

# CHAPTER I

## INTRODUCTION

### 1.1 Background

Economic development is an essential topic of discussion in every country. This is because economic development is one of the measures of the success of a country's development. Development aims to increase the availability and broaden the distribution of basic living goods, improve living standards and expand economic and social choices. In the long term, economic development is expected to improve people's welfare to reduce poverty (Smith & Todaro, 2011).

In achieving Indonesia's economic development goals, there are problems of poverty and income inequality. Based on Statistics Indonesia data for 2020 show that 10,19 percent of Indonesia's population is below the national poverty line. Poverty is still spatially concentrated in rural areas, where 13,20 percent of the rural population and 7,88 percent of the urban population are below the poverty line (Statistics Indonesia, 2021). Although the number of poor people continues to decline, overall, in 2020, inequality based on the Gini index will increase to 0,385 (Statistics Indonesia, 2021). This shows that the income distribution gap is widening.

The poverty that continues in Indonesia is a vicious circle of poverty that is difficult to break. According to Ragnar Nurkse, this is due to low income, which results in low savings. A low saving state means low capital formation. Low capital formation affects the level of investment to be low as well. Low investment levels result in low productivity. Low productivity causes low income, and so on (Jhingan, 2011). One way to describe the welfare condition of the population in



Indonesia is labour productivity as measured by the income of the working population.

Income is one of the crucial issues to assess the welfare of the labours, and income shows the appreciation of the owners of capital for labour. Income represents the provider's self-esteem, where the higher the income the labour receives, the more self-esteem accumulates in the form of human capital as a service provider (Madris, Sabir, & Dianasari, 2020). The main focus in income setting in Indonesia is to ensure that incomes provide a decent living for labours and their families, reflect remuneration for their work, and provide adequate incentives to encourage increased labour productivity.

Increasing labour productivity can be implemented through efforts to improve the level of human capital. Education is a major for individuals to acquire the abilities, skills, and knowledge needed to contribute effectively to the labour market. Increasing income is determined mainly by increasing labour productivity through education, where education produces knowledge and skills (Akinyemi, 2013). The higher the labour productivity, the more income will also increase. The return on educational benefits in the form of income is known as the rate of return on educational investment (Patrinos, 2016). The higher the level of education, the increase in purchasing power, skills, ways of thinking, and skills will increase labour income.

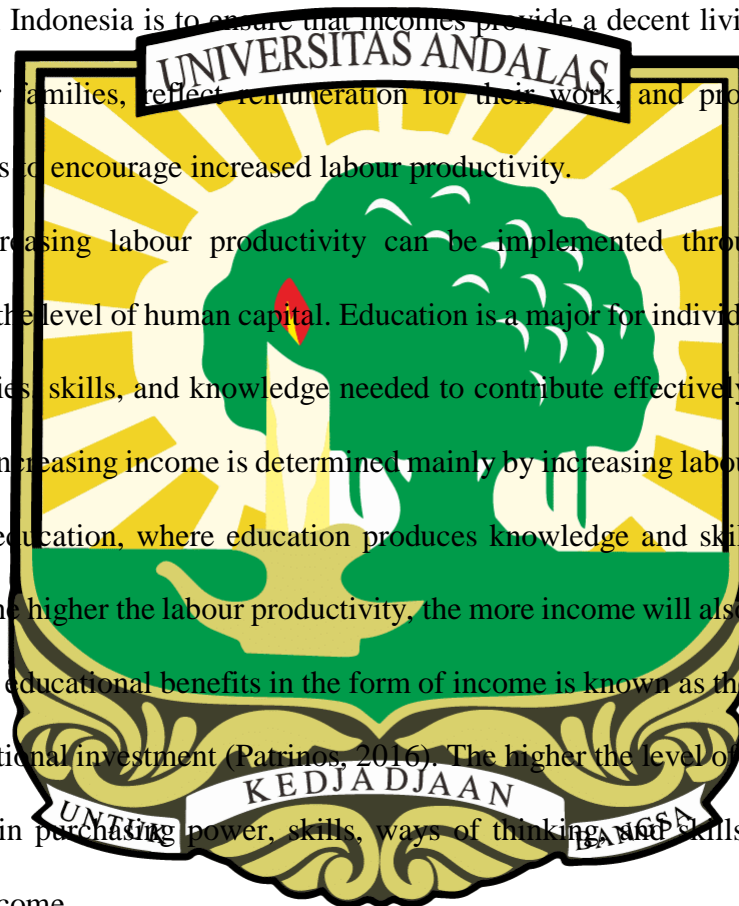


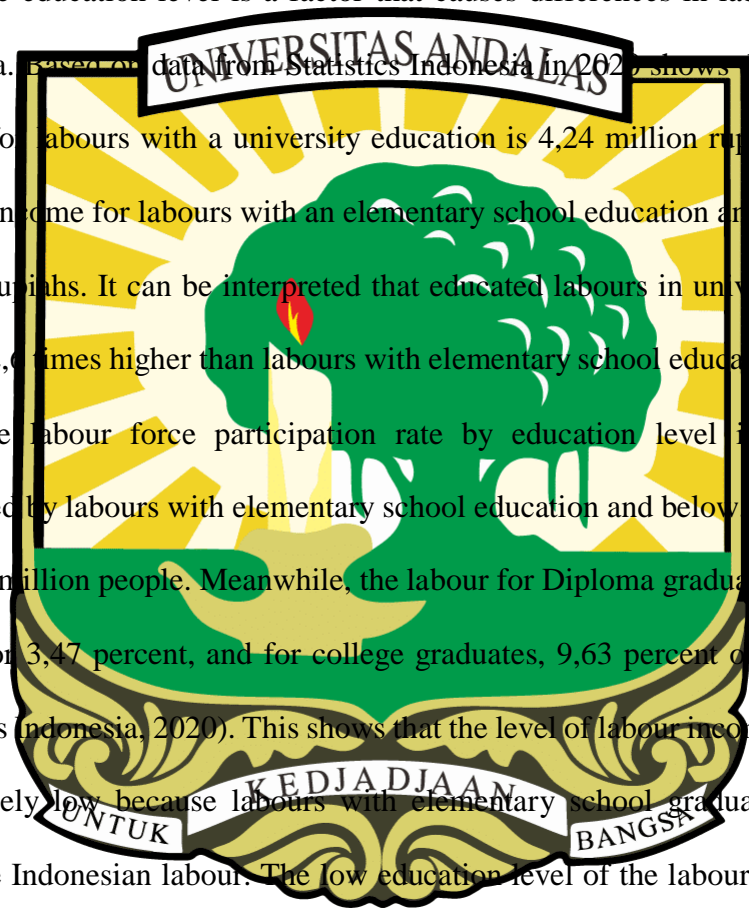
Table 1.1 Average Incomes of Labour by Level of Education and Gender

Level of Education	Male	Female	Male + Female
Elementary School below	Rp.1.885.121	Rp.1.142.238	Rp.1.650.259
Junior High School	Rp.2.166.813	Rp.1.542.276	Rp.1.985.814
Senior High School	Rp.2.947.377	Rp.2.064.207	Rp.2.673.767
Vocational High School	Rp.2.896.447	Rp.2.163.206	Rp.2.686.689
Diploma I/II/III	Rp.4.296.813	Rp.3.017.279	Rp.3.572.370
University	Rp.5.042.099	Rp.3.461.141	Rp.4.237.947
Average Labour Income	2.907.530	2.980.557	2.354.599

Source: Statistics Indonesia (2020)

The education level is a factor that causes differences in labour income in Indonesia. data from Statistics Indonesia in 2020 shows that the average income for labours with a university education is 4,24 million rupiahs, while the average income for labours with an elementary school education and below is 1,65 million rupiahs. It can be interpreted that educated labours in universities receive income 2,6 times higher than labours with elementary school education.

The labour force participation rate by education level in Indonesia is dominated by labours with elementary school education and below which is 38,89 or 49,96 million people. Meanwhile, the labour for Diploma graduates is only 2,70 percent or 3,47 percent, and for college graduates, 9,63 percent of 12,36 million (Statistics Indonesia, 2020). This shows that the level of labour income in Indonesia is relatively low because labours with elementary school graduates and below dominate Indonesian labour. The low education level of the labours indicates that the quality of human resources and the productivity of Indonesian labour is low and should be higher. The quality of labour can be assessed through the level of education, where the level of education plays an essential role in determining labour income.



Another factor that influences differences in labour income is job training. Job training complements education. Education is only general, while training is specific and operational technical. Job training is an essential investment for labour, which can increase labours' skills, knowledge, and productivity in the labour market (Simanjuntak, 1985). The impact of job training on earnings is empirically not widely available, especially for statistical data. The rate of return provided by job training is greater than the return obtained from education. Labours gain at least indirect benefits from job training (Haerjanto & Borghans, 2012). Job training attended by labours is one of the important factors that can increase their income compared to labours who have never attended training (Kirchberger, 2017).

Gender differences also cause differences in labour income. According to data from Statistics Indonesia in 2020, there is a difference in incomes between male labours and female labours, where the incomes of male labours are 2.980.557 rupiah and the incomes of female labours are 2.354.599 rupiah (Statistics Indonesia, 2020). Several studies also reveal that there are differences in income receipts in terms of gender. Research by Salma Ahmed and Mark McGillivray (2015) proves that female labours have lower income levels than male labour. Ashwini Deshpande, Deepthi Goel, and Shantana Khanna (2018) also prove that males' income is higher than females' income.

Work experience is also a factor that affects the income received by labour. The longer the work experience is owned by labour, the potential to increase income to a certain point (Takasaki, 2017). Labours with work experience are considered to have high productivity because it has been trained for a certain period, which increases the income received by labours.

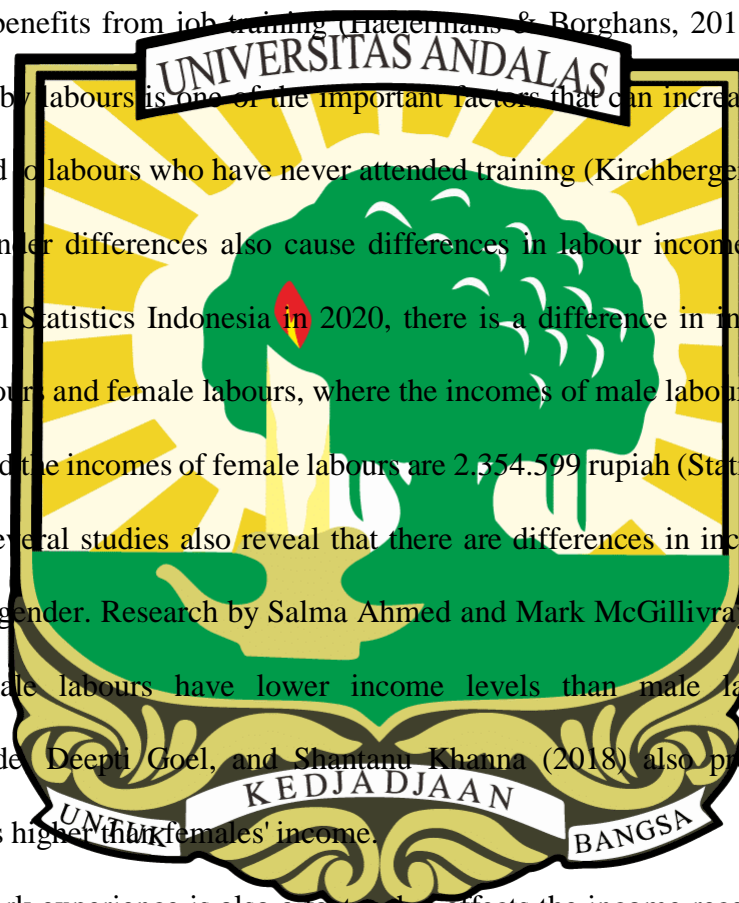


Table 1.2 Average Hourly Incomes of Labours by Region of Residence

Residential Area	Average Hourly Incomes of Labours by Region of Residence		
	2018	2019	2020
Urban	Rp.17.326	Rp.17.825	Rp.19.651
Rural	Rp.11.557	Rp.12.205	Rp.14.242
Urban+Rural	Rp.15.257	Rp.15.823	Rp.17.696

Source: Statistics Indonesia (2020)

The table above shows that the income of labours living in urban areas is higher than in rural areas. Urban residents tend to have higher incomes than rural residents (Dodaro & Satrio, 2003). Indonesia is a country that has extensive demographic conditions, with a population of 270.203.917 people in 2020 with a population growth rate of 1,25 percent. The population in urban areas is around 56,7 percent, while the population in rural areas is around 43,3 percent (Statistics Indonesia, 2021). This shows that the majority of Indonesia's population lives in cities, as evidenced by the rate of urbanization. The high rate of urbanization in cities is driven by economic motives, where these motives develop due to economic inequality between rural and urban.

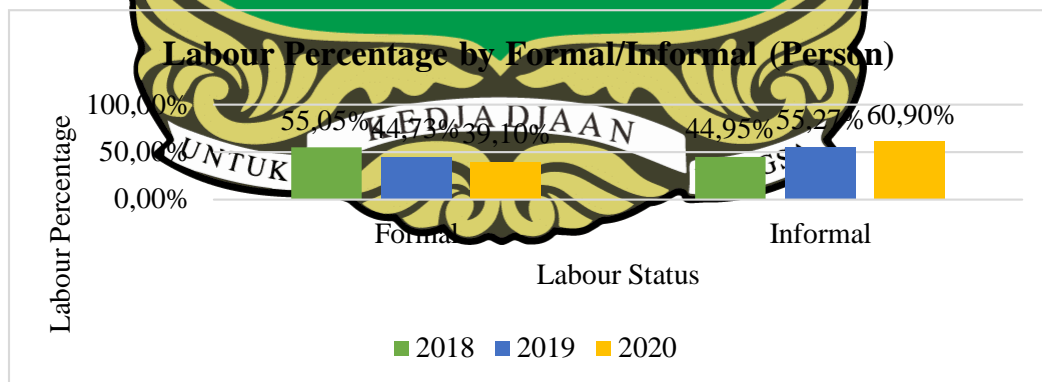


Figure 1.1 Labour Percentage by Formal/Informal (Person)

Source: Statistics Indonesia (2020)

Based on figure 1.1 above, the development of the number of labours in the formal and informal sectors has experienced dynamic movements. The number of labours in these two sectors in the last three years shows that the informal sector still absorbs the most labour. This shows that the informal sector is in great demand by labours in Indonesia. However, the percentage increase in informal labour in the last three years has decreased, and conversely, the percentage decline for formal labour has decreased. The informal sector is a stepping stone for labours who want to get a job in the formal sector (Bargain & Kwenda, 2011). Jobs in the informal sector are considered important in the national economy by accommodating labour that cannot join the formal sector (Cuevas et al., 2009).

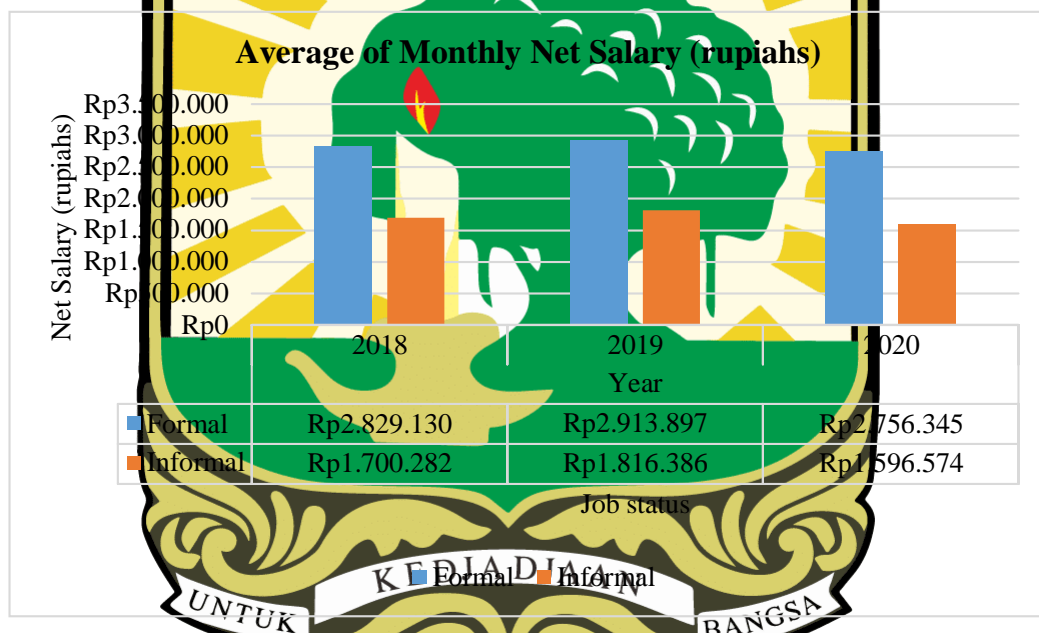


Figure 1.2 Average of Monthly Net Salary (rupiahs)

Source: Statistics Indonesia (2020)

Based on Figure 1.2, The income gap between formal and informal labor is getting bigger in 2020, where the income of informal labor has decreased more than formal labor, so the income gap has become bigger than the previous year. Formal and informal labour income from 2018 to 2019 has increased and in 2020 it



decreased due to the COVID-19 pandemic. Formal labour is commonly defined as paid labour under a formal agreement or contract with the provider (Malta et al., 2019). Formal labour has a higher income than informal labour because formal jobs require higher skills and education. Informal labour tends to have lower education, skills, and income than formal labour (Günther & Launov, 2012).

There are differences in income received between labours in the formal and informal sectors. This is what is interesting to study, namely what factors affect the income received between formal and informal labours, and the comparison of income received between formal and informal labours in 2020. In this study, researcher used variables of education type, work experience, gender, region of residence, job training, and job status as determinants that affect labor income using the Heckman Selection Model Method.

## 1.2 Formulation of the Problem

Based on the explanation above, there are several things that become problems in the research, namely a vicious circle that is difficult to break, the greater the Gini index which indicates that income inequality in Indonesia is widening, unequal access to education among the Indonesian population which causes income inequality at every level of education, income differences caused by work experience, job training, gender, residential area, and job status.

While the main problem of this research is the increasing income inequality between formal and informal labour. The income of informal labour has decreased significantly compared to the income of formal labour which results in the increasing income inequality between formal and informal labour. Meanwhile, the informal sector absorbs the most labour and has even increased in the midst of a

decrease in income during the economic crisis due to the COVID-19 pandemic in 2020.

Based on these problems, the following problems can be formulated

1. What factors affected the probability of work participation among formal and informal labour in Indonesia 2020?
2. What factors affected the level of income received by formal and informal labours in Indonesia in 2020?

### 1.3 Object of Research

Based on the formulation of the problem that has been stated above, the objectives of this research are:

1. Analysis of factors affecting the probability of work participation among formal and informal labour in Indonesia 2020.
2. Analyse the factors that affect the level of income received by formal and informal labours in Indonesia 2020.

### 1.4 Benefits of Research

The following are the benefits of the research that the authors hope:

1. This research is supposed to contribute to the study of theories in the field of economics regarding the analysis of factors affecting labor income and become a reference for further relevant research.
2. This research is hoped to serve as a consideration for the government in planning policies regarding labour income and improving the quality of labour in Indonesia.
3. The results of this study are expected to provide valuable input for the community regarding analysing factors that affect income so that the income





generated is more optimal.

### 1.5 Scope and Limitations of the Research

Limiting the issue in light of the background and issues mentioned above is necessary. Given the scope of the issues, this study will only analyse the variables influencing the income of labours in Indonesia's formal and informal sectors using information from National Labour Force Survey (SAKERNAS) data 2020. Based on the level of education, work experience, gender, type of residence, job training, and job status, the factors are restricted.

### 1.6 Systematic Writing

#### CHAPTER I INTRODUCTION

This chapter contains the background, problem formulation, research objectives, research benefits, research scope, limitations, and research systematics on the factors that affect the income of formal and informal labours in Indonesia.

#### CHAPTER II THEORETICAL FRAMEWORK

This chapter contains grand theory, previous research, framework, and hypothesis that explain the theories related to the topic, previous research, as well as the theoretical basis regarding income, labour, human capital, and the mincerian model, which is a reference in the analysis of this research.

#### CHAPTER III RESEARCH METHODOLOGY

This chapter contains specific research objectives, the time and place of research, research methods, sampling techniques, data collection techniques, and data analysis techniques. The research variables used were type of education, work experience, gender, residential area, job training and job status as independent variables. Labour income in the formal and informal sectors is the dependent



variable. The data collection method is quantitative, with secondary data types in the form of National Labour Force Survey data (SAKERNAS), and the data source comes from the Statistics Indonesia. The data analysis method used is a two-step model from Heckman consisting of two models, namely a selection model with a probit model known as the probability of work participation model and a results model with a mincer income estimation model known as the mincer model.

#### CHAPTER IV RESEARCH RESULTS AND DISCUSSION

This chapter contains descriptions of variables, results and data analysis, interpretation of data, analysis, and testing of hypotheses on the variable factors that affect the income of formal and informal sector labours, namely education level, work experience, gender, residential area, job training, and job status.

#### CHAPTER V SUMMARY AND CONCLUSION

This chapter discusses the conclusions from the discussion of research data analysis, implication of research, and beneficial suggestions for further research.

