POLICY BRIEF

WHAT ARE THE LABOR IMPACTS OF THE GLOBAL FINANCIAL CRISIS?

Flexibility vs Protection: A Case Study of Labor Outsourcing in Bekasi, Indonesia

I. Background

The impact of the global financial crisis (GFC) in Indonesia started to be felt when the economic growth slowed sharply at the end of 2008. Even though the economy still showed some resilience towards the GFC compared to the neighboring countries, marked by 4.4% GDP growth in the first quarter of 2009, we observed a rapid contraction in trade, large declines in export, and major falls in prices of important commodities. The largest fall in sectoral growth was in the manufacturing industries (of textile-leather-footwear, wood, and wood products) and in the trade, hotel, and restaurant (retail and wholesale trade) industries. The growth of these sectors declined to its lowest point in the middle of the 3rd quarter of 2009.

In order to obtain a micro-level picture on how the crisis transmitted and how it had impacted the manufacturing sector at the community and household levels, SMERU conducted a qualitative assessment in one urban community close to a major industrial park in Kabupaten Bekasi. As for the macro-level picture of the crisis impact, it was obtained through a quantitative assessment using a nationally representative labor force survey (Sakernas) before and after the onset of the GFC, conducted by research partners from the Institute of Development Studies (IDS), University of Sussex, United Kingdom (UK). This policy brief specifically draws on both assessments to offer key messages with policy relevance especially on the impact of GFC on the labor market.

II. Key Findings

The data used for the quantitative assessment is taken from the three waves of Sakernas: February 2008, August 2008, and February 2009. The period between the first two waves marks the run up to the GFC in the midst of the global food

crisis. The GFC itself hit Indonesia between the second and third waves of the survey. The Sakernas questionnaire is designed to collect data on the workforce for individuals aged 10 and over. However, households are only sampled if they live in a physical building and are either a family living together, an individual renting a room independently, or a group of lodgers with less than 10 people.

From the data, we found that Indonesia weathered the storm rather well: There is little evidence for changes in school dropouts or attendance, except for younger students where dropout rates fell and attendance improved. Similarly, labor force participation is unchanged for the most part. Unemployment rose for the young, but fell for workers over 25. The changes for female workers were the same as those for male workers and there did not appear to have been any major sectoral shifts in labor. The most surprising finding is the significant and large increases in real wages for employees over the period of the financial crisis, although those outside the formal sector do not share this improvement (McCullogh and Amit Grover, 2010).

The repeated visits[1] to the sample community in Kabupaten Bekasi for the qualitative assessment offer more or less

[1] The village was visited four times in a year (2009–2010) to monitor the impact and development of the crisis.

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similar results to those of the quantitative analysis especially related to the little effect on schooling and participation in the labor force, particularly permanent employees. However, the qualitative study provides more in-depth evidence; much of it is about the impact of the crisis on outsourced (subcontract) workers. Using the qualitative-participatory approach by conducting a series of discussions with people who worked (or had worked) in the industrial park, as well as for firms and labor outsourcing companies, we gain a better understanding of how outsourcing has worked in practice and its impact upon firms and workers especially during the crisis.

The Reality of Labor Contracts: the case of Bekasi

Due to the GFC, in early 2009, production in most electronics and automotive industries in the Bekasi industrial park had substantially slowed down. This is particularly affecting outsourced workers in the industries, mostly young migrant workers who experienced immediate contract terminations (even before their contract legally ended), nonrenewal of contracts, and reduction in working hours and overtime. Some workers have left the area, but others stayed on, hoping for an early recovery in the situation. In August 2009, things were gradually improving, as some industries had recalled old workers and recruited new workers. Some new industries had even started production, providing employment opportunities to as many as 6,000 new workers, mostly young women. The recovery continued toward the end of 2009 and early 2010. There were more labor placements and less layoffs as well as their frequency, and some companies started to have normal working hours and overtime. Nevertheless, the problem faced by subcontract workers remains the same. In some cases, they are now facing more precarious job conditions, with less bargaining power to have a better working condition. Aside from GFC as a pretext, much of the problems are related to Labor Law No. 13/2003 and the prolonged concern over its implementation.

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Outsourcing laws have given firms the flexibility to downsize rapidly when faced with the crisis. Our interviews confirmed the importance, from the perspective of the firms, of having the flexibility to reduce the size of their labor force. Most large firms employ substantial numbers of contract workers, either directly or indirectly through labor outsourcing organizations (LPTK). For example, one Japanese firm in the automotive sector had 850 employees at the end of 2008, but over 200 of them were contract workers. All of these contract workers had been let go during the crisis. A large electronics firm has moved from a ratio of 70% permanent and 30% outsourced to 50:50. Thus, the existence of outsourced workers has enabled firms to substantially reduce production cost when faced with a dramatic reduction in demand from abroad.

Almost all firms have reduced or eliminated overtime and reduced the number of shifts worked. Others have cut back on benefits (e.g., transport, food, healthcare) that previously were given to workers. These reductions have had a substantial impact on workers. For example, in one firm in the automotive sector, the basic pay for a new entry worker is Rp1–1.5 million per month, but with overtime, monthly take home pay before the crisis was typically Rp4–4.5 million. Thus, the elimination of overtime represents a large reduction in take home pay.

Firms routinely rotate workers to avoid making them permanent. To avoid workers becoming permanent, firms employ them through outsourcing companies. This allows firms to employ these workers for "noncore" tasks for up to 2 years. They then often shift workers from being employed by the outsourcing company to being employed as contract workers directly by the firm. Firms can legally employ them

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as contract workers for a further two years. After this, most contract employees are let go to avoid making them permanent. In many cases, they go back to work for the outsourcing company.

However, to avoid the suggestion that they are breaking the law, workers are sometimes put in a different firm for a certain period of time before returning to the original one; alternatively, their name can be modified so that the same name does not appear in the records more than once. In this way, workers oscillate between contract and outsourcing employment for a few years without ever becoming permanent workers.[2]

Outsourced workers do not only do "noncore" activities. Many of the firms in the industrial park employ hundreds of employees performing relatively simple assembly line tasks. These are clearly core activities, in that they pertain to the production of the main product of the firm. However, the definition of "core activities" in the law is unclear, so some firms and outsourcing companies appear to define "non-core" as meaning only making a small part of the final product. Since this is true for almost every task in an assembly line, all operator or production line jobs become eligible for outsourcing.

Firms deliberately disempowered workers to ensure a compliant workforce. Most openly, all production line workers must be between 18 and 24 years old. Our interviews with firms and outsourcing companies confirmed that this was done to ensure that the workers have no experience of working conditions elsewhere and, as relatively new employees, are disinclined to complain. Moreover, firms prefer employing migrant workers from outside the region—mostly from Central Java—to locals. Firms perceive these workers to be more hardworking and less inclined to give up or be absent. Their lack of roots in the local community also makes them less likely to be involved in demonstrations or complaints.

Migrant workers are alienated from the local communities in which they live. They rarely participate in community events and never receive any benefit from social protection programs. However, in the village surveyed, relations between the local community and the migrant workers seem reasonably amicable. One reason for these good relations may be the support that is given to them by local village officials. In part, this is because local officials recognize the benefit in terms of local demand for the presence of a large number of migrants in the village. However, some officials also benefit financially from their presence since they own a large number of the rudimentary blocks of accommodation which house the migrants.

Some outsourcing companies charge fees for employment. Although many outsourcing companies appear to provide a useful recruitment and training service, some require candidates to pay significant nonrefundable deposits to obtain a job. For example, one female worker interviewed had to pay Rp1.5 million to get a 3-month contract with a wage of Rp1.2 million per month. We also heard of cases in which local officials will take money from workers to secure jobs and cases where local thugs will take money from workers and then threaten outsourcing companies to find them jobs.

Outsourced and contract workers have no union to represent them and a very little bargaining power. Unions represent permanent workers and look after their interests. Indeed, the conditions of permanent workers are so much better than those of contract and outsourced workers, that it would

[2] One respondent even described a case in which two restaurants "swapped" their non-permanent staff so that neither restaurant would have to make them permanent.

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be against their interests to take up their cause since this might result in a reduction in benefits for permanent workers. There are no bodies looking after the interests of contract and outsourced workers or negotiating on their behalf. The contract workers we spoke to feared that they would be instantly dismissed if they were to form or join such an association

III. Key Messages and Policy Recommendations

The existence of outsourcing has given firms the flexibility they needed to downsize when faced with a sharp reduction in demand and to increase employment again when demand recovers as is now beginning to happen.

However, the constant rotation of workers in and out of outsourced and contract jobs serves no useful purpose and only arises because of labor policy. It also has an economic cost since firms sometimes let workers who have gained valuable skills and experience go just to avoid the cost of making them permanent. At the same time, firms use the ability to constantly change workers, as well as their selection only of young workers and migrants, as a way of ensuring no demand for better conditions. This is clearly unfair and discriminatory.

Two changes to labor policy could both provide firms with the flexibility that they need and also improve protection for the majority of workers:

1. Abolish the distinction between permanent and nonpermanent employment.

The rotation of employment between outsourced and contract work only happens because firms wish to avoid the high benefits, inflexibility, and high severance costs associated with permanent employment. However, workers vary greatly, both in the wages and benefits that they are willing to accept and in their ability to bear insecurity. For example, younger workers may be much more willing to accept temporary or insecure work than older workers with families to support. It therefore makes much more sense to allow firms to tailor contracts to demand. If the distinction between permanent and nonpermanent was abolished, then firms could offer a range of contracts of different lengths and with different benefit packages based upon their needs for different skills and experience. At the same time, all contracts, both short and longer term, could provide severance pay, which is proportionate to length of service and is accumulated through compulsory monthly contributions from employer and employee, just as other basic social security is currently provided.

2. Introduce compulsory plant level representation for all workers.

A key concern with abolishing the distinction between permanent and nonpermanent employment would be that firms would reduce all contracts to short-term positions with poor benefits. The need to keep skilled workers in a competitive labor market makes this unlikely for the top end of the wage distribution, but it is perfectly possible that firms could continue to exploit the weak bargaining power of those at the bottom of the wage distribution. Compulsory representation could alleviate this by providing a legally mandated coordination mechanism for all workers to press for improvements in pay and conditions consistent with the performance of the plant.

These changes would require a major change in mindset for both firms and workers. However, they could also help to end discriminatory treatment of workers and improve the pay and conditions for the majority of workers, whilst still giving firms the flexibility they need to deal with changing demand.

In addition to that, it is also necessary to ensure that effective monitoring system and law enforcement are in place, especially related to the existing practice of labor outsourcing company, giving sanctions to any violations. This could be done through revitalizing government's roles in monitoring the process of labor outsourcing.

It is also important to ensure that that contract workers are participating in the Employee Social Security (Jamsostek) program and only have one number of membership (though they have worked in different companies). This will be a safety net for workers when subject to working termination especially in time of crisis. n