

# Better Work and State Regulation in Indonesia: Towards Reinforcement

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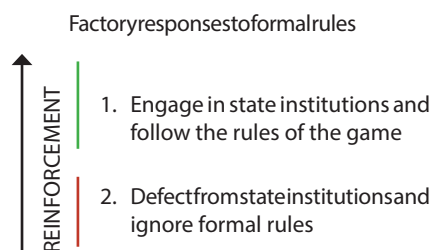
This research brief summarizes a study of the interactions between Better Work Indonesia (BWI) and Indonesian state labour market institutions, focused on governance of fixed-term contracts and minimum wage negotiations.<sup>1</sup> To improve working conditions beyond the short-term, transnational regulatory efforts must not only address immediate problems in factories, but also strengthen the state institutions that govern interactions between workers and employers. This study provides evidence to suggest that transnational regulators like Better Work<sup>2</sup> can reinforce the state, dependent on two conditions: local labour mobilization, and support from key stakeholders for engaging the state and factories in order to achieve authoritative interpretations of rules. These findings illuminate the potential, and limits, of transnational initiatives to reinforce state labour regulation.

## Transnational regulators and reinforcement of state institutions

Workplaces throughout the world are regulated by both transnational and state actors. While transnational initiatives like Better Work play a crucial role in global industries, research has suggested their effects are ultimately bounded by domestic contexts.<sup>3</sup> Therefore, instead of transcending local contexts, transnational initiatives should support the ability of local actors and institutions to improve working conditions themselves. A key problem facing state regulators is that formal labour laws often diverge widely from actual practices on the

ground. Employers defect from state rules to save costs, often at the expense of their workers. Thus, transnational regulators like Better Work have the potential to “reinforce” state regulation by pushing actors into domestic institutions that effectively constrain behavior (Figure 1).

Figure 1: Reinforcement pushes factories to engage state regulatory institutions



This research finds that two key conditions make such reinforcement likely. The first is worker mobilization targeting the state, which creates public contestation over the rules and pushes officials to take pro-worker actions, such as stricter enforcement or raising minimum wages. Mobilization affects transnational regulators indirectly: unions pressure state regulators to activate state institutions, creating public conflicts that then must be addressed by transnational regulators in factories. By contrast, without mobilization, state institutions remain marginal because transnational regulators attempt to resolve violations without dialogue with state actors. Even when transnational regulators do require factories to interact with state regulators, such encounters tend to be superficial without political pressure to actually make these institutions constrain employer behavior. Requiring employers to engage with weak state institutions creates avenues for corruption, rather than meaningful oversight.

Mobilization alone, however, is insufficient to drive reinforcement. When rules are contested and institutions are weak, actors try to exploit

1. This brief is a summary of the research article: Amengual, Matthew and Chiro, Laura. “Reinforcing the State: Transnational and State Labour Regulation in Indonesia,” forthcoming (2016) in *Industrial and Labour Relations Review*.

2. Better Work is a partnership between the International Labour Organization and the International Finance Corporation designed to mobilize garment factories, global apparel brands, governments and workers to improve working conditions and drive productivity in the sector. More information available from [betterwork.org](http://betterwork.org).

3. For example: Locke, Richard M. 2013. *The Promise and Limits of Private Power: Promoting Labour Standard in a Global Economy*. New York: Cambridge University Press.

## Who determines how BWI interprets Indonesian labour law?

The Ministry of Manpower and Transmigration (MOMT) plays the key role in determining BWI's compliance assessment criteria, which combine ILO core conventions and domestic labour law. An "Ad Hoc Committee" made up of MOMT and BWI staff meets frequently to examine problematic instances of non-compliance encountered by BWI during factory visits, and to clarify legal ambiguities encountered in the field. The Ad Hoc Committee determines which interpretation of Indonesian labour law should guide BWI's factory assessments.

vagaries in the ways rules are applied, offering interpretations that align with their interests. Workers can mobilize and gain to legal victories, but if transnational regulators simply adopt pro-employer interpretations that allow factories to maintain the status quo, reinforcement will not occur. Thus, how competing interpretations are adjudicated is critical. Reinforcement requires that transnational regulators have support from their governing bodies – be they buyers, NGOs, unions or governments – to interpret contested rules in an authoritative way that forces firms into activated state structures, instead of allowing them to remain disengaged.

## Research Approach

This research examines these questions in the context of Better Work Indonesia, taking a mixed-method approach. Case studies trace the processes by which BWI influenced factories' actions, and statistical analysis is used to analyse the association between BWI membership and factory engagement with state institutions. The cross-case comparison relies on a subnational comparison of four districts (out of a total 14) where BWI has a significant number of garment factories enrolled, selected for variation in local union mobilization. Interviews were conducted with 189 factory managers, government officials and union leaders in each district, as well as BWI staff and buyers<sup>4</sup>. The quantitative analysis draws on an Indonesian government directory of manufacturing firms and public records of garment factory participation in supervised minimum wage negotiations.

## Findings

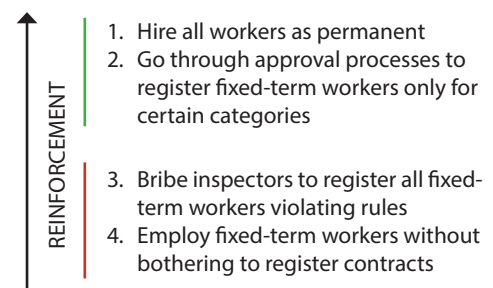
The study examines two Indonesian regulatory institutions, fixed-term contracts and factory-level minimum wage renegotiations. Both of these institutions offer employers the opportunity to engage with the formal rules of the game, or to defect and circumvent the formal rules, often to the detriment of workers. BWI is not reinforcing the fixed-term contracting institution, but it is reinforcing wage renegotiations.

### Fixed-Term Contract Approvals

Indonesian law allows companies to use permanent and non-permanent employment contracts. Employers may hire non-permanent workers for "temporary" or "seasonal" work for up to three years (a two-year contract with a one-year renewal). To control the use of these

contracts, employers are required to register new contracts as well as to periodically submit the entire list of contracts for approval by the district labour office, thereby requiring firms to engage with the state to determine exactly when use of fixed-term contracts is allowed. Critically, the law does not specify whether workers in globalized industries subject to volatile demand, like garments, are "continuous" or "seasonal" workers.

Figure 2: Fixed-term contracts: Garment factory options



In principle, the contract registration procedure allows regulators to ensure that contracts are legally compliant. In practice, though, local officials exercise little oversight over the use of fixed-term contracts for garment workers. In Jakarta, Bogor, and Semarang, district manpower offices allowed factories to "manipulate the regulation," in the words of one manager, by endlessly renewing workers' temporary contracts instead of transferring them to permanent contracts.<sup>5</sup> Regulators recognized that the restrictions were widely abused, yet they routinely approved contracts without close consideration of legal eligibility, creating perpetual uncertainty for workers.<sup>6</sup> Even when they identified violations, regulators rarely enforced the rules.<sup>7</sup> But in these three districts, unions did not mobilize around the contracts issue. Thus, even though BWI required factories to get contracts approved, the institution did not constrain behavior because local regulators allowed factories to violate the rules.

In one district (Subang) unions did mobilize to pressure government officials to end garment factory abuse of contracts, but even here BWI was not able to push factories to engage with this activated institution more fully. Process tracing reveals that the weak point was the difference in interpretation of the contract law between local and Ministry of Manpower and Transmigration officials in Jakarta: the Ministry, which is the

4. Fieldwork was conducted in Indonesia in May-July 2014 and April 2015. Fieldwork was conducted in Indonesia in May-July 2014 and April 2015.

5. Interview F7, garment factory compliance officer, Subang.

6. Interview U16, district union leader, Bogor; interviews G10, G12, G15, G18, G38, local labour officials in Subang, Bogor and Jakarta.

7. Interview G20, local labour inspector, Bogor.

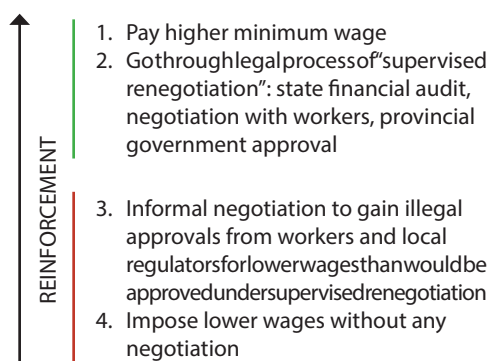
main arbiter of BWI's legal interpretations, gave BWI an interpretation of the regulation that could not justify a larger intervention. The result was that BWI was unable to strongly reinforce the state institutions governing fixed-term contracts.

### Minimum Wage Renegotiations

BWI's role in minimum wage renegotiations offers a counterpoint. After a series of massive strikes and demonstrations around Jakarta in 2012-2013, many districts experienced nominal year-on-year increases of between 40% and 70% in local minimum wages. Indonesian law, however, allows factories in labour-intensive industries such as garments to pay below the minimum wage if they go through a supervised renegotiation with their workers. Renegotiations soften the impact on factories by allowing for gradual increases over the course of a year. To receive state approval to renegotiate wages, factories must obtain approval from at least half of their workers and submit to a financial audit, disclosing past and future production plans. This information goes to the provincial minimum wage council, where unions and employers debate the merits and make a recommendation to the governor, who then approves or rejects the results of the renegotiation. This process is intended to provide flexibility while also stopping employers from unilaterally imposing lower wages. It also requires that companies to pay at least the previous year's minimum wage, ensuring that all factories raise their wages every year.

When the wage hikes occurred, many factories tried to avoid the supervised renegotiation process by making informal, illegal agreements with their workers to a lower wage, often with tacit or explicit support from local officials

Figure 3: Garment factory responses to minimum wage increases



BWI responded to the institutional breakdown in three ways: incentives, information, and coaching. First, BWI created incentives for factories to follow the rules through its standard assessment process. BWI did not accept any questionable approvals, instead marking as

non-compliant factories that received local government approvals, and reporting these findings to buyers<sup>8</sup>. Second, BWI informed the Ministry (MOMT) of the informal agreements, based on its extensive on-the-ground knowledge of happenings in factories, and it channeled the MOMT's authoritative legal interpretations back down to buyers, factories, and local governments. One MOMT official said he viewed BWI as a "bridge" facilitating these communications between the central government and factories<sup>9</sup>. BWI also issued four detailed Legal Updates that were circulated to factory managers and buyers, and organized a refresher training with local officials in offending districts<sup>10</sup>. Third, BWI coached factories through the process and received complaints from unions when there were attempts to use intimidation in renegotiation.

To assess the association between participation in BWI and supervised wage renegotiation more broadly, we created a dataset of 372 BWI and non-BWI garment factories using Indonesia's Industrial Manufacturing Directory<sup>11</sup>, adding a variable to indicate whether or not factories had received government approval for wage renegotiation in 2013 and 2014. The raw data shows that BWI factories are more likely to have gone through supervised renegotiations than non-BWI factories. Within districts where unions mobilized and won large wage increases (30% or more), half of BWI factories went through supervised renegotiation, as compared with only 28% of non-BWI factories. In one district, Bogor, eight out of nine BWI factories applied for and received approval for renegotiation after a 70% wage hike, compared to 43% of garment factories as a whole.<sup>12</sup>

Furthermore, regression analysis exploiting cross-sectional variation between BWI and non-BWI factories in the same districts shows that factory participation in BWI is associated with a statistically and substantively significant increase in the likelihood of supervised wage renegotiation. In the presence of wage shocks, participation in BWI is associated with a 15% increase in the likelihood of renegotiation. The case studies suggest that BWI participation should be associated with supervised renegotiation only where unions contested and won significant wage increases, and the statistical analysis confirms this conclusion.

8. Interview F36 and F43, garment factory human resources and compliance officers, Bogor.

9. Interview G2, MOMT labour inspection official, Jakarta.

10. Interview, BW4, BWI senior official.

11. The Directory is made publicly available by BPS, Indonesia's national statistical bureau, and includes information on over 23,000 large and medium manufacturing firms in Indonesia. We include firms whose main product codes is apparel (14111) or knitwear (14301), and restrict the sample to districts with more than one BWI factory and where supervised renegotiation data are available.

12. Data from West Java and Bogor manpower offices.

This analysis cannot alone support causal claims because these data could be subject to selection bias: factories enroll in BWI voluntarily, and all are exporters selling to major Western brands. Combined with the case studies, however, it does provide suggestive evidence of a positive relationship between BWI participation and wage renegotiations.

Broad union mobilization activated and politicized the institution of supervised wage renegotiations, and the MOMT offered a legal interpretation that factories must go through the formal process. These two factors allowed BWI to push employers into a state institution that truly constrained behavior, driving up wages and rendering the institution itself more relevant.

## Conclusions and Recommendations

This research shows that Better Work can do more than improve conditions in factories: it can also, at times, reinforce state regulatory institutions. It is not possible to say whether this will result in a long-term behavioral or institutional shift; what is clear, though, is that without engagement, state institutions will remain weak.

The study suggests three implications for Better Work and other transnational initiatives.

First, transnational initiatives' potential for reinforcement is limited by local politics, specifically worker mobilization. BWI only reinforced state regulatory institutions when they were activated by labour groups. In contexts of repressive labour relations where workers lack collective rights, transnational regulators will have few opportunities for reinforcement. This condition can only be changed by supporting workers' rights to advocate for their interests and pressure governments to uphold regulations. For transnational regulatory initiatives to reinforce state institutions, workers need the freedom to mobilize.

By itself, however, pressure by workers is insufficient because there is ample room for actors to exploit institutional weaknesses that allow them to advance their interests through self-serving interpretation of the rules. How transnational regulators adjudicate among these conflicting interpretations depends on their governance. For BWI, ILO involvement brought the central state and unions into the process, but reinforcement only occurred when the MOMT took an authoritative position that clarified the rules of the game in a way that required engagement with local institutions.

Thus, a second implication is that we must pay attention to how initiatives' governance structures influence their potential for reinforcement. These structures dictate how conflicts among different actors over the rules of the game are resolved, thereby determining whether or not factories are required to engage with local institutions.

A third implication is that Better Work's potential for reinforcing state institutions derives from its core compliance work in factories. Reinforcement is a by-product of BWI's core work: by working to increase factory compliance through incentives and information that require engagement with state institutions that constrain behavior, BWI is reinforcing state institutions indirectly. Thus, Better Work's comparative advantage in building state capacity to regulate labour standards may not reside mainly in direct "capacity building" activities with the government, but rather in its day-to-day compliance work in factories.