



The Relation Between Minimum Wages and Poverty in Indonesia: An Islamic Perspective

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Abstract: This study is part of Islamic economics research that aims to determine the relationship between the minimum wage and poverty rate in Indonesia, especially case studies in West Java, Central Java, East Java, Special Region of Yogyakarta, and Banten during the period 2007-2013. In addition to the primary independent variable, there are six control variables are used, the level of education, the GDP per capita, unemployment rate, inflation rate, average wages and economic growth. The analysis technique used in this study are Arellano Bond Dynamic GMM (Generalized Method of Moment). The results of this study found that the minimum wage is not a significant effect on poverty levels in 2007-2013, especially in the districts/cities in West Java, Central Java, East Java, Special Region of Yogyakarta and Banten. Based on the explanation above, it can be concluded that government has responsibilities and sufficient role to reduce poverty through minimum wage standardization, the state also has responsibilities to create social security, both for those who are unable to work, informal workers and vulnerable workers, so that the level of wages (income) they can meet any basic needs according to Ibn Hazm include food, clothing, health, education and housing.

Keywords: Minimum Wage, Poverty Rate, Dynamic GMM

Introduction

Poverty often sees as complex problem and has multidimensional perspective to be solved. Based on these circumstances, the effort to eliminate poverty should be accomplished comprehensively (Nasir in Prasetyo, 2010). According to Siddiqi in Haneef (2010) , state has responsibility which is written in Al Quran and as-Sunnah to intervenes in poverty reduction, and secures each citizen's basic needs. One of the government's action related to this issue is regulating the minimum wages policy, which ensures wages rate is sustainable with citizens' standard living expenses (ajru mistli).

As mentioned by (Sabia and Burkhauser, 2010):"The minimum wage is considered by many politicians to the an effective anti-poverty tool." Standardizing minimum wages is a policy which is being applied in many countries, with its main objections to manage and eradicate poverty by improving citizen income. Simanjuntak in Gianie (2009) explained that basically minimum wage is a policy which can be seen in two perspectives. First, minimum wages is a protection tool for workers to keep their wages values and has not decreased to cover their daily expenses. Second, it positioned as a protection tool for the companies to keep the workers productivity.

Previous research related to minimum wage policy demonstrated contradictive result. On the other hand, the result from previous researchers found significant relations between minimum wage policy and poverty rate reduction. One of the examples is a research conducted by Alaniz, Gindling and Terrel (2011). The aim of this research is exploring the relation between minimum wage and household income in Nicaragua on 1998-2006. The result of this research found that the increasing minimum wage plays significant role on poverty rate reductions. The same results occur in Card and Krueger's (1995), Gindling and Terrel's (2010) research.

On the other hand, another research result show that minimum wages policy do not have significant correlations with poverty rate reduction. Research conducted by Lustig and McLeod (1996), which focused on describing the relations between minimum wages and poverty rate in developing countries, demonstrated ineffective result. Moreover, researchers stated that policies related minimum wage even increasing unemployment rate. Several research results also demonstrated similar conclusions, such as research from Burkhauser and Sabia (2007), Neumark and Wascher (2002), Maloney and Pacheco, (2011).

Based on this circumstance, the researcher would like to offer different perspective regarding to this issue. This research will focus on relations between minimum wage and poverty rate, in Islamic Economy approach. This research also uses data in residence/city scale, representing total residences/cities around Indonesia, i.e. West Java, East Java, Central Java, Yogyakarta Special Region and Banten Province in 2007-2013 respectively.

Case studies in West Java, Central Java, East Java Yogyakarta Special Region and Banten Provinces are chosen considering several reasons. First, in accordance with data from Central Bureau Statistic (Badan Pusat Statistik/BPS) in 2016, minimum wages rate in Indonesia has been increased significantly since 2007-2013. The average increase in the provincial minimum wage in Indonesia continues to experience a significant increase, which amounted to Rp. 110 750 per year. This rate still considerate lower, compared with several main countries in ASEAN region. As mentioned by World Bank Database in Rahman (2015), Indonesia ranks fourth the percentage of wages/salaries to total employment is only about 30-40 percent. Ranges from 80-90 percent while Singapore, Malaysia and Thailand 70-80 percent 35-45 percent.

Secondly, though Indonesia embraces significant improvement on minimum wage, on the same time standardization on minimum wages has not been proven to reduce poverty rate. National Statistic Bureau (Badan Pusat statistik /BPS) in 2016 stated that in September 2015 there were 28.51 million people or 11.13 percent from total population who lived in poverty. This rate decreased in 0.3% from March 2015 which reached 28.59 million people or 11.22 percent. Citizen Welfare Report in BPS stated that the decreasing rate was the lowest rate in 4 years. Beside, in 2015 the amount of citizens who lived in poverty in 2015, experienced increasing rate in 310 million people in 2014 and 520 million people in 2013.

In 2015, East Java Province ranked first among the provinces with the poorest population, i.e. 4. 775.970. Central Java and West Java ranked in second and third position with population whom 4.505.780 and 4.485.650 population in their areas lived in poverty. In addition, in 2015 the number of poor people in the province of East Java, West Java and Banten also increased from 2014, respectively amounted to 27 550 inhabitants, 246 690 inhabitants and 41 480 inhabitants.

The paper is written for several reasons: First, fulfilling the vacant literature in Islamic Economy. Second, analyze the role of minimum wage policies in cities/residences in Indonesia, especially to reduce poverty. Third, as be considered by the government in determining policies relating to standardization of the minimum wage.

The paper is organized as follows: Section 1 described the research background, and than followed by Section 2 which reviews the relationship between minimum wages to poverty rate. Then, Section 3 described methodology, data and model which being used in analysis.

Result and discussion related to regression analysis on the relation between minimum wage and poverty rate will be set in Section 4. The paper ends with a section of concluding remarks.

Literature Review

Once upon a time, Prophet Muhammad SAW had defining the minimum wage of a people who work in the government, based on his view, to give him a better life. Rasullullah said in a hadist (as mentioned by Chaudhry, 2012):

“For a government employee, if he is not married, let him get married, if he did not have an assistant, she may have one; if it does not have a home, let it build a, and anyone who is over the limit, then surely he is a usurper or a thief. ”

Qardhawi (1997) stated that there are two important factors in determining minimum wage, i.e. work values and daily expenses. Work value become fundamental since it will be unjust to simplify the work of skilled labor and unskilled labor, who do not possess desirable skill. Meanwhile daily expenses also important as it relates to the labor's basic needs.

In Addison and Blackburn's research (1996), which supported by Neumark and Wascher's (1997) research; they analyzed the relations between minimum wage and poverty through family income. Poverty is closely related to the ability to participate in economy activity, which in the end can be measured by family income. The range of minimum which is being determined by government, designed to keep the wage amount from formal worker is not lower than the minimum wages. Since wages become one of family sources of income, and determine whether they are able to cover their expenses or not.

Neumark in his current research (2015), stated that the range of wage, which is regulated in government policies, are able to help worker in low income. Since wages describe the amount of income which is be accepted by workers, thus minimum wage standard directly affects to the improvement of income for the workers (Kristanto, 2014). According to Manning and Sumarto (2011, at least there are two options to help the poor from the poverty, i.e. income and expenses. Minimum wages standardizations which lie upon daily need expenses, is the government action to get the workers out from poverty through their income.

The main purpose of the minimum wage set by the government is creating a qualified living standard, i.e. sufficient income to support the achievement of five aspects of life that meets (maqashid sharia). Since minimum wages standard of cities/ regencies is set based upon various regional economic considerations, it can determine the real income whom received by the workers, which in turn can play an active role as one of the government's efforts to reduce poverty. Watanabe emphasized on his research in 2013 “Minimum Wage, Public Investment, Economic Growth”. In this research he stated that minimum wages helped decreasing poverty and keep and maintaining minimum living standard.

Furthermore, SMERU (2001) found that the improvement of minimum wage which occurred since 1990's affected the regulation related to wage improvement in many companies. The effects of this circumstance, the regulation on minimum wages are able to change the whole structure of workers income on formal sector in various cities. Because of comprehensive effects, standardization in minimum wage become one of methods which often be used by many countries to solve and help the workers from poverty.

Research Method

This research uses data panel from all over cities. Regencies in West Java, Central Java, East Java, Special Region of Yogyakarta, and Banten Province respectively. Arellano-Bond Dynamic GMM is used as analytic technique in this research.. Apart from two main variables, i.e. minimum wages (UMK) and poverty rate (TK), this research also uses six control variable i.e. education rate (T_PEND), average real income (UPAHRILL), PDRB per capita (PDRB_PK), unemployment rate (TPT), inflation (INF), and economic growth (P_EKO). All data is used in

regression analysis in the form of percent change. This research is based on modified model from Kapelyuk (2015), Lustig and MacLeod (1996), Iceland et.al (2005), Ramirez et.al (2015) Thus, the regression model is formatted as follows:

$$TK_{kirt} = 1 [\gamma_0 + \gamma_1UMK_{it} + \gamma_2R_UPAHRIL_{it} + \gamma_3INF_{it} + \gamma_4TPT_{it} + \gamma_5PDRB_PK_{it} + \gamma_6T_PRND_{it} + \gamma_7P_EKO_{it} + \varepsilon_{kirt} \geq 0]$$

Result and Discussion

Result

Table 1
Arellano-Bond Dynamic GMM Estimated Result

Variabel	pc_TK (1)	pc_TK (2)	pc_TK (3)	pc_TK (4)	Information
pc_TK lag 1	0.0125 (0.641)	0.012 (0.661)	0.0012 (0.963)	0.0100 (0.697)	*p<0.05 **p<0.01
pc_UMK	0.0103 (0.810)	0.009 (0.825)	0.0008 (0.983)	0.0100 (0.818)	***p<0.001
pc_T_PEND	-0.194** (0.003)	-0.195** (0.003)	-0.158* (0.017)	-0.16 (0.133)	
pc_R_UPAHRIL				-0.024 (0.593)	
pc_PDRB_PK			0.0124 (0.142)	0.0092 (0.239)	
pc_TPT	-0.0009 (0.733)	-0.0009 (0.732)	-0.0002 (0.940)	-0.0008 (0.764)	
pc_INF	0.029*** (0.000)	0.029*** (0.000)	0.029*** (0.000)	0.0325*** (0.000)	
pc_P_EKO		-0.0003 (0.935)	-0.0075 (0.159)	-0.0005 (0.902)	
_cons	-5.647*** (0.000)	-5.640*** (0.000)	-5.635*** (0.000)	-5.553*** (0.000)	
Number of Obs	548	547	547	547	
Sargan Test	0.0820	0.0653	0.0840	0.0593	
Wald chi2	77.19	77.78	74.71	82.70	
Prob>chi2	0.0000	0.0000	0.0000	0.0000	

Source: Processed data, 2016

The result analysis of the research is displayed in different four regression model. From four estimated model, the relation between pc_UMK and pc_TK are always worth insignificant, i.e. 0.810; 0.825; 0.983; and 0.818. The estimated model which is used in this research is displayed in Table 4.

Here is the estimated model from the research result:

$$\begin{aligned}
 pc_TK_{it} = & 1 [-5,553 + 0,01 pc_TKlag1_{it} - 0,160 pc_T_PEND_{it} \\
 & + 0,100 pc_UMK + 0,092 pc_PDRB_PK \\
 & - 0,242 pc_R_UPAHRIL - 0,0008 pc_TPT + 0,325 pc_INF \\
 & - 0,0005 pc_PEKO + \varepsilon_{kit} \geq 0]
 \end{aligned}$$

The estimated coefficient of the changing percentage of the minimum wage in cities/regencies (pc_UMK) is 0,100. The coefficient is marked positives as there was positive relationship between the changing percentages of minimum wage in cities/regencies and the changing percentage of poverty rate in cities/regencies in WEST Java Central Java, East Java, Yogyakarta Special Region and Banten Province respectively. If the percentage change of minimum wage in residence/cities improves 1 percent, then the percentage change of poverty rate experiences improvement in 1 percent, ceteris paribus, vice versa. There was an insignificant effect of a variable percentage of minimum wage changes the residences/ cities (pc_UMK) through the changing percentage of poverty rate (pc_TK) residences/cities with p-value ($P > |z|$) in $0,818 > 0,05$ (5% rate significance) in 95% believe rate. With this result, it can be concluded that the percentage change of minimum wage on residences/cities effect insignificantly through the presentation change in poverty rate on West Java, Central Java, East Java a, Yogyakarta Special region and Banten Province in 2007-2013 respectively.

Discussion

Result in the research found that there was insignificant relation between minimum wages policies and poverty rate reduction. In accordance with Kapelyuk's (2011) which stated that minimum wages had smaller effect to poverty reduction activity. Supported this explanation, Lustig and McLeod (1996) stated that there was no cause to support the standardization of minimum wage in poverty eradication. Because, in their findings, (Lustig and McLeod, 1996) described that high minimum wage rate is able to create high unemployment rate. Besides, even if minimum wage affects the poverty reduction in short term, it brings contrary effects in the longer time period, High minimum wage is tend to decrease better work chance.

The consequences of the increase in minimum wage is risen the informal employment sector, as a result of the weakening of formal employment and a slowdown in job creation in the formal sector. Shortly, an increase in minimum wage is tend to create higher unemployment rate in formal sector and increasing full time employee whom received low wages (OECD Economic Survey, 2015).

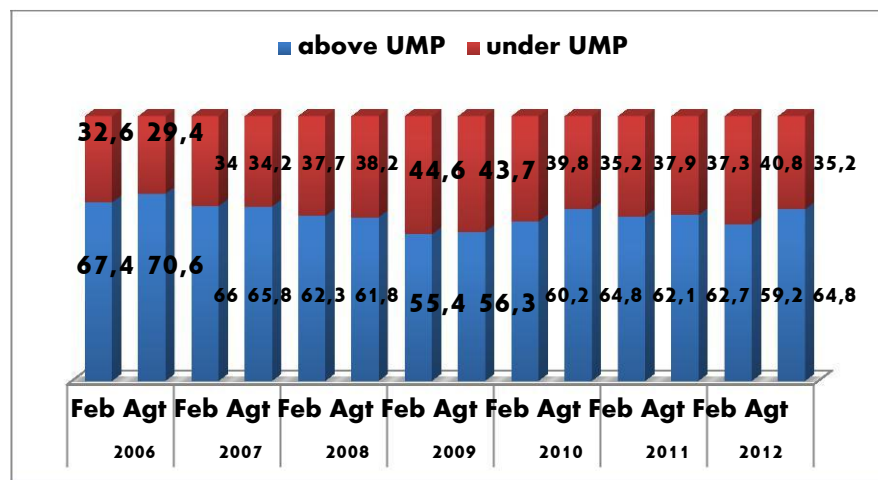
ILO (2008) explained that the parameter for qualified labor market in developing countries with high informal economic as Indonesia is by exploring the changing wage structure and work condition in various informal economic sectors, not by exploring the changes in unemployment rate. Regarding this matter, Central Bureau of Statistic (2015) reported that even tough formal sector employee rate is decreasing every year, but in February 2015 informal sector employee rate is lied on 51.9 percent.

There are three reasons which are able to explain the insignificant reason between minimum wage improvements to poverty rate reductions in Indonesia i.e.: (a) The condition of minimum wage structure (b) the conditions of informal sector employee (c) the conditions of vulnerable employee.

The Condition of Minimum Wage Structure

Budiarty (2015) explained that the effects of minimum wage improvement in developing countries such as Indonesia, has stronger effects on formal sector employee, but it does not happen on informal sector. Since informal economic sector in Indonesia do not use minimum wage regulations as basic platform in determining wage. Thus, standardization of

minimum wage will only directly affect formal working sector. Despite the fact that not all of the formal employment sector also comply with the rules of the minimum wage set by the government.



Sources: National Statistic Bureau, 2016

Figure 1
Percentage Worker/Labor who Received Wage Below and Above Minimum Wage

ILO in the Report of Labor and Social Trends in Indonesia (2015), mentions that there are at least 51.7 percent of workers who still earn low wages below the wage set by law in February 2015. In Figure 1 we can see that the percentage of workers / workers who earn wages below the minimum wage looks fluctuated and still relatively high. When viewed from the period August 2006 to August 2012, the percentage of workers who earn wages below the standard minimum wage increased from 29.4 percent to 35.2 percent. The level of non-compliance with minimum wage peaked in February 2009, which amounted to 44.6 percent.

World Bank (2013) in its analysis result found that non-compliance in the implementation of the minimum wage is proportional to the pattern of the minimum wage increase, although there is a slight pause. Regression analysis based on the data in the time period 1991 to 2007 shows that any increase in the minimum wage by 10 percent, followed by a 2.6 percent rise in non-compliance.

In connection with the implementation of the minimum wage, some experts claim that the minimum wage in Indonesia is still an opportunity for companies to put it as an option and not an obligation. Saget (2006) explained that the existing provisions allow exceptions for companies that can not afford to pay the minimum wage, can apply for suspension of the minimum wage which is based on agreements between employers and workers. So as long as the union / worker in the company level agreed to accept the situation, then the wages are likely to be under the provisions of the applicable minimum wage.

The Conditions of Informal Sector Employee

Ministry of Labor and Transmigration (2011) also explained that labor problem in Indonesia is still rounded around employment in formal and informal sector. Despite caused by dominance percentage, mostly employee in informal sector is vulnerable with economic shocks and poverty. In 2005, employment rate in informal sector is 70%, and 40% of it lied on agriculture sector which the worker is vulnerable with economic shocks (ILO, 2008; Ministry of Labor and Transmigration, 2011).

The small effect of increasing minimum wage in residence/ cities on reducing poverty is due to the nature of the minimum wage increase only improve and strengthen income formal sector workers, while the majority of the poor and vulnerable workers actually are in the informal labor sector. By standardizing the minimum wage using the standard needs of living as one of determining indicators, the impact of minimum wage increases can be directly felt by formal sector workers with a level of income that can support a decent subsistence. Although - refers to the ILO report (2015) - that there are still a lot of workers in the formal sector who do not have a formal contract, which is often paid less than the minimum wage.

In different positions, informal sector workers still earn wages below the minimum wage districts / cities, which means the ability to meet basic needs is also below the standard of decent living needs. So even though the minimum wage level districts / cities continue to rise - at the same time - informal sector workers remain on the cycle of poverty because two underlying conditions, i.e. : (1) economic conditions that are vulnerable (poor), and (2) the level of wages under decent living standards (low wages).

Referring to the definitions and indicators Sakernas in Labor Force Report (2013), explained that in 2013 the number of informal labor force in Indonesia as much as 61,593,776 or approximately 53.31 percent. Agriculture, forestry, hunting and fishing informal- that according to the ILO report an employment sector (informal) that are vulnerable to economic shocks and poverty - to accommodate labor force of 34,678,372 people, or about 56.30 percent of the total workforce in the informal sectors. The percentage of vulnerable workers is very high and dominating the workforce in the informal economic sector.

Beside, the number of workers who belong to the working temporary laborers / workers were not paid is also quite high, as many as 18,629,826, or approximately 16.12 percent of the total labor force in 2013. Thus, it can be concluded that the majority the people who work in the informal sector in 2013 have conditions that are vulnerable to economic shocks, and are not included in the group of workers who directly feel the impact of minimum wage increases.

The dominance of informal labor sector also occurred in the province of Central Java, East Java, D.I. Yogyakarta and Banten. The following data is the percentage of informal sector workers in four provinces:

Table 2
Percentage of Informal Worker in Central Java, East Java, Yogyakarta Special Region, and Banten in 2011-2013

Name of Province	2011	2012	2013
Central Java	59,02	56,96	-
East Java	-	58,83	57,54
D.I. Yogyakarta	46,51	47,89	48,27
Banten	38,12	35,57	45,02

Source: National Bureau of Statistic, proceed (206)

The Conditions of Vulnerable Employee

According to Social Report and Employment (ILO, 2014), vulnerable worker in Indonesia is included entrepreneur, entrepreneur with being helped with full time/part time labor, freelance and family worker/ unpaid. Several indicators of vulnerable workers are based on the characters of daily workers in Indonesia, which is informal and sometimes do not have sufficient wages, low productivity rate and poor working conditions.

Based on Workforce Market Indicator (2014), is explained that the conditions and status of main worker which is classified into vulnerable workers in West Java in 2013 amounted to 53.79 percent and increased by 0.22 per cent to 54.01 per cent in 2014. The

dominance rate of vulnerable worker also happened in Central Java, East Java, and Special region of Yogyakarta. Hereby the following data related to vulnerable worker in three provinces as follows:

Table 3
Percentage of Vulnerable Worker in Central Java, East Java , D.I Yogyakarta and Banten Province , in 2011-2013

Name of Province	2011	2012	2013
Central Java	68,84	66,03	-
East Java	-	66,20	66,22
D.I. Yogyakarta	55,61	56,56	56,47
Banten	38,12	41,49	39,64

Source: National Bureau of Statistic, proceed (2016)

How the Islamic Economy Perspective Examines Insignificant Effects from Increased Minimum Wage in Poverty Rate

As-Sadr (2008) in his book *Iqtishoduna* explains that Islam had already delegated state to provides social welfare to all of citizens, especially keeping standard living expense. He classified those state's duties into two social securities, i.e. gives chance engaging in productive labor and provide citizens social security to secure living standards.

First, state had to provide each individual a broad range of change to engaged in productive work, thus the citizens are able to keep their needs in by their own. Thus, their standards of living can be gradually improved, as well as their family welfare. In the end, they are able to improve the quality of human capital for the state.

In Islamic Economy state is not allowed to fully submit human resources allocations (workforce) to market mechanism. Naqvi in Haneef (2010) stated their disbelief in market mechanism for resource allocations.

“Expectations and hopes for al-.,adl (justice) and its inclinations towards the poor, and weak make him put his faith state ability play important role in economic matters”
(Haneef, 2010)

Then in support of the policy of increasing minimum wage, government had to seek formal creation of new jobs, so that informal sector workers had the opportunity to be involved in the work in formal sector, or in general give people an opportunity to become part of the formal employment sector. So in the end, there will be more people or workers who can directly feel the impact of minimum wage increases districts / cities through expanding formal sector employment.

Then, in long term period, the government should improve human resources quality by improved education standard. Low education becomes main obstacle for workforce, in finding a job in formal sector or proper job. Therefore, the government are expected to encourage and provide sufficient facilitate for each citizens for better education quality.

Secondly, when individuals are not able to perform productive work, and are not able to keep their needs, or a condition which caused state cannot provide employment opportunity, the second social security should be formed. The state should provide an amount of money in sufficient rate to keep their basic needs and improve standards of living for the informal sector and vulnerable workers. Since they often experience a few effect of improved minimum wage. Therefore, even though living standards is improving steadily, the economic conditions of those

two classified workers do not embrace any significant differences. Moreover they still received minimum wage which insufficient with minimal standard of living

Therefore, the government is expected to provide more attention to informal sector by still providing social security to the informal workers, especially the vulnerable workers whom do not directly experience the improved minimum wage. Supported Naqvi's statement, Siddiqi and Haneef (2010) emphasized that if the market system is failed to achieve justice, the state are ought to intervene. One of state intervention (according to Siddiqi) is provide and ensure the need of each citizen sufficiently.

As-Sadr in Haneef (2010) called it as standard of living, explain that state is expected to provide the balancing standard of living for the citizen. There are three main aspects which become the state important task in economy, according to Sadr (in Chamid, 2010), namely:

1. Set up a system of wealth distribution is based on the willingness and working capacity of each individual in society.
2. Integrate the rules of Islamic law in each deployment and management of national resources.
3. Design social welfare system through secured social balancing in society. Based on the explanation above, it can be concluded that government has

responsibilities and sufficient role – despite as the one who sought to reduce poverty through minimum wage standardization – but viewed as a part who actively participated in creating employment opportunity for society, i.e. by widening the chance to work in formal sector. Furthermore, state also has responsibilities to create social security, both for those who are unable to work, informal workers and vulnerable workers, so that the level of wages (income) they can meet any basic needs according to Ibn Hazm include food, clothing, health, education and housing.

Conclusion

This study focused to analyze the relationship of increased minimum wage on poverty reduction in Indonesia during the period 2007-2013. Results of regression all districts / cities in West Java, Central Java, East Java, D.I. Yogyakarta and Banten found that there is no significant relationship of the minimum wage increases the level of poverty in Indonesia.

Insignificant impact can occur due to high labor needs in informal sector and there still ware opportunities for formal sector enterprises not using minimum wage as a reference in determining wage levels. The high number of informal sector and vulnerable workers make increased minimum wage impact only felt by a few of them. Since most of them are in the informal labor sector with low wages or not feasible. Therefore, the government is expected to implement other policies that support minimum wage, so an increased revenue is not only experienced by formal sector workers, but also have a major impact for informal sector workers, especially those who belong to the category of vulnerable to economic shocks.

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