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## Labor and Environmental Issues in Indonesia

Efforts to include environmental and labor standards in trade agreements have proven controversial. Ahmed Galal and Robert Z. Lawrence (2005) observe that the scope of governance should normally match the scope of the problem; for that reason, national rather than international rules are best suited to address most environmental issues because international spillover effects are the exception, not the rule. Even so, many nongovernmental organizations (NGOs) and legislators in America and Europe yearn to include common standards in trade pacts. But countries at disparate levels of economic development often wish to make different environmental choices. Hence, built-in tensions exist between the ideal of common standards and the ideal of national sovereignty.

Greenhouse gases and other global warming issues as well as the problems of endangered species, extinction rates, and other biodiversity concerns attract media notice and properly require international action. But in poor countries, local air and water pollution frequently demand more urgent attention, and harmonizing standards to the highest levels—that is, those of developed countries—could unfairly penalize countries with limited means. Meanwhile, rich countries sometimes turn their national-level environmental attention to preserving old-growth timber and pristine wilderness rather than taking on global issues. Environmental problems with an international or global scope beyond the abilities of national mechanisms to address may be dealt with better through an explicit environmental agreement, such as the Montreal Protocol, rather than through bilateral or multilateral trade agreements.

Labor standards are even more contentious than environmental standards partly because the “race to the bottom” and “social dumping”

metaphors are more plausible for labor than for environmental issues. It may be better to leave determining most labor standards to national processes, particularly when the standards primarily affect workers making nontraded goods and services. That said, fundamental labor standards that are akin to human rights could be better addressed through the mechanisms of the International Labor Organization (ILO) than through the World Trade Organization (WTO) or bilateral FTAs.

In 1998 the ILO approved a Declaration on Fundamental Principles and Rights at Work, which contained a consensus definition of four core labor standards: freedom of association and the effective recognition of the right to collective bargaining, elimination of all forms of forced and compulsory labor, abolition of child labor, and elimination of discrimination in the workplace. These standards have since become the centerpiece of the global labor standards movement. Eight ILO conventions have been identified as embodying the core standards,<sup>1</sup> and Indonesia has ratified all of them. The United States has ratified only two: Convention 105 concerning the abolition of forced labor and Convention 182 concerning the worst forms of child labor. The US approach has been to ratify only those conventions with which US law is already in accord. Congress does not prioritize ratifying conventions that would require it to amend existing US legislation;<sup>2</sup> it holds an unstated view that US norms are already superior to ILO conventions and that nothing would be gained by ratifying conventions that might muddy the obligations articulated in US labor law.

Yet since the early 1980s, many congressmen have tried to link labor rights with trade pacts, with two purposes in mind. The first is to help level the playing field by protecting US jobs and wage levels from what legislators consider to be unfair competition from low-standard, low-wage foreign producers. The second is to help improve working conditions in developing countries. In a 1984 amendment to the generalized system of preferences (GSP), Congress prohibited GSP concessions to developing countries “not taking steps to afford their workers internationally recognized worker

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1. The eight conventions are Convention 29 Concerning Forced Labor (1930), Convention 87 Concerning Freedom of Association and Protection of the Right to Organize (1948), Convention 98 Concerning the Application of the Principles of the Right to Organize and to Bargain Collectively (1949), Convention 100 Concerning Equal Remuneration for Men and Women Workers for Work of Equal Value (1951), Convention 105 Concerning the Abolition of Forced Labor (1957), Convention 111 Concerning Discrimination in Respect of Employment and Occupation (1958), Convention 138 Concerning Minimum Age for Admission to Employment (1973), and Convention 182 Concerning the Prohibition and Immediate Action for the Worst Forms of Child Labor (1999).

2. As an example, the Office of International Labor Affairs of the US Department of State “seeks ratification of ILO Convention 111 on non-discrimination in employment” as part of its mission statement, but this has yet to gain Congressional approval. US Department of State, Bureau of Democracy, Human Rights, and Labor, [www.state.gov](http://www.state.gov) (accessed on June 30, 2006).

rights,” defining such rights to include the following basic protections:<sup>3</sup> the right to associate, to form unions, and to bargain collectively; the prohibition of forced or prison labor; rules against child labor; and minimum standards for wages, hours, and occupational safety and health.

This chapter first describes current labor and environmental conditions in Indonesia. Then it examines how labor and environmental issues have been addressed in existing US FTAs. The arguments raised during the congressional ratification of the Central American Free Trade Agreement–Dominican Republic (CAFTA-DR) pact are particularly important. The last section presents our recommendations for dealing with labor and environmental rules in the context of a prospective US-Indonesia FTA.

## **Labor Standards in Indonesia**

In 2005 the US Department of State examined labor practices in Indonesia and pointed out that, despite significant improvements in several areas, serious problems remain. Indonesian authorities have difficulty enforcing laws that prohibit antiunion discrimination and that provide for collective bargaining. Forced labor from migrant workers is an issue, and child labor is still widespread.<sup>4</sup>

### **The Right of Association**

Numerous pieces of repressive labor legislation have been repealed since the demise of the Suharto regime in 1998. Indonesian law provides broad rights of association for workers, allowing them to form and join unions of their choice without previous authorization or excessive requirements, and workers do so in practice. The law stipulates that 10 or more workers have the right to form a union, with membership open to all workers, regardless of political affiliation, religion, ethnicity, or gender. Private-sector workers are by law free to form worker organizations without prior authorization, and unions may draw up their own constitutions and rules and elect representatives. The government records rather than approves the formation of a union, federation, or confederation, giving it a registration number (US Department of State 2006b).

However, the 2003 Manpower Development and Protection Act (Manpower Act), which regulates the right of association, collective bargaining,

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3. GSP Sec. 502(a)(4) at the Web site of the US Trade Representative (USTR), [www.ustr.gov](http://www.ustr.gov).

4. See US Department of State (2006b). Indonesia was the target of several petitions filed under GSP legislation arguing that Indonesia did not meet internationally recognized labor standards. A formal GSP review was suspended in February 1994 without terminating Indonesia’s GSP benefits.

the right to strike, and general employment conditions, includes some elements that conflict with the principles of freedom of association and collective bargaining as laid out in the relevant ILO conventions. While the procedures for creating a union are straightforward by international standards, a union can be dissolved for conflicting with the ideology of national unity (ICFTU 2003).<sup>5</sup>

According to the Indonesian government, the country's total labor force consists of approximately 110 million workers, 42 percent of whom work in the agricultural and forestry sector. From April to September 2005 the manpower ministry conducted a survey of union membership, finding a significantly smaller number of union members than previous estimates suggested. In the past, the government had relied on self-reported membership statistics from the unions. Based on its new survey, the manpower ministry estimated total trade union membership at 3.4 million workers, less than 4 percent of the national workforce. However, compared with the country's 23.8 million formal-sector employees—a category that excludes the self-employed, casual workers, and unpaid workers—union membership would be approximately 14 percent, about the same as in the United States. The law also recognizes freedom of association for civil servants and their right to organize. Employees of several ministries have formed employee associations and union organizations have tried to organize the workers. Unions have also attempted to organize employees of state-owned enterprises (SOEs), but they have encountered resistance from management, and the legal basis for registering unions in SOEs remains unclear (US Department of State 2006b).

The International Confederation of Free Trade Unions (ICFTU) points out that numerous Indonesian practices restrict the right to freedom of association (ICFTU 2003) notwithstanding the legal guarantees. The law prohibits antiunion discrimination by employers and provides penalties for violations, but the government does not enforce the law effectively in many cases. Frequent reports indicate employer retribution against union organizers, including dismissals and violence.<sup>6</sup> Employers have warned employees against contacting union organizers, and unions have claimed that strike leaders were singled out for layoffs when companies downsized (US Department of State 2006b).

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5. At the beginning of 2006, the Indonesian government presented a legislative proposal to reform the Manpower Act, aimed at easing labor market rigidities. Rigidities are an important cause of Indonesia's high rate of unemployment (World Bank 2006a). However, in September 2006, in response to widespread protests staged by trade unions, the government decided to abandon its reform plan. See box 4.1 for more information.

6. Oxfam International (2006) details a series of labor abuses in Indonesian sportswear factories, including denial of trade union rights and violent assaults on workers who attempted to form unions. See also Quinn (2003).

#### **Box 4.1 Indonesian government's attempts at labor-market reform**

Despite steady economic growth between 2001 and 2006, open unemployment in Indonesia rose by 2 percentage points to 10.1 percent. During this period, economic growth averaged 4.7 percent annually, a rate that was historically sufficient to absorb new entrants. However, if the current weak relationship between economic growth and employment continues to hold, Indonesia will need to grow by 7 percent annually between 2005 and 2010 to absorb 2 million workers each year (World Bank 2006c).

Limited employment growth partly reflects Indonesia's poor labor policies. A rapidly rising minimum wage has pushed up labor costs and dampened manufacturing employment (World Bank 2006c). Moreover, according to a survey conducted by the World Bank in 2005, Indonesian firms rank labor regulations at both the national and local level as a severe business obstacle, though they are less of a hindrance than macroeconomic instability, policy uncertainty, or corruption. Forty percent of firms reported that labor regulations are moderate to severe obstacles, and 31 percent of firms reported that labor regulations reduce their competitiveness in domestic or international markets.

The most objectionable labor regulations are severance pay rules and layoff procedures. These were cited by around 22 percent of respondents as severe or very severe obstacles.<sup>1</sup> Requirements to hire workers from the surrounding community and minimum wage rates were also cited as severe or very severe obstacles by around 12 percent of respondents (World Bank 2006c).<sup>2</sup>

In 2006 the Indonesian government announced a plan to reform labor legislation, the 2003 Manpower Act, as part of a wider investment package to improve Indonesia's business environment. The proposed labor reform was to make Indonesian labor more flexible by addressing layoff procedures, severance payment rates, outsourcing, and wage rates.

The proposed reform entailed revisions to Labor Law No. 13/2003, the adoption of which, according to the World Bank (2006c), significantly raised hiring costs in Indonesia compared with other economies in the ASEAN region. The proposed revisions included the following:

- *Fixed-term contracts (FTCs)*. FTCs are currently limited to designated temporary jobs, and workers can be employed on an FTC basis for only three years before they acquire permanent status. The proposed revisions would allow employers to use FTCs for all work activities and allow firms to hire workers on an FTC basis for up to five years.
- *Outsourcing*. Outsourcing would be possible for all types of work under the revised draft law, rather than being limited to designated activities, as is the case under the current law.

*(box continues next page)*

#### **Box 4.1 Indonesian government's attempts at labor-market reform** (continued)

- *Minimum wage.* Under the new system, the minimum wage would be set at a social-safety-net level, rather than on the criterion of adequate living needs.
- *Severance pay.* Severance pay is probably the most contentious issue. The government proposals would reduce severance pay to a maximum of 7 months (from 9 months in the current system). Long-term service pay would also be reduced from 10 months to a maximum of 6 months. If a worker is dismissed for economic reasons, the maximum total severance pay (severance plus long-term service pay) would be 13 months, compared with 28 months under the current law.

In September 2006 the Indonesian government decided to withdraw its labor reform initiative from parliamentary consideration. The proposed reform had provoked mass protests by labor unions in May 2006, and the unrest prompted a government decision to establish a panel of academics to assess the reform proposals. The panel recommended not to change existing legislation significantly.<sup>3</sup>

In September 2006 Vice President Jusuf Kalla announced that the government would not pursue reforms in labor legislation, but would instead use executive regulations to address business concerns on some labor issues. It is still unclear whether these regulations will be similar in content to the original legislative proposal.<sup>4</sup>

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1. According to the World Bank–International Financial Corporation joint publication *Doing Business in 2006*, Indonesia has the 6th highest level of dismissal costs among countries in the study.

2. Only 24 percent of survey respondents stated that labor regulations are not a problem; 36 percent stated that labor regulations are a minor problem.

3. Shawn Donnan, "Indonesia Drops Plan for Labour Reform," *Financial Times*, September 12, 2006.

4. Azhar Ghani, "Indonesia Gives Up Bid to Reform Labour Laws," *Straits Times*, September 14, 2006.

## **The Right to Organize and Bargain Collectively**

Indonesian law provides for collective bargaining and allows unions that register with the government to conclude legally binding collective labor agreements (CLAs) with employers and exercise other trade union functions. However, the law establishes some restrictions on collective bargaining as well, including a requirement that a union represent more than 50 percent of a company's workforce to negotiate a CLA. According to Indonesia's manpower ministry, in 2005 there were 9,146 CLAs in effect between unions and private companies. Company agreements, permitted

under government regulations, substituted for CLAs in another 36,459 companies, many of which did not have union representation (US Department of State 2006b).

In January 2004 then-President Megawati Sukarnoputri approved the Industrial Relations Disputes Settlement Act, drafted with ILO assistance. Together with the 2000 Trade Union Act and the 2003 Manpower Act, the legislation establishes the revised legal basis for industrial relations and worker rights. The Disputes Settlement Act creates a new system of tripartite labor courts, replacing the previous tripartite committees. The act also outlines settlement procedures through mediation and arbitration. The Manpower Act requires that employers and workers form joint employer-worker committees in companies with 50 or more workers, a measure to institutionalize communication. However, the number of such bodies did not increase significantly after the act passed (US Department of State 2006b).

All workers in Indonesia have the legal right to strike whether or not they are union members, except for public-sector workers and those involved in public-safety activities.<sup>7</sup> In 2005 the large majority of recorded strikes involved nonunion workers. Unions or workers' representatives must provide seven days' notice to carry out a legal strike. The law calls for strike mediation by local manpower ministry officials but does not require government approval. In the past, workers and employers rarely followed the statutory dispute settlement procedures and workers rarely gave formal notice of their intent to strike, because manpower ministry procedures were slow and had little credibility. The Manpower Act did not significantly change this situation, and the number of recorded strikes has declined in recent years, from 220 strikes involving more than 97,000 workers in 2002 to 125 strikes involving some 53,000 workers in 2004 (US Department of State 2006b).

The ICFTU claims that Indonesia experiences so many illegal strikes because the requirements of prestrike notification procedures are complex and time consuming. The procedures also give ample space to employers to have strikes declared illegal by deliberately creating disorder, often using hired thugs, and employers can abuse lockout provisions to threaten the livelihoods of all workers, not only those engaged in negotiations (ICFTU 2003).

In 2005 the underpayment or nonpayment of legally required severance packages precipitated many strikes and labor protests. The Solidarity Center documented cases in which foreign firms in the garment and footwear industry, faced with falling orders and plant closures, fled the country to avoid making severance payments (US State Department 2006b). At times the police intervened in labor matters, usually to protect business

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7. The law allows such public workers to carry out strikes if the strikes do not disrupt the public interest or endanger public safety.

interests. In April 2005, however, the national police adopted new guidelines for “handling law and order in industrial disputes,” developed with the assistance of the ILO (US Department of State 2006b).

Seven export processing zones (EPZs) operate in Indonesia. There are no special laws or exemptions from regular labor laws in EPZs. However, nongovernmental observers, including the Solidarity Center, described stronger antiunion sentiment and actions by employers in EPZs (US Department of State 2006b).

## Prohibition Against Forced Labor

Indonesian law prohibits forced labor, including labor of children; however, such practices are reported. Unscrupulous recruiting agencies that target migrant workers, coupled with poor enforcement of government regulations, have often led to debt bondage and extended confinement. The Solidarity Center (2005) reports that recruiting agencies frequently keep migrant workers in holding centers for months before sending them abroad. While in the holding centers, migrant workers normally are not paid, and recruiters often do not allow them to leave. In most instances, workers are forced to pay recruiters the cost of their forced stay, resulting in large debts to the recruiters (US Department of State 2006b).<sup>8</sup>

According to the ICFTU, a government decree requires outbound migrant workers to waive their rights to recount hardships encountered overseas, suggesting that the actual occurrence of forced labor among migrant workers in Indonesia could be much higher than reported. Human trafficking, including for prostitution, is widespread: Some sources suggest that as many as 20 percent of the 5 million outbound migrants are involved in trafficking (ICFTU 2003).

In 2002 the Indonesian and Australian governments launched the so-called Bali Process to develop practical measures at a regional level against trafficking and smuggling. Two regional ministerial conferences were held in 2002 and 2003, followed by a senior officials’ meeting in Brisbane, Australia, in June 2004. At the Brisbane meeting, attention was drawn to trafficking for labor exploitation. The process has moved from enunciating principles to more practical measures, and the focus has changed from

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8. Jordan, a new US FTA partner, is experiencing problems associated with labor standards for the inbound migrant community. In June 2006 Sharif Ali Zu’bi, the Jordanian trade minister, shut down three garment factories after a US labor group reported abusive labor conditions for foreign workers in plants producing goods that qualify for duty-free access to the United States. Labor sources said that the problems in Jordan will be used as leverage in the battle over approving an FTA with Oman, which has a large inbound migrant worker population. See “Schwab Says GSP Review Will Consider Limits on India, Brazil,” *Inside US Trade*, August 11, 2006.

intercepting smuggling to preventing trafficking and protecting victims (ILO 2005).

## Prohibition Against Child Labor

Indonesian law prohibits children from working in hazardous sectors, including mining, skin diving, construction, offshore fishing platforms, and prostitution and mandates severe criminal penalties and jail terms for persons who violate children's rights. In 2005 the government prosecuted a small number of cases under these provisions. However, the government does not consistently enforce its child labor laws. As a practical matter, some children must work to supplement family incomes. The Manpower Act prohibits the employment of children, defined as persons under 18, but makes an exception for those who are 13 to 15 years of age, who may work no more than three hours per day under a number of conditions, such as parental consent, no work during school hours, and payment of legal wages. The law does not appear to address exceptions for children ages 16 to 17 (US Department of State 2006b).

The government has separate national action plans to eliminate the worst forms of child labor, combat trafficking, and eliminate the commercial sexual exploitation of children. However, an estimated six to eight million children exceed the legal three-hour daily work limit, working in agriculture, street vending, mining, construction, and prostitution (US Department of State 2006b).<sup>9</sup> More children work in the informal sector than in formal jobs. Some children work in large factories, but their numbers are unknown, largely because documents verifying age can be falsified. Children are known to work in industries such as rattan and wood furniture, garments, footwear, food processing, toy making, and small-scale mining operations. Many girls between 14 and 16 years of age work as live-in domestic servants. The ILO estimates that there were 2.6 million domestic workers in Indonesia in 2003, of whom at least a quarter were children (ILO 2004).

According to Human Rights Watch (HRW 2005), some Indonesian children between 12 and 15 years of age work 14 to 18 hours per day, seven days a week, from 4 a.m. to 10 p.m., often as household servants. Some employers subject them to physical and sexual threats. A significant number of children also work against their will in prostitution, pornography, begging, drug trafficking, and other exploitative situations, such as fishing platforms (US Department of Labor 2005).

Social and cultural resistance remains a challenge in addressing child labor. Many parents disagree with government efforts to restrict children

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9. The Indonesian government reports similar figures. See US Department of Labor (2005, 239).

from working, arguing that the government has taken inadequate measures to ensure that their families can survive. Despite legislative and regulatory measures, most children who work, including as domestics, do so in unregulated environments. Anecdotal evidence suggests that local labor officials seldom investigate child labor conditions (US Department of State 2006b).

## Acceptable Conditions of Work

Provincial and district authorities rather than the central government establish minimum wages, which vary by province, district, and sector. Provincial authorities determine provincial minimum wage levels based on proposals by tripartite wage commissions (workers, employers, and government). Local districts set district minimum wages using the provincial levels as references. In practice, official minimum wage levels apply only to the formal sector, which accounts for 35 percent of the workforce (US Department of State 2006b).

Provinces and districts conduct annual minimum wage-rate negotiations, which often engender controversy and protests. In 2005 the minimum wage levels that most local governments set arguably did not provide a decent standard of living for a worker or his family. Most provincial minimum wage rates fell below the central government's calculation of basic minimum needs, and enforcement is often inadequate. During 2005 Jakarta enacted the highest minimum wage of 710,000 rupiah—around \$71—per month, while the manpower ministry reported official minimum wages as low as 340,000 rupiah (around \$34) per month. In December 2005 most provincial governments decided to raise minimum wages at least 15 percent starting in January 2006. Following that decision, thousands of workers in the cities of Medan, Surabaya, Jakarta, and elsewhere demonstrated to protest minimum wage rates, asserting that they were still below the government-determined minimum standard for cost of living. Employers argued that higher wage rates would make Indonesian workers less competitive internationally and limit job growth (US Department of State 2006b).

Labor law and ministerial regulations provide workers with a variety of benefits. The law requires employers to register workers and pay contributions to the state-owned insurance agency, Jamsostek. At the end of the year 2005, according to Jamsostek, companies had registered 26 million workers. The law establishes a normal 40-hour work week, with one 30-minute rest period for every 4 hours of work. The law requires at least one day of rest weekly (a five and a half- or six-day work week is common). In 2005 the daily overtime rate was one and a half times the normal hourly rate for the first hour and double the hourly rate for additional overtime, with a maximum of 3 hours of overtime per day and no more than 14 hours per week. Workers in industries producing retail goods for export fre-

quently worked overtime to meet contract quotas. Unions complain that companies rely on excessive overtime in some electronics assembly plants, to the detriment of worker health and safety.

The observance of laws regulating benefits and labor standards varies among sectors and regions. In 2005 workers at more modern facilities often received health benefits, meal privileges, and transportation. However, employer violations of legal requirements were fairly common, resulting in strikes and protests.

According to Indonesian law, workers are obligated to report hazardous working conditions, employers are forbidden from retaliating against those who report, and local officials are responsible for enforcing industrial health and safety standards. However, the law is not enforced effectively. In larger companies, the quality of occupational health and safety programs varies greatly. In smaller companies and the informal sector, health and safety standards tend to be weak or nonexistent. According to press reports, Jamsostek records about 100,000 occupational accidents annually (US Department of State 2006b).

## **Environmental Standards in Indonesia**

The Environmental Sustainability Index (ESI) ranks Indonesia 75th out of 146 countries according to five broad criteria.<sup>10</sup> The quality of environmental systems is measured by air quality, biodiversity, land, water quantity, and water quality. The extent of environmental stress is measured by air pollution, ecosystem stress, population stress, waste and consumption pressures, water stress, and natural resource management. Human vulnerability is indexed by human sustenance and vulnerability to environment-related natural disasters. Social and institutional capacity includes private-sector responsiveness, environmental governance, and the level of science and technology. Global stewardship determined by the extent of international collaborative efforts, greenhouse gas emissions, and transboundary environmental pressures.

The ESI report draws attention to current problems, in particular severe water quality issues. The Central Intelligence Agency (CIA 2006a) likewise points out problems of water pollution from industrial wastes and sewage, together with deforestation, air pollution in urban areas, and smoke and haze from forest fires.

The Energy Information Administration (EIA 2004) similarly concludes that Indonesia's environmental problems are large in scope, with

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10. See 2005 Environmental Sustainability Index of the Environmental Performance Measurement Project (Yale University, Columbia University, and the World Economic Forum).

illegal logging one of the largest. Illegal logging reflects the relative poverty of much of Indonesia's population as well as the abundance of timber—Indonesia contains 10 percent of the world's forest cover and has the third largest tropical rain forest—and the weakness of enforcement.<sup>11</sup> Logging affects Indonesia's environment in many different ways. Deforestation has been closely linked with floods and landslides and with industrial runoff that pollutes Indonesia's water supply (EIA 2004).<sup>12</sup> Ominously, the experience of the US-Singapore FTA suggests that a US-Indonesia FTA could make the problem of illegal logging even worse. US imports of wood products from Singapore are projected to be nearly three times their pre-FTA levels (USITC Interactive Tariff and Trade Dataweb, 2006), and environmental activists claim that shipments through Singapore of Indonesian timber known to be of illegal origin have increased by 62 percent (EIA 2006). Evidently, in the case of forestry products, a US-Indonesia FTA would need to be accompanied by strong measures to guard against US imports of illegal logs.<sup>13</sup>

Air pollution is perhaps Indonesia's most severe environmental problem, generating serious financial and public health costs.<sup>14</sup> Motor vehicles

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11. The Indonesian political debate in recent years has been characterized by bitter controversy over whether mining should be allowed in the country's protected forests. A 2004 government regulation overruled the 1999 Forestry Law that prohibited open-pit mining in protected forests, allowing mining activities to resume. However, in 2006 the Forestry Ministry issued new guidelines for mining firms intending to operate in protected forests. The Indonesian Mining Association and the Association of Indonesian Coal Producers have strongly criticized the guidelines for imposing excessive burdens on mining firms. "Mining group objects to new forest guidelines," *The Jakarta Post*, May 31, 2006.

12. In 2006 the United States and Indonesia launched negotiations for an agreement to facilitate bilateral cooperation to combat illegal logging. US officials hope to extend this agreement to include other important regional actors. See "USTR Portman and Indonesia Trade Minister Pangestu Launch Negotiations on Landmark Illegal Logging Initiative," USTR press release, April 4, 2006, [www.ustr.gov](http://www.ustr.gov) (accessed on July 6, 2006).

13. Brooks et al. (2001) estimated that the accelerated tariff liberalization in forest products may increase aggregate world trade in this sector by 2 percent and increase the world timber harvest by 0.5 percent. They note that this need not imply net deforestation, as planting new trees may increase as well. An FTA might have an indirect effect on pollution. The so-called "pollution haven" hypothesis suggests that economic integration can result in some countries "exporting" pollution to others, so that the overall level of pollution does not change. Levinson and Taylor (2001) find that those US industries facing the largest rise in environmental control costs have experienced the largest increases in net imports from Canada and Mexico. However, Frankel and Rose (2002) find little evidence that trade has had a detrimental effect on the environment.

14. Inflammation of the respiratory tract, which is directly linked to air quality, was the sixth leading cause of death in Indonesia, after accidents, diarrhea, cardiovascular disease, tuberculosis, and measles (EIA 2004).

are one of the chief sources of air pollution in Indonesia, and between 1995 and 2001, the number of vehicles in Indonesia grew from 12 million to almost 21 million. Many vehicles are motorcycles or scooters that lack the catalytic converters required for cleaner emissions. Moreover, almost no motor vehicles in Indonesia use unleaded gasoline; instead, leaded gasoline or diesel fuel is standard, leading to high concentrations of airborne lead (EIA 2004).<sup>15</sup> Forest fires also contribute to Indonesian air pollution, and often these fires result from illegal logging of Indonesia's rain forests.<sup>16</sup> Indonesia's industrial sector, which embraces chemical, petroleum, coal, plastic, rubber, and food processing, is another significant polluter, though there is limited quantitative data on their overall effect. In 1992 the Ministry of Environment initiated the Blue Sky Program to improve air quality in Indonesia's five largest cities, Jakarta, Bandung, Semarang, Surabaya, and Medan. The Blue Sky Program imposed controls on 20 industries (EIA 2004).

Indonesia's water quality is deteriorating. One of the most serious problems is the lack of sewerage systems in urban areas. The World Bank (2003) ranks Indonesia among the worst countries in Asia for sewerage and sanitation coverage. Few Indonesian cities possess even minimal sanitation systems.<sup>17</sup> Without an established sanitation network, many households rely on private septic tanks or dump their waste directly into rivers and canals. The result is significant contamination of Indonesia's surface and groundwater, as well as repeated epidemics of gastrointestinal infections (EIA 2004).

Weak controls on industrial emissions have degraded water resources, and agricultural chemicals have damaged water resources in Indonesia's farmlands. Because small-scale mines operate with little or no environmental precautions, Indonesia's mining sector is an increasing source of water pollution. Indonesian coastal waters are highly polluted, especially in high-traffic areas such as the Malacca and Lombok Straits, major shipping pathways between Asia and the Middle East. Unsustainable fishing practices such as blast fishing, industrial effluent, sewage, and agricultural discharges have jeopardized the ecosystems of Indonesia's reefs, the most biologically diverse in the world (EIA 2004).

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15. Notwithstanding the phasing out of leaded gasoline, Jakarta's air remains among the most polluted in the world (EIA 2004).

16. The World Bank estimated that the costs of forest fires in Indonesia in 1997 and 1998, when fires were especially destructive, exceeded the combined legal liabilities assessed for the Exxon Valdez oil spill and the Bhopal chemical disaster (World Bank 2003).

17. According to Sukarma and Pollard (2002), less than 3 percent of Jakarta's population is connected to a sewer system.

## Labor and Environmental Issues in US FTAs

Many voices in the United States, both in Congress and the broader public, urge the inclusion of labor and environmental rules in bilateral FTAs. These voices now dominate the US political debate, despite the misgivings of commentators that labor and environmental matters should be addressed either at a national level or internationally by specialized organizations or protocols, such as the ILO or the Montreal Protocol. However, given these pressures, which first erupted in the North American Free Trade Agreement (NAFTA) debate of 1993, it is useful to summarize how labor and environmental issues have been addressed in existing US FTAs.

None of the agreements signed by the United States require adherence to new and detailed environmental and labor standards. Instead, the agreements commit countries to promote workers' rights and protect the environment generally, proclaiming that each government should enforce its own domestic environmental and labor laws and not weaken laws or reduce domestic labor protection in a "race to the bottom" to encourage exports or foreign investment. The Chile and Singapore FTAs reaffirm each party's existing commitment to the core labor standards contained in the ILO's Declaration on Fundamental Principles and Rights at Work and also "recognize that it is inappropriate to encourage trade or investment by weakening or reducing the protections afforded in domestic labor laws" (Elliott 2004, 6).

NAFTA was the first trade agreement linked to workers' rights provisions in a major way. Its companion side agreement, the North American Agreement on Labor Cooperation (NAALC), went into effect with NAFTA on January 1, 1994. Through the NAALC, the NAFTA signatories agree to enforce their own labor laws and standards while promoting 11 labor principles over the long term. These principles are divided into three tiers, with access to remedies for inadequate enforcement of domestic law varying according to the tier. Under the NAALC, monetary penalties and theoretically sanctions are applicable to only 3 of the 11 principles, those in the third tier: domestic law standards on minimum wages, child labor, and occupational safety and health (Hufbauer and Schott 2005).<sup>18</sup>

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18. By contrast, offenses under the first tier are only susceptible to review and ministerial oversight. No committee of experts is called to evaluate the enforcement of labor principles in the first tier, and no penalties are provided for noncompliance. The first tier applies to matters concerning freedom of association, collective bargaining, and the right to strike. In the second tier are principles subject to review by the National Administrative Office (NAO), ministerial consultations, and evaluation by a committee of experts, but without arbitration of disputes or penalties for noncompliance. The second tier covers forced labor, minimum employment standards pertaining to overtime pay, gender pay equity, employment discrimination, compensation in case of injury or illness, and protection of migrant labor (Hufbauer and Schott 2005).

The NAALC's main function is to provide a forum for cooperation. In principle, instances of noncompliance can be investigated following a citizen's complaint or a party's request. To this end, the Commission for Labor Cooperation (CLC) Secretariat was created to oversee implementation and promote cooperation (Hufbauer and Schott 2005).<sup>19</sup> The NAALC has been criticized for its limited scope, and while it provides a consultation and cooperation mechanism as well as a constrained dispute settlement arrangement, it does not provide effective remedies for workers whose rights are violated (Hufbauer and Schott 2005).

The environmental side agreement, the North American Agreement on Environmental Cooperation (NAAEC), was similarly designed to encourage cooperative initiatives, ensure appropriate implementation of environmental legislation, and mediate environmental disputes. The North American Commission for Environmental Cooperation (CEC) is the institutional structure created to achieve all three goals. The NAAEC has two major shortcomings. First, the "nonenforcement" mechanism contained in Articles 22–36 is disappointing; it deceives those who identified this mechanism as the "teeth" of the side agreement. Second, NAFTA governments have not supported the CEC adequately. These weaknesses have been addressed, to some degree, in subsequent US FTAs (Hufbauer and Schott 2005).

The US-Jordan FTA, completed in late 2000, incorporated provisions from both the NAALC and the "fast-track" authorization bills debated in the 105th Congress (CRS 2001). The US-Jordan FTA established a precedent by including in the main text a section on labor that is subject to the same dispute settlement procedures as other provisions in the agreement. However, letters exchanged by the US and Jordanian governments vowed to resolve differences under the agreement without resorting to sanctions. Similar to the NAALC, the US-Jordan FTA provides that "a party shall not fail to effectively enforce its [own] laws."<sup>20</sup> In addition, Article 6(2) provides that "each Party shall strive to ensure that it does not waive or otherwise derogate from, or offer to derogate from [domestic labor laws] as an encouragement for trade with the other Party."<sup>21</sup>

The US-Jordan FTA does not offer procedural guarantees of impartial tribunals to adjudicate labor matters,<sup>22</sup> nor does the agreement create

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19. Because the CLC does not have the power to develop factual records—unlike the CEC—submissions have to be filed with the NAO of each country. To bring a case against his own country, a citizen must file with another country.

20. See Article 6 (4)(a) in USTR (2000).

21. The US-Chile, US-Singapore, US-Morocco agreements, as well as CAFTA-DR, expanded on the US-Jordan language to clarify that weakening or reducing labor protections should not be done to encourage trade or investment. They also define what is meant by a "derogation" that should not occur (USTR 2005a).

22. The procedural guarantees that were later written into CAFTA-DR and the US-Morocco FTA are based on those contained in the NAALC (USTR 2005a).

a labor-related institutional mechanism.<sup>23</sup> The labor language was not particularly intended to exert upward pressure on standards, and moreover, the dispute settlement procedures in the US-Jordan FTA leave considerable discretion to each government in deciding whether and how hard to push enforcement actions on labor, environment, and other matters.<sup>24</sup> So far, no such actions have been brought under the US-Jordan FTA.

The next two US FTAs, with Chile and Singapore, followed the US-Jordan standard by including workers' rights provisions in the body of the agreement and making violations subject to the same dispute settlement procedures as commercial disputes. In contrast to the NAALC under NAFTA, there is no distinction among tiers of applicable labor standards. However, the US-Chile and US-Singapore FTAs follow the practice of basing labor obligations on the effective enforcement of each country's own laws in trade-related sectors. The US-Singapore FTA states that the parties "shall strive to ensure" that their own labor laws are enforced and are consistent with the right of association, the right to organize and bargain collectively, the prohibition on forced labor, a minimum age of employment, and acceptable work conditions (USTR 2003b). However, in a step back from the Jordan framework, while recognizing that it is inappropriate to encourage trade or investment by weakening or reducing the protections afforded in domestic laws, these agreements explicitly exclude such derogations from dispute settlement provisions (Elliott and Freeman 2003).

Like the NAALC, and in a departure from the US-Jordan FTA, the US-Chile and US-Singapore agreements limit enforcement measures in labor disputes to monetary fines, with the possibility of suspending tariff concessions if necessary to collect the fine (fines are explicitly not a trade sanction). Unlike NAFTA, the fines would accrue annually if a problem remains unresolved. In commercial disputes, the country violating the agreement could choose to pay a fine, but traditional trade retaliation remains an option. The US Trade Representative (USTR) argues that, while not "mirror images," the mechanisms for enforcement of labor and commercial disputes would be equally effective and therefore meet the congressional standard of equivalence (Elliott and Freeman 2003).

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23. Both CAFTA-DR and the US-Morocco FTA have annexes to the labor chapter detailing labor cooperation and capacity-building activities. The US-Jordan FTA has no such annex (USTR 2005a).

24. If the sequence of steps—consultations, a dispute settlement panel, and finally a hearing by the joint committee—does not resolve a dispute, the complaining party is authorized "to take any appropriate and commensurate measure" (Elliott and Freeman 2003).

## Labor and Environmental Issues in CAFTA-DR

CAFTA-DR is the eighth FTA to include labor protections.<sup>25</sup> During the CAFTA-DR debates, Democrats in Congress argued that the US-Chile, US-Jordan, and US-Singapore FTA labor frameworks inadequately address the severe labor problems in Central America. Democratic congressmen argued that Central American countries simply could not be relied upon to carry out meaningful enforcement. US promises to implement a cooperation program to promote compliance with labor standards proved insufficient to sway Democratic votes, partly because the implementation records of the labor and environmental side agreements in NAFTA were weak (Hufbauer and Schott 2005). The labor and environmental provisions in Chapters 16 and 17 of CAFTA-DR also did not satisfy critics, especially Democratic congressmen, though they pushed the frontier in including such standards in FTAs. In a close congressional vote along highly partisan lines (217–215), the House of Representatives ratified CAFTA-DR on July 28, 2005.

### *Chapter 16: Labor*

Chapter 16 of CAFTA-DR requires consultations if a party believes that another party is not complying with identified core labor standards. Under the agreement, only a partner government—not unions or individual workers—can invoke consultations and subsequent enforcement measures. If the matter concerns a party's obligation to effectively enforce its labor laws, the complaining party may, after an initial 60-day consultation period, invoke the provisions of Chapter 20 (Dispute Settlement). These provisions entail additional consultations or a meeting of the CAFTA-DR cabinet-level Free Trade Commission. If the commission cannot resolve the dispute, the matter may be referred to a dispute settlement panel. The parties maintain a roster of experts to serve on such panels.

To build institutional capacity for handling labor and environmental issues, \$20 million in US government assistance has been allocated specifically under CAFTA-DR. The Bush administration has also supported a request for \$40 million for fiscal year 2006 and will propose similar funding levels through fiscal year 2009, with the exact form and level of assistance to be decided on a country-specific basis.

Along with the money, Chapter 16 creates mechanisms to strengthen each party's institutional capacity. The mechanisms assist the parties to establish priorities for and carry out initiatives on effectively applying

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25. The first seven are NAFTA and the six US bilateral trade agreements with Jordan, Chile, Singapore, Australia, Morocco, and Bahrain. After CAFTA-DR, US FTAs with Oman and Peru also contained labor provisions.

fundamental labor rights, legislation, and practice relating to ILO Convention 182 dealing with the worst forms of child labor, stronger labor inspection systems and labor tribunals, complying with regulations pertaining to working conditions, and eliminating gender discrimination in employment.

Chapter 16 establishes a cabinet-level Labor Affairs Council to oversee the chapter's implementation and provide a forum for consultations and cooperation. Each party must designate a contact point for communications with the other parties and the public. Each party's contact point must provide transparent procedures to submit, receive, and consider communications from the public.

### ***Chapter 17: Environment***

Chapter 17 draws on the NAAEC of 1994 and the environmental provisions of other US FTAs. But CAFTA-DR goes further: It is the first US FTA to provide a public submission process on environmental enforcement matters in the body of the FTA. Modeled on Articles 14 and 15 of the NAAEC, the submission mechanism creates a new avenue for citizens to raise specific problems associated with enforcing environmental laws, subject to review by an independent secretariat.<sup>26</sup>

The CAFTA-DR mechanism goes beyond NAFTA in several respects. Under CAFTA-DR, it is easier for a meritorious case to develop a detailed factual record by request of a single member of the Environmental Affairs Council, whereas NAFTA requires the assent of two of the three parties. There are modest provisions for implementing the findings of the factual record, as the joint Environmental Affairs Council can make recommendations to the Environmental Cooperation Commission. This provision represents an innovation to the NAAEC, which contains no such provision for follow through. CAFTA-DR also contains provisions for including environmental expertise in resolving disputes. If a party does not comply with a dispute panel's finding that the party is failing to enforce its environmental laws, CAFTA-DR allows for monetary assessments to address the underlying enforcement problem.

Chapter 17 establishes a cabinet-level Environment Affairs Council to oversee implementation. At the council's meetings, members of the public have the opportunity to express their views. The parties also agree, under Chapter 17, to consult on WTO negotiations regarding multilateral envi-

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26. The CAFTA-DR public submissions procedure does not allow US citizens to raise concerns about US enforcement of its own environmental laws; such persons already have recourse to other remedies, including procedures under Articles 14 and 15 of the NAAEC. However, citizens of other CAFTA-DR parties may raise concerns about US enforcement under the CAFTA-DR provisions. The FTA governments agree to establish a new unit within the Secretariat for Central American Economic Integration (SIECA) to serve as the "secretariat or other appropriate body" to undertake the functions set out in Articles 17.7 and 17.8 of the agreement (USTR 2004a).

ronmental agreements. The Environmental Cooperation Agreement (ECA),<sup>27</sup> established under Article 17.5 of CAFTA-DR, provides for benchmarks to establish short-, medium-, and long-term goals for improving environmental protection and for outside monitoring by organizations such as the United Nations Environmental Program (UNEP) and the Inter-American Development Bank (IDB).

## ***Chapter 20: Dispute Settlement***

Equivalent compliance procedures apply to disputes over labor and environmental enforcement. If a panel determines that a party has not met its enforcement obligations, and if the disputing parties cannot agree on how to resolve the dispute, or the complaining party believes that the defending party has failed to implement a resolution, the complaining party may ask the panel to determine the amount of an annual monetary assessment to be imposed on the defending party. The panel establishes the amount of the assessment, subject to a \$15 million annual cap, accounting for relevant factors, both trade-related and otherwise. The assessment is paid into a fund established by the commission for appropriate labor and environmental initiatives. If the defending party fails to pay an assessment, the complaining party may take other appropriate steps, such as suspending tariff benefits as necessary to collect the assessment.

As written, the CAFTA-DR provisions seem amenable to establishing panels and imposing monetary fines. However, the absence of serious funding in the CAFTA-DR pact is glaring. Funds to build institutions of even \$40 million annually will not make a meaningful difference when much heavier lifting is required for adequate sanitation, clean water, paved roads, and reforestation. The labor dispute settlement provisions seem promising if the new machinery focuses on a limited number of core labor standards, such as child labor or discrimination, and comes down hard in documented cases of abuse.

## **Recommendations**

The umbrella for all our recommendations is the reality that numerous reports by NGOs and US agencies have chronicled the difficult and sometimes distressing labor and environmental conditions in Indonesia today. Some of the reports may be exaggerated or inaccurate, but perceptions are crucial; congressional perceptions in particular will demand robust corrective measures as part of an FTA text. Of course, labor and environmen-

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27. Negotiated in parallel with CAFTA-DR, the ECA builds on the US Agency for International Development's (USAID) long-term environmental planning in the region and is specifically linked to activities under the Central American-US Joint Accord.

tal conditions are correlated with income, and the per capita income in Indonesia is \$3,600 on a purchasing power parity basis.<sup>28</sup> This is less than that of current US FTA partners in the developing world, Jordan (\$4,500), Morocco (\$4,200), the CAFTA-DR countries (\$5,000),<sup>29</sup> and one prospective US FTA partner, Egypt (\$4,200). While higher labor and environmental standards by themselves cannot raise the level of per capita income,<sup>30</sup> they can be used to eradicate the worst forms of labor and environmental abuse. With that goal in mind, we offer recommendations for both labor and environmental provisions.

## Labor Provisions

- A US-Indonesia FTA should adopt the basic labor and dispute settlement framework of the CAFTA-DR pact, as laid out in Chapters 16 and 20.
- The progression of labor chapters in US FTAs is toward stronger enforcement measures and higher standards. With that evolution in mind, the Indonesian government should promote the amendment of the Manpower Act to conform to the ILO conventions that Indonesia has ratified.
- The Indonesian government should undertake more vigorous and systematic enforcement of existing labor legislation, in particular laws and regulations against antiunion discrimination as well as forced and child labor. Indonesian authorities should commit to periodic independent audits of their accomplishments by the ILO or another independent body.
- Indonesia is a member of the International Organization for Standardization (ISO).<sup>31</sup> Just as businesses in Indonesia have adopted the voluntary quality standards developed by the ISO, firms that export to the United States should adopt codes of conduct for labor matters. These

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28. 2005 estimate from CIA (2006a).

29. This is the simple average per capita income of the CAFTA-DR countries: Costa Rica (\$9,600), the Dominican Republic (\$6,300), El Salvador (\$4,900), Guatemala (\$4,200), Honduras (\$2,800) and Nicaragua (\$2,300). A weighted average figure would be lower, because Honduras and Nicaragua together have a relatively large population in the CAFTA-DR group.

30. Average wages are far more dependent on the national productivity level than on specific legislation aimed at labor abuses. National productivity is determined by an array of factors, of which labor legislation is a comparatively small component.

31. A member of the ISO is the national body "most representative of standardization in its country." Only one such body for each country is accepted for ISO membership. Member bodies can participate and exercise full voting rights on any ISO technical or policy committee. See ISO, "ISO Members." Available at [www.iso.org](http://www.iso.org) (accessed on December 7, 2006).

codes should reflect the ILO Declaration on Fundamental Principles and Rights at Work. Companies should self-certify their compliance. Randomly selected companies—say, 10 percent per year—should submit to an independent audit to ensure that they observe the codes.

## **Environmental Provisions**

- Chapter 17 of CAFTA-DR provides a good framework for environmental provisions in a US-Indonesia FTA. For violations with a direct trade impact, monetary assessments subject to approximately the same annual cap (\$15 million) are appropriate.
- The United States should adopt strong measures against importing illegal timber and wood. In addition, given the transnational nature of commerce in illegal logs, the United States should continue to pressure Indonesia, Singapore, and Malaysia to conclude a binding agreement with good enforcement tools to prohibit exports and imports of illegal wood in all forms.
- Initiatives should be adopted to strengthen the institutional and technical capacity needed to deal with infringements of environmental regulations, in particular illegal logging and industrial emissions. In addition, mechanisms should be established for external monitoring by regional or international organizations.
- The United States should provide support at or above the CAFTA-DR level (\$40 million annually), on a matching basis with Indonesia, to strengthen labor and environmental institutions. In addition, specifically for water and sewer projects, the United States should urge the World Bank to launch a major program. We have not attempted to estimate the scope, but it could reach several billion dollars over a decade.

