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Outsourcing and the Constitutional Court Decision

Issues in Indonesia and Abroad, and Possible Solutions

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Solutions

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INTRODUCTION

The constitutional court (MK) decision of January 17, 2012, brought some awkward questions to the surface for Indonesian policymakers. Unions and employers have clashed over outsourcing continuously since Law 13 was issued in 2003. While the Ministry of Manpower is preparing its response in the form of a ministerial decision, it is worth reflecting on the issues and possible solutions to an issue that has been at the forefront of conflicts between employers and trade unionists in the 2000s. Information on three topics can advance understanding of the context and policy options:

The Spread of OS and PKWT workers. Short-term contracts (PKWT) and outsourcing (OS) have become much more prominent in all countries in the past 10 years, including in Indonesia. Two factors have been most important in this trend: the dominant role of services in job creation, and global production networks and jobless growth, especially in East Asia. While many unionists argue for legislation to end outsourcing and PKWT, it is unlikely to happen, and would harm employment.

The MK decision: positive and negative aspects for employment. The MK decision has some positive and negative aspects, from the perspective of achieving a credible balance between creating jobs and supporting and labor standards.

- On the positive side, the MK identified an important problem that has increased labor tensions in Indonesia in the recent past: employers' use of OS and PKWT to avoid fixed costs associated with employing regular workers.
- On the negative side, it ruled that PKWT (associated with OS) can only be justified for activities that are irregular or seasonal, and not for regular activities. This ruling goes against international practice, particularly in services, and its enforcement severely damages employment prospects.

Avoiding the "Prisoner's Dilemma" and Working for a Win-Win Solution among Employees and Employers. Both employers and employees stand to gain from cooperation arising out of the MK decision, which balances new global realities in labor deployment, with the need for better regulation of labor standards. This would involve continuing to work toward a *long-term strategy* for reform of UU13 integrated with the introduction of the SJSN.

1. THE SPREAD OF OS AND PKWT: OVERSEAS AND AT HOME

International

Both OS and PKWT have spread in developed and developing countries in the past two decades.¹ Employment protection legislation (EPL) restrictions have been eased (such as controls of short-term contracts) in many countries. Service sector jobs have proliferated as countries move into the middle income group. International outsourcing using casual and PKWT workers has become a major source of jobs in the expanding information industry.² India and the Philippines are now world leaders in BPOs, which deliver services directly to consumers in developed countries ("Mode 1" in services

¹ See especially OECD (2004, 2010); ILO (2011a and 2011b).

² Conditions in the huge BPO sector in the Philippines led to a special bill being introduced in parliament for the protection of these workers in 2010.

trade). At the same time, there has been jobless growth in manufacturing in many parts of the world since the crisis in 1998, except for the Asian giants, China and to a lesser extent India.³

In part, the communications revolution has meant labor market flexibility has become more important for business survival. The need for greater need for greater labor flexibility in “factory Asia” partly relates to the spread of production networks linked to China, the world center for the assembly of electronics and machine goods.⁴

Indonesia

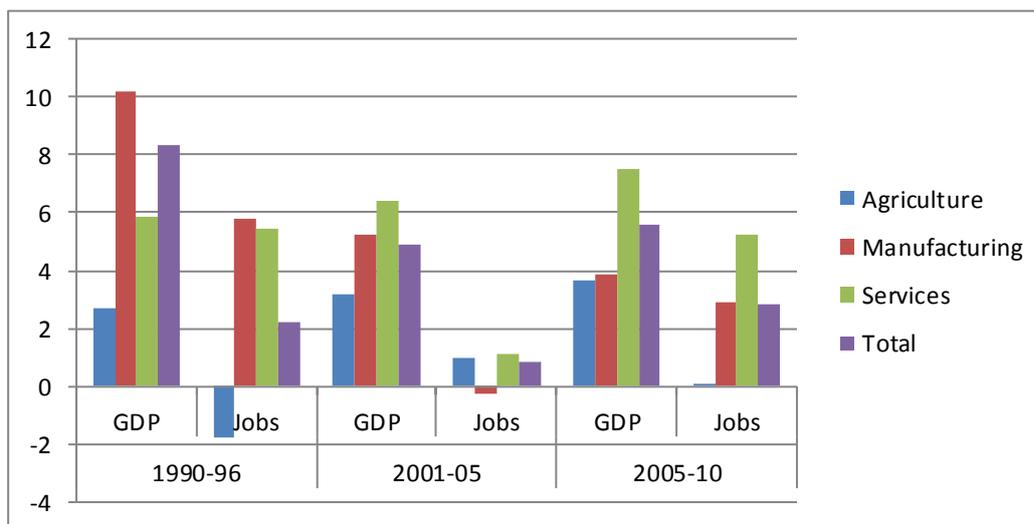
Indonesia has experienced much more rapid growth in services employment than in manufacturing, and a spread of casual employment in the 2000s. Figures 1-3 show some of these developments. The following points are relevant:

New Jobs in Services, and Stagnation in Manufacturing

- Growth and employment in services outstripped that of manufacturing in the 2000s. Services (excluding construction) accounted for about two-thirds of new jobs generated in Indonesia in the 2000s (Figure 1).
- The poor performance in manufacturing employment can be attributed to a marked deceleration in labor-intensive exports, and few new jobs in faster growing, heavy industry.
- Female engagement in services: expansion of new service activities has involved jobs for many more educated females, and is probably one reason for the sharp decline in female unemployment from 2005 (Figure 2).

Figure 1

Growth Rates in GDP and Employment by Major Sector, Indonesia, 1990-2010 (% p.a.)

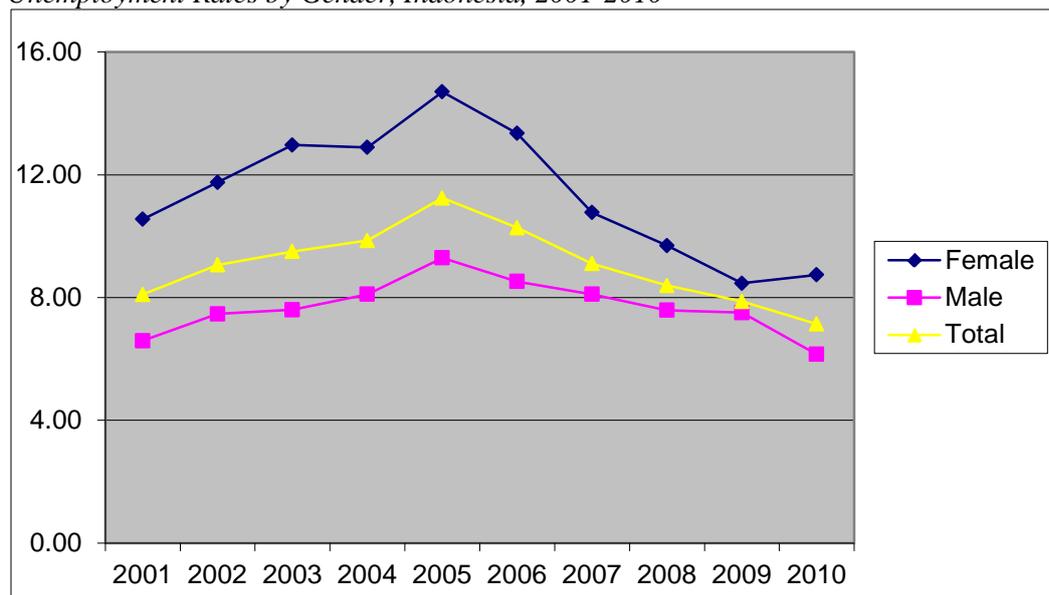


SOURCE: National Accounts and National Labor Force Survey (SAKERNAS) 2001-2010.

³ See especially Aswicahyono et. al. (2011) and Aswicahyono and Manning (2011).

⁴ See for example, Ferrarini (2011).

Figure 2
Unemployment Rates by Gender, Indonesia, 2001-2010



SOURCE: National Labor Force Survey (SAKERNAS) 2001-2010.

Casualization

- Most new jobs were casual. Almost all the new jobs recorded in SAKERNAS were casual (even in services) in the first half of the 2000s; there was some recovery in formal jobs from 2005, but casual work still grew faster (Figure 3).
- Casualization stood out in manufacturing and construction, the number of regular wage jobs had not recovered in 2009, compared with the start of the decade.
- Casual workers earn less. Not only are casual jobs less secure. Earnings are much lower, and the participants less educated than employees in regular jobs.⁵

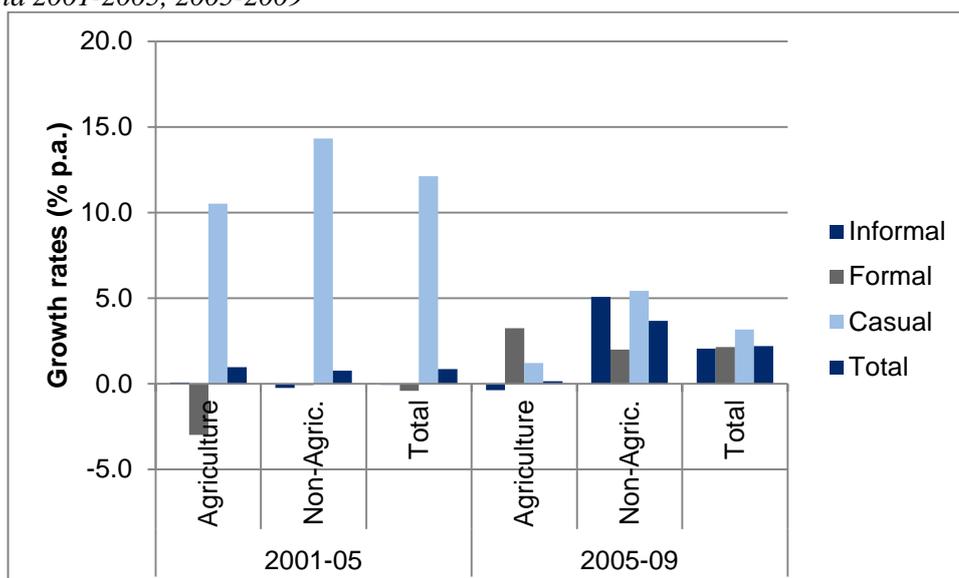
2. THE MK DECISION: POSITIVE AND NEGATIVE ASPECTS FOR EMPLOYMENT

The MK decision has some positive and negative aspects in relation to casual, contract and outsourced work, from the perspective of balancing employment and labor standards.

- On the positive side, the MK identified an important problem that has contributed to labor tensions in Indonesia: employers' use of OS and PKWT to avoid fixed labor costs that are normally paid to regular workers.
- On the negative side, it ruled that PKWT (associated with OS) can only be justified for activities that are irregular or seasonal, and not for regular activities. This ruling goes against international practice, particularly in services, and its enforcement severely damage employment prospects.

⁵ Average *hourly* wages were more than twice as high in regular jobs, and most regular workers were much better educated (80 percent SLA or more), compared with casual employees, among whom the largely majority only had a primary education or less (Manning 2012).

Figure 3
Annual Growth Rates in Employment by Employment Status in Agriculture and Non-Agriculture, Indonesia 2001-2005, 2005-2009



SOURCE: National Labor Force Survey (SAKERNAS) 2001-2009.

Avoiding paying *tunjangan* to OS and PKWT employees. The MK is right to seek to eliminate what amounts to discrimination between regular workers [PKWTT] on the one hand, and OS workers and PKWT workers on the other, in levels of pay and nonwage emoluments/*tunjangan*. The decision is not easy to implement, given naturally low levels of unionization in OS companies. However, stricter implementation of minimum wages and other basic standards, and improved rights of casual workers, means it is important to counter discrimination. It is likely to slow the rate of casualization. Following from the MK decision, a special ministerial regulation may also be needed to improve standards and rights for OS and PKWT workers.

Part of the problem arises because some fixed costs, especially severance pay, are unusually high in Indonesia, and encourage employer to try to circumvent the law by using OS. To overcome this problem, a long-term strategy would be to revise Law 13, to encourage more employment of regular workers. In addition, a more professional approach is required in negotiations with unions to cover such revisions. It would be useful to start deliberations on how the new SJSN can be introduced, at the same time as key clauses of UU13/2003 are revised (a win-win for workers and for employers). The spread of casual employment in Indonesia (partly related to over-regulation in UU13) is a threat to productivity, as well as labor standards.

Eliminating OS except for irregular work. This is an unexpected ruling on Law 13, and conflicts with widespread business practice. Outsourcing is very common for regular *noncore* activities in most countries, particularly in services (e.g., cleaning services and security, auxiliary activities in mining and other industries). The most urgent need here appears to be to provide a clearer definition of core and noncore activities (often interpreted very liberally by employers), rather than to focus on whether an activity is ongoing (*tetap*) or intermittent.

3. AVOIDING THE “PRISONER’S DILEMMA” AND WORKING FOR A WIN-WIN SOLUTION AMONG WORKERS AND EMPLOYERS

Employers and employees alike stand to gain from cooperation arising out of the MK decision, which calls for better regulation of labor standards. The prisoner’s dilemma arises in labor negotiations because while both employers and employees stand to both gain overall from change, neither is prepared to do so.⁶ Both are unwilling to bear some costs, in moving to a new equilibrium.

Following the MK decision, a package of reforms could be put on the table: (1) better regulation of labor standards and rights for employees on OS and PKWT, (2) acceptance of both forms of employment as legitimate and (3) a long-term strategy to reduce severance pay, in return for greater security through the SJSN.

For unions (and workers), the potential gain is more regular jobs and tighter regulation of standards for OS firms and PKWT employees.

- These gains are likely to outweigh the costs of acceptance of outsourcing as a legitimate form of employment. Short-term contracts and OS are a reality of the national and international labor market. They are likely to persist, and possibly even deepen. In Indonesia, casual employment has increased markedly in the past decade, and this reflects a trend towards outsourcing, as well as PKWT. While these jobs will not disappear, they can be regulated better.
- Following this proposal, unions would also need to accept some dilution of the severance pay clauses in UU13. However, they would gain in membership from more employment of regular workers, and from better social security through SJSN.

For employers, the gains will come from less industrial conflict, lower unit fixed costs of employment of regular workers, and higher productivity through the employment of more regular workers.

- These gains are likely to outweigh the costs of tighter regulation of standards for O-S and PKWT employees, and from the costs of moving some of the casual workers onto more regular contracts.

This package of reforms would involve continuing to work toward a long- term strategy for reform of UU13 integrated with the introduction of the SJSN.

⁶ See an excellent article by Iwan Ungsi (*Jakarta Post* 14/2/2012) for a fuller discussion of these issues.

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