction

The fall of the New Order under President Suharto in 1998 ended authoritarian rule and marked the beginning of a democratic era in Indonesia. In the political context of Reformation Era Indonesia, the debate over minimum wages has been influenced to a significant degree by changes in labor policy and the move toward decentralization. Since 2000, the minimum wage increased significantly as a direct result of the rise of the labor movement and the impact of a new governance structure based on regional autonomy. During the last six years (2007-2013), the real average minimum wage among the provinces increased by 61.8 percent, with the highest single annual increase being 31.5 percent in 2013.

***By shifting authority over labor affairs to local governments, this new governance structure has resulted in greater politicization of the wage-setting process.***

Freedom of association in Indonesia ended the era of a single nationwide and government-controlled trade union. During the New Order, the government curbed collective bargaining in three important ways: (1) It subsumed all worker representation under one organization; (2) it limited the mandate of that singular organization to social and economic activities, circumscribing the ability to bargain collectively; and (3) it ensured control over the national union by placing its own party members in leadership positions.<sup>1</sup>

After the fall of Suharto, the newly established freedom of association prompted a proliferation

of unions and almost instantly strengthened the power of workers' organizations vis-à-vis local and central governments. Since the year 2000, several government plans to revise labor regulations that – from the unions' point of view – had the potential to reduce workers' rights, were thrown out because of strong opposition from workers.

Workers' bargaining position also grew stronger within the process of minimum wage setting, as trade unions were afforded greater representation on wage councils. The expansion of unions' power is related not only to freedom of association, but also to regional autonomy policies introduced at the time. By shifting authority over labor affairs to local governments, this new governance structure has resulted in greater politicization of the wage-setting process.

This chapter discusses the political economy of minimum wage setting that has developed in Indonesia and seeks to examine the changing role of workers, employers, and local governments. First, the chapter explains the differences between New Order-era minimum wage setting and the regulations of the current Reformation Era. It then explains how these reforms, along with the newfound freedom of association, have transformed the political economy of the minimum wage-setting process.

The next section explores empirically how much minimum wages have actually increased. After a brief discussion of enforcement and compliance, the chapter concludes with policy recommendations toward improving Indonesia's wage-setting mechanisms.

## Minimum wage setting in Indonesia's political regimes

Three factors distinguish the minimum wage policies of the New Order period (pre-1998) and the Reformation period (post-1998): the mechanics of determining minimum wages; the level of trade union involvement; and the role of local governments. In the New Order era, minimum wage setting was carried out

by national and regional wage councils that consisted of government, employer and union representatives. The latter two, however, were appointed by the government.

In the New Order, the minimum wage applied to workers with less than 12 months of employment,

– with compensation rising afterwards based on experience and on the company’s wage structure  
– and the minimum wage review process took place every two years. The minimum wage setting was executed by the Minister of Labor, assisted by the national wage research council, based on a proposal by the local government and local wage council.<sup>1</sup>

There were six factors determining minimum wages as stated in the same regulation:

- Minimum needs for decent living, or KHL (Kebutuhan Hidup Layak), determined through market surveys administered by regional wage councils;
- Consumer Price Index;
- The potential impact on companies’ profitability;
- Local and regional average wages;
- Labor market conditions;

- Provincial level of economic development.

The minimum wage setting process was very simple and efficient in the New Order era. There was no objection to the minimum wage, largely

because there were neither redress mechanisms nor workers’ organizations. Even in the context of the Asian financial crisis of 1998, when the government decided not to increase the minimum wage, there was no labor unrest.<sup>2</sup>

***In the political arena, the issue of minimum wages has become a vehicle for picking up workers’ votes in local elections. In some cases, local candidates have – in an effort to rally last-minute support from workers – intervened in the minimum wage setting process by violating its procedures and regulations.***

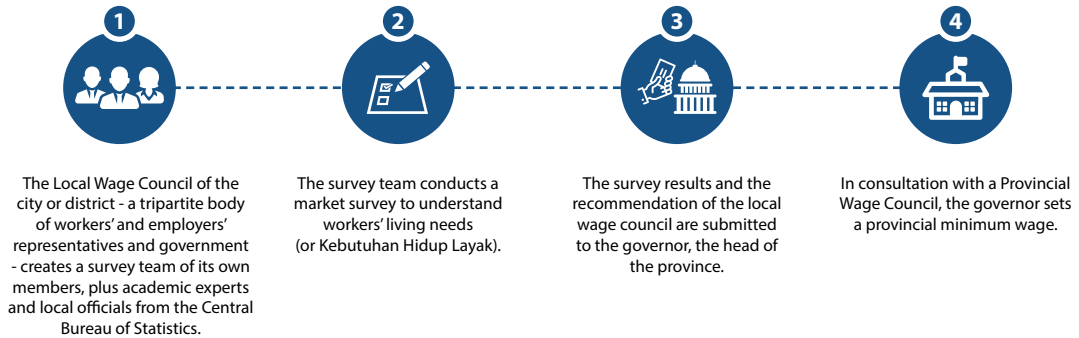
Soon after the fall of Suharto, new minimum wage regulations were introduced, transferring authority over minimum wage setting to the local government, i.e. the governor, mayor or district head. Under the new laws, the local district head (or mayor in cities) proposes the minimum wage to the governor, based on the recommendation of a local wage council.

The local wage council now has a more balanced composition of members, including government officials, trade unions and employers’ associations.

*1 As stated in the Minister of Labor’s regulation no 1/1999 on Minimum Wage. Another feature of the minimum wage law stipulated that the basic wage must make up at least 75 percent of total earnings (benefits can make up the other 25 percent).*

Figure 1

### Provincial minimum wage setting process



In addition to the provincial and local minimum wage, the new regulation also sets the sectoral minimum wages. The process is depicted in **Figure 1**.

Beyond mere representation on these councils, the power of trade unions to influence wage council proposals grew significantly as compared to representatives of government and employers, as the following paragraph will explain.

Another fundamental change is that the review of the minimum wage now happens once a year, doubling the frequency at which unions can exercise their power.<sup>3</sup> The variables used in

determining the minimum wage are equivalent to the previous regulations. However, a new ministerial decree in 2005 expanded the number of items included in "minimum needs for decent living" (KHL), adding education, health, transportation, recreation and savings.

Another post-1998 change in the minimum wage setting is the right of employers to apply for temporary suspension of payment of minimum wages with the approval of the union, as stated in an article in the Employment Law of 2003. This particular article is contrary to the general applicability of the minimum wage, which is compulsory.<sup>4</sup>

## Minimum wage setting in the Reformation Era: The power of unions and local governments

After Suharto stepped down, Indonesia's first Reformation Era presidential administration –

under B. J. Habibie – set up a plan reforming employment law with the aim of promoting the

freedom of association. The new regulations attempted to create a modern system of industrial relations that would guarantee collective bargaining rights.<sup>5</sup> The government also ratified ILO Convention no. 87, Freedom of Association and Protection of the Right to Organize, and a new law on trade union rights was enacted.

The immediate result of these policies was the mushrooming of workers' organizations. The latest data from 2013 show that there are six confederations, 92 federations, 11,852 company-based unions, and 170 state-owned enterprise unions – with a total membership base of 3,414,455 workers.<sup>6</sup> This still represents only 3 percent of Indonesia's workforce,<sup>7</sup> but the proliferation of voices in the collective bargaining landscape has significant implications for the ways in which minimum wage setting functions.

Due largely to the reforms discussed above – along with the newfound freedom of association – the political economy of minimum wage setting has undergone a dramatic transformation in the Reformation Era. Nearly every stage of the process has become a political battleground between trade unions, the government, and employers.

Minimum wage setting has become a very dynamic process because unions now have the political capital to get actively involved in the process.<sup>8</sup> Moreover, regional autonomy created

a more complex minimum wage setting process at the local level, especially in industrial zones. This growth in complexity has created additional opportunities for intervention by unions.

Minimum wages act as the core issue that unites competing unions and mobilizes hundreds of thousands of workers across the country. For each of the last 10 years, unions have leveraged the annual minimum wage setting process to flex their muscle, placing tremendous pressure on the central and local governments to set higher wages. In Jakarta and the most important industrial areas throughout Indonesia, the minimum wage fixing process is always marked by street protests and the mass mobilization of union members, who aim to influence the sessions on minimum wage setting in the local wage council.

In the political arena, the issue of minimum wages has become a vehicle for picking up workers' votes in local elections. In some cases, local candidates have – in an effort to rally last-minute support from workers – intervened in the minimum wage setting process by violating its procedures and regulations.

In 2012, for instance, a district-level incumbent made large minimum wage increases a central campaign promise.<sup>9</sup> In the same year, Joko "Jokowi" Widodo – the current president of Indonesia – approved a 40 percent increase in

the minimum wage of Jakarta while serving as governor, igniting protests from employers. In other cases, local governments have tried to counter major union-led protests with steep increases in the minimum wage. This kind of action is seen by many as undermining the role of the wage council and violating the minimum wage setting procedure. Technically, however, the local head is granted this right based on the minimum wage law.

Unions see the KHL – or basic needs index – as another way to influence the process. They advocate for additional components

and for increasing the allocations for existing components, arguing that workers are entitled to better quality goods as well. For example, unions have proposed changing certain household needs, such as suggesting that the allocation for cookware should cover the cost of a gas stove rather than an oil burner. These proposals become the subject of debate between unions and employers. In 2012, a ministerial decree increased the number of items in the KHL basket from 46 to 60 items based on the results of a study on living wages,<sup>10</sup> though the change did not meaningfully alter the KHL calculation.

Table 1

### Monthly Minimum Wage 2015 – Comparison of West Java and Central Java Districts

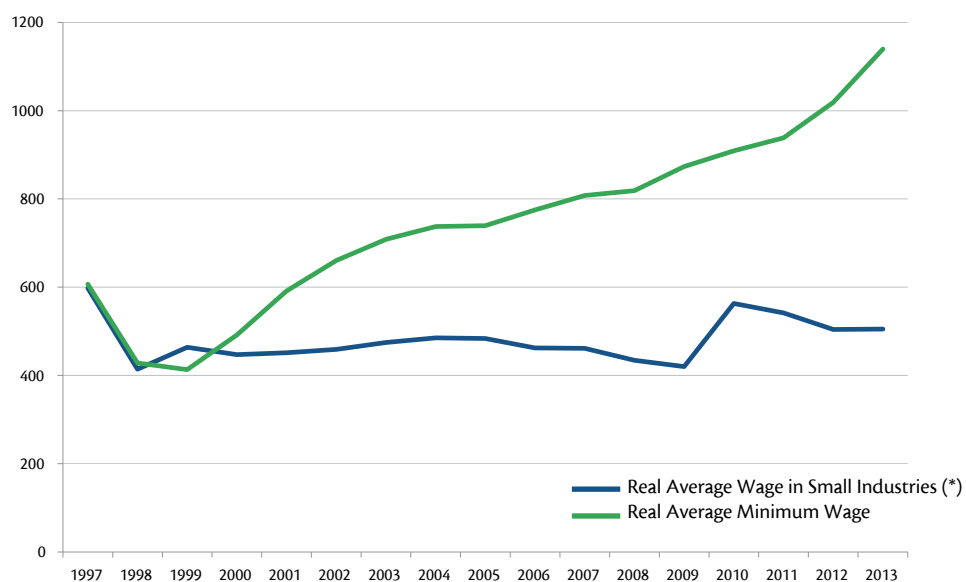
West Java		Central Java	
District / City	Minimum Wage	District / City	Minimum Wage
Bandung	Rp 2.001.195 (US \$150)	Semarang	Rp 1.419.000 (US \$107)
Purwakarta	Rp 2.600.000 (US \$195)	Pekalongan	Rp 1.271.000 (US \$95)
Karawang	Rp 2.957.450 (US \$222)	Boyolali	Rp 1.197.800 (US \$90)
Bekasi	Rp 2.840.000 (US \$ 213)	Sukoharjo	Rp 1.223.000 (US \$92)
Bogor	Rp 2.590.000 (US \$195)	Karanganyar	Rp 1.226.000 (US \$92)

Source: Daftar UMP-UMK 2015 Seluruh Indonesia. Accessed on August 15, 2015.



Figure 2

### Average Minimum Wage vs. Average Wage in Informal Small Industry Sector (1997-2013) (expressed in adjusted 2010 currency)



\* A small industry/enterprise is defined to have between 5 and 19 employees.

Source: Daftar UMP-UMK 2015 Seluruh Indonesia. Accessed on August 15, 2015.

West Java, the heart of the labor movement and where the country's most important industrial areas are located, has witnessed significant increases in minimum wages. One consequence of the increases is the growing number of factory relocations into Central Java,<sup>11</sup> which has much

lower minimum wages – about half, on average – and a weaker labor movement. **Table 1** shows a comparison of minimum wages in some important industrial cities and districts of West Java and Central Java.

## How much have minimum wages increased?

The result of this new dynamic of minimum wage negotiations means that the national average minimum wage has risen much faster than average wages in other parts of the economy.

**Figure 2** compares the national average minimum wage to the average wage in informal small enterprises over the Reformation period.

The graph shows two important trends: First, it demonstrates that the difference between the minimum wage and wages levels that firms would “naturally” set has grown. This could have adverse impacts on employment, hours worked, and non-wage benefits. Second, the graph illustrates the increasing wage polarization between those who work in Indonesia’s formal economy, earning

minimum wages, and those who work in the informal economy, where most small enterprises are located. This could be one reason for growing inequality in the country.

Moreover, the gap between minimum wages and wages in small, informal economy industries

is widening. This means that, in theory, one barrier to formalization faced by small business – the requirement to pay workers in accordance with minimum wage standards – has grown significantly. Interestingly, Indonesia is in fact not witnessing greater levels of informality.

***Increasing wage polarization between those who work in Indonesia’s formal economy, earning minimum wages, and those who work in the informal economy, could be one reason for growing inequality in the country.***

In 2015, 52 percent of the country’s workers were in the informal economy, compared to nearly 66 percent in 2011.<sup>12</sup>

# Compliance and the private sector's stance on wage developments

Employers claim the minimum wage increases have eroded Indonesia's competitiveness, soured the investment climate, and made foreign investors reluctant to come to Indonesia.<sup>13</sup> This claim is rejected by unions and has become a central point of debate surrounding the minimum wage issue. Trade unions see the significant increases in the minimum wage as the end of an era of undervalued, cheap labor in Indonesia.

Businesses object most strongly to sharp increases in the minimum wage that bypass procedures for wage setting. Some employers, through industrial associations, have taken legal action against government decisions.<sup>14</sup> Anecdotal evidence shows that other employers have shut down their factories, while many simply do not comply with the government's edicts.

***A stronger industrial relations system, where unions and employers negotiate employment terms bilaterally, would also reduce the political pressure that currently weighs down the minimum wage setting process.***

The level of compliance with minimum wage regulation is highly dependent on the characteristics of the company and on the effectiveness of local law enforcement. The minimum wage regulation says that only workers with less than 12 months of employment at the firm are supposed to be compensated at the minimum wage, with compensation rising afterwards based on experience and the wage structure of the company. In reality, workers with more than a one-year tenure are commonly paid the minimum wage.<sup>15</sup> Another violation is delay in payment. Suspension of wage payments is only allowed with union and government approval, but companies sometimes take this measure unilaterally without the necessary permission.

## Conclusions and policy recommendations

Since minimum wages are politically highly contentious between unions and employers, the government must play the role of a mediator. The current environment for minimum wage setting is the result of Reformation Era policies, and both unions and employers feel that the central government is in a weak position when it comes to wage policy.

First of all, local government leaders need to play a more productive role in setting the minimum wage according to the norms laid out in official policy. They have to respect unions' considerations but cannot ignore other factors, such as the business environment. Currently, government leaders prefer to avoid confrontation with unions by bowing to their demands, even if that means bypassing the established procedures for minimum wage setting, which are designed to take into account the needs of all stakeholders.

Another reason why minimum wage has become the focus of such intense political debate is because it is one of the only redress mechanisms available to workers. Whereas minimum wage was intended as a basic wage for only those workers with less than a one-year tenure at their company, it now functions as a kind of welfare policy, with other forms of collective bargaining playing a minimal role, if any role at all. A stronger industrial relations system, where unions and employers

negotiate employment terms bilaterally, would also reduce the political pressure that currently weighs down the minimum wage setting process.

To establish a more coherent and productive minimum wage setting process that is less disruptive and politicized, several steps must be taken:

1. **Reinforce the definition of the minimum wage as a safety net for workers with less than a year tenure, rather than a replacement for collective bargaining.** The government should require that companies paying a high proportion of their workers at minimum wage levels, including more experienced employees, submit to a review of their compensation structures.
2. **Maintain minimum wage setting procedures under the existing regulations.** Local governments should resist the path of political expediency and follow existing procedures for minimum wage setting, rather than issuing pre-election edicts to solicit workers' votes. This kind of unpredictable policy environment will ultimately detract from their districts' competitiveness.
3. **Revitalize and strengthen the role and authority of local wage councils.** Local governments should, first of all, respect the authority of local wage councils and

only override their recommendations in extraordinary circumstances. Second, the government has a role to play in strengthening these wage councils to ensure they reflect appropriate, equal representation of unions and employers, and that they adequately follow established procedures for recommending local minimum wages.

4. **Review the decentralized minimum wage setting policy.** The central government should undertake a review

of the decentralized wage-setting policy to determine whether it is still the most effective method. Just as minimum wage setting has become a union-dominated process in parts of the country where the labor movement is strong, it is also possible that minimum wages are too low in less industrialized regions where workers are not mobilized and the political economy favors employers.

## Endnotes

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