



ANTICIPATING THE POTENTIAL IMPACT OF THE CRISIS RESULTING FROM THE COVID-19 PANDEMIC ON INDONESIA'S EMPLOYMENT SECTOR



EXECUTIVE SUMMARY

The economic crisis triggered by the coronavirus disease 2019 (COVID-19) pandemic has had an impact on the employment situation in Indonesia. There are at least two implications of the crisis on the employment sector: (i) an increase in unemployment rate and (ii) changes in the landscape of the labor market.

A simulation by The SMERU Research Institute (SMERU) shows that the unemployment rate could rise to 6.19%–6.69% by the end of March 2020, as compared with 4.99% in February 2020. Meanwhile, in terms of business type, the construction industry, processing industry, trade, and corporate services are the businesses that have reduced their labor absorption the most. Efforts to stop the increasing number of unemployment will be a challenge as the possible rate of labor reabsorption will not equal the number of workers being laid off. Another challenge is that the future employment landscape will require workers to be skilled in information technology and a more flexible system of labor relations. That is the reason why a specific strategy to address the employment challenges is needed. This includes, among other things, support for the relaxation of company's operating cost, a sustainable training program for employees, a review of labor regulations to push for flexibility in the labor market, and efforts to improve productivity in the informal sector.

WITH THE PANDEMIC, COMES THE CRISIS

The COVID-19 pandemic that was first reported in Indonesia in March 2020 has had an impact on the country's socioeconomic condition in general. The pandemic has forced the government to put a halt to a number of social and economic activities temporarily to minimize the spread of the virus. For this purpose, some regions have started to impose a large-scale social restriction (PSBB) policy. This move was one of the factors behind the disruption of economic activities that has triggered the economic crisis. A report by Statistics Indonesia (BPS) stated that the country's economy in the first quarter of 2020 grew by only 2.97%, much lower than 5.02%, as recorded in 2019 (BPS, 2020). The declining economic performance affects the employment situation in Indonesia. There are at least two implications of the crisis for the employment sector: an increase in unemployment and changes in the landscape of the post-crisis labor market.

AN INCREASE IN UNEMPLOYMENT

The crisis has resulted in many employees being furloughed or laid off. According to the Ministry of Labor, by early April 2020, around one million employees were furloughed or laid off (Biro Humas Kemnaker, 2020). However, the number does not accurately describe the overall unemployment rate as it does not include the unemployment rate of the informal sector and the new workforce that is still unemployed. Therefore, it is necessary to have information about the overall rate of unemployment that (i) covers the informal sector, resulted from lay-offs, and includes the new workforce which had just entered the labor market.

SMERU simulated a calculation of the total increase of unemployment and calculated the rates of the declining labor absorption of each business sector as a result of the economic contractions until the end of March 2020 (Figures 1 and 2; the method is presented in Box 1). The simulation provides at least two pieces of information that can be used to formulate employment policy strategies: (i) a general overview of unemployment rate and (ii) basic information on backgrounds of the workers who have lost their jobs, based on the business fields they had worked in before they were laid off.

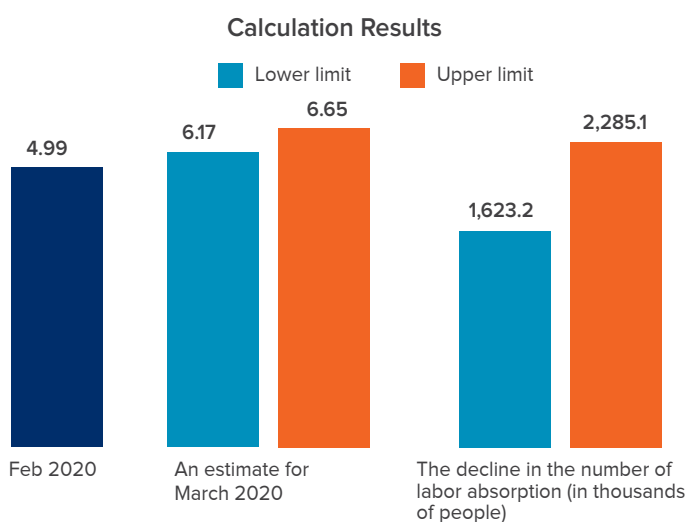
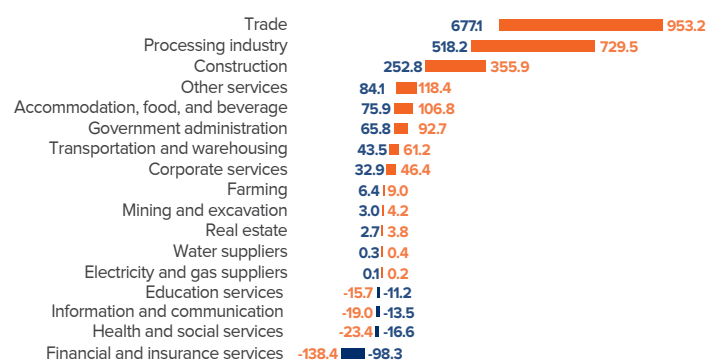


Figure 1. Results of the simulation of open unemployment rate and decline in the number of labor absorption

The simulation shows that the open unemployment rate will rise from 4.99% in February 2020 to around 6.17%–6.65% by March 2020. The percentage equals the decline in the number of labor absorption that reaches 1.6 to 2.3 million people.

The decline in the number of labor absorption (in thousands of people)



Proportions of the Decline in Labor Absorption (%)

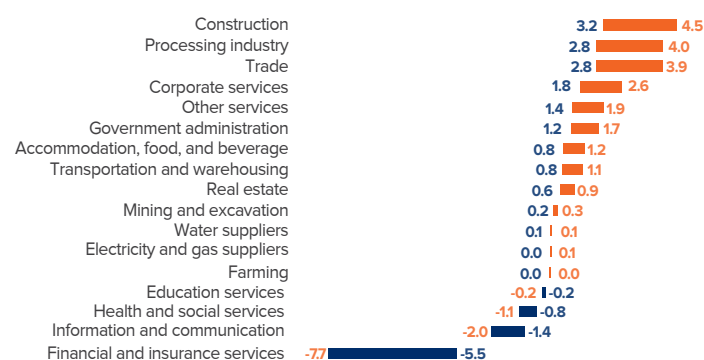


Figure 2. Number and proportions of the decline in labor absorption of 17 business fields

When seen in terms of sectoral distribution, trade is the sector that has been undergoing the sharpest decline of labor absorption. The estimation shows that labor absorption of this sector has dropped to around 677,100–953,200 people. However, when seen in terms of proportions, construction is the sector that has the most reduction in labor absorption, with a proportion of 3.2%–4.5% of its total workers in February 2020. Nevertheless, there are sectors, such as education services, information and communication, health and social services, and financial and insurance services, estimated as still absorbing labor. This is likely to happen because during the first quarter of 2020, the gross domestic product (GDP) of these sectors showed an increase, compared to the same period of 2019.

POST-CRISIS CHANGES IN THE LANDSCAPE OF THE LABOR MARKET

Another challenge for the labor sector is the potential post-crisis changes in the labor market. The changes may lead to less formally educated and low-skilled workers being eliminated from the formal sector. There are at least four factors that will trigger this to occur.

- First, labor absorption rate will not equal the number of workers being laid off.
- Second, companies will only recruit employees who have high productivity and are able to perform multiple tasks. For example, hotels will only recruit employees who have some managerial skills and can serve guests at the hotel's restaurant.
- Third, businesses that are projected to grow after the COVID-19 pandemic are those related to technology, for, as the current crisis has taught us, technology enables economic activities to keep going, even when there is very little physical interaction between people (McKinsey & Company, 2020). Therefore, in the near future, workers in demand are those who have the know-how to use technology.
- Fourth, business owners will be more interested in outsourcing and hiring contract workers as both provide the companies with high flexibility in relation to labor.

TAKING COMPREHENSIVE STEPS TO MITIGATE THE IMPACT OF THE CRISIS ON THE LABOR MARKET

Considering the impact of the crisis on the increasing rate of unemployment and potential changes in the labor market in the near future, we recommend the following.

1. Helping businesses to endure the crisis by formulating more relaxation policies

The government needs to provide businesses with assistance in the form of relaxation of companies' operating cost and monitor its implementation so that layoffs and furloughs—the moves companies take to reduce their operating costs—can be minimized. Even though the Ministry of Finance has issued a tax relaxation policy, more relaxations are needed for other elements of operating cost, such as electricity and interest on loan, so that businesses can survive in the time of crisis.

2. Revisiting labor regulations to encourage labor market flexibility

The Ministry of Labor needs to revisit regulations related to the time-specified work agreements (PKWT), the time-unspecified work agreements (PKWTT), and the daily work agreements (PKHL) as there will be possible changes in the post-pandemic employment landscape. Among the regulations is Article 56 of Law No. 13 of 2003 on Labor. Revisiting existing regulations is needed to improve labor market flexibility in order to encourage post-pandemic labor absorption. Improving labor market flexibility, however, should not sacrifice the welfare of the workers in the long run. Therefore, it should be accompanied by prioritizing an increase in the coverage of workers in the labor social security scheme, within a more flexible ecosystem of labor market. Furthermore, after the pandemic, the flexibility will be necessary to minimize possible changes in resource composition from one that is labor-intensive to one that is capital-intensive.

3. Empowering low-skilled workers through a sustainable training program to improve their skills

The Ministry of Labor, together with relevant stakeholders, need to design a sustainable training program for low-skilled workers so that they can compete in the labor market. The changes in the labor market landscape—resulting from the lessons business owners learned from various changing situations during the pandemic—have made businesses in every economic sector act more efficiently in hiring workers. High-skilled workers and those with multiple skills are far preferable than low-skilled workers.

4. Giving more attention to the informal economic sector, such as MSMEs, as it plays an important role in slowing down the increasing rate of unemployment

With the fact that more people from the less formally educated or low-skilled workforce will be pushed into entering the informal sector, the central government needs to provide greater support (in the forms of, for example, capital support and technical assistance) to the informal sector, especially the micro-, small-, and medium-sized enterprises (MSMEs). This is important to improve the productivity of MSMEs. It is hoped that the growth in the informal sector's productivity, followed by the growing size of the businesses, will become an enabling factor to absorb ex-workers who cannot be reabsorbed by the companies after the pandemic. Furthermore, MSMEs, whose businesses have stopped operating during the pandemic, are in need of capital support and technical assistance to start a new venture or restart their previous one. ■

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Box 1 Estimation Methods

Estimation of an Increase in Open Unemployment Rate

We came up with an estimate of an increase in open unemployment rate by calculating the elasticity of unemployment rate against economic growth. The first step is calculating the changes in the unemployment rate of 2005. The calculation uses the following formula.

For each i scenario:

$$\Delta TPT_{2020,i} = \Delta TPT_{2005,i} \times \frac{\Delta PDB_{2020}}{\Delta PDB_{2005}}$$

$PDB = \text{GDP}$
 $TPT = \text{open unemployment rate}$

in which $i=\{1,2\}$, $\Delta TPT_{2005,1} = TPT_{\text{Aug 2005}} - TPT_{\text{Feb 2005}}$, and $\Delta TPT_{2005,2} = TPT_{\text{Aug 2005}} - TPT_{\text{2004}}$. In this formula, figures 1 and 2 refer to, respectively, the lower and upper limits of the estimate. The economic growth difference used is $\Delta PDB_{2020} = PDB \text{ growth of } q1 \text{ 2020} - PDB \text{ growth of } q1 \text{ 2019}$ for the economic growth difference of 2020 and $\Delta PDB_{2005} = PDB \text{ growth of } q4 \text{ 2005} - PDB \text{ growth of } q4 \text{ 2004}$ for the economic growth difference of 2005.

Estimation of a Decline in Labor Absorption

After calculating the increase in the open unemployment rate, the next step is calculating the rate of labor absorption decline that reflects the changes in the open unemployment rate. The calculation uses the following formula.

$$\Delta UNEMP_{2020,i} = \Delta TPT_{2020,i} \times \text{Feb 2020 workforce}$$

in which $i = \{1,2\}$ with 1 and 2 showing the lower and upper limits of the estimate.

Estimation of the Spread of Labor Absorption Decline in Each Business Sector

After we have the number of labor absorption decline, the next step is calculating the spread of the number for each sector. For each sector j and scenario i :

$$\Delta UNEMP_{2020,j,i} = \Delta UNEMP_{2020,i} \times \frac{\Delta US_{2020,j}}{\text{SigDeltaUS}_{2020}}$$

in which $\Delta US_{2020,j}$ is the effect of the changes in sectoral growth on number of workers in each sector, calculated using the formula $\Delta US_{2020,j} = \Delta PDB_{2020,j} \times \text{no. of workers}_{2020,j}$ while SigDeltaUS_{2020} is the number of workers affected by the changes in growth calculated using the formula $\text{SigDeltaUS}_{2020} = \sum_{i=1}^{17} \Delta US_{20,i}$. The growth change of every sector j for the GDP of the first quarter of 2020, $\Delta PDB_{2020,j}$ is the difference of the GDP growth of the first quarter of 2020 for every sector j from the GDP growth of the first quarter of 2019 for every sector j . In other words, $\Delta PDB_{2020,j} = \text{growth of } PDB \text{ } q1_{2020,j} - \text{growth of } PDB \text{ } q1_{2019,j}$.

Adjustment to the Estimate Based on the Sources of Economic Growth

The last step in the estimation process is making an adjustment to the estimation result of the previous step by considering the sources of economic growth of the first quarter of 2020. The adjustment is necessary to capture the role of each sector in the economic growth in order to calculate the spread of the labor absorption decline. The sources of economic growth of the first quarter of 2020 against those of the first quarter of 2019 for every sector j , $\text{SOG}_{2020,j}$ are calculated using the formula:

$$\text{SOG}_{2020,j} = \frac{PDB \text{ } tw1_{2020,j} - PDB \text{ } tw1_{2019,j}}{\sum PDB \text{ } tw1_{2019,j}}$$

After calculating the sources of growth, the next step is calculating the proportion of the sources of economic growth of the first quarter of 2020 for every sector j , $\text{PrSOG}_{2020,j}$ using the formula:

$$\text{PrSOG}_{2020,j} = \frac{\text{SOG}_{2020,j}}{\sum_{j=1}^{17} \text{SOG}_{2020,j}}$$

The proportion is then multiplied by the estimate of the spread of the rate of labor absorption decline in every sector j and scenario i , $\text{ADJ}_{2020,j}$ to adjust the proportion of the labor absorption decline.

$$\text{ADJ}_{2020,j} = \Delta UNEMP_{2020,j,i} \times \text{PrSOG}_{2020,j}$$

The final step is recalculating the spread of labor absorption decline in every sector j and scenario i , $\Delta UNEMP_ADJ_{2020,j}$ using the formula:

$$\Delta UNEMP_ADJ_{2020,j,i} = \Delta UNEMP_{2020,i} \times \frac{\text{ADJ}_{2020,j}}{\sum_{i=1}^{17} \text{ADJ}_{2020,j}}$$