

CHAPTER I

INTRODUCTION

1.1 Background

Recent trends in the global labor markets show that widespread economic recovery is not reflected necessarily in employment creation. The International Labor Organization (ILO, 2025a) statement expressed that following global economic growth slowdown and increased uncertainty, employment growth is fragile and uneven across regions. Following the post-pandemic period, there has been a recovery in headline employment indicators. However, many economies continue to suffer from the persistent challenge of generating productive and inclusive employment opportunities. The output growth has outpaced job creation hence reflecting a decoupling of macroeconomic from labor market developments, especially in developing and emerging economies.

According to the information provided by the ILO (2025a, 2025b), the recent global labor market developments were characterized by stubborn employment gaps and a weak recovery in labor forces. According to both reports, for each year in recent years, growth in employment has lagged behind the growth in the working-age population. This has resulted in an increasing gap in job creation especially in developing and emerging economies. In addition, the report said, labour force participation hasn't been able to reach pre-pandemic levels which indicate that many people still remain withdrawn from the labour market. The documents point at a structural shift in job creation. Informal and low-productivity activities created the new jobs. Crucially, it was capital-intensive activities that largely led investment and productivity growth. These significant trends show that the recent growth was not accompanied by a similar growth in employment. In addition, the connection between macroeconomics and the labour market seems to be weakening.

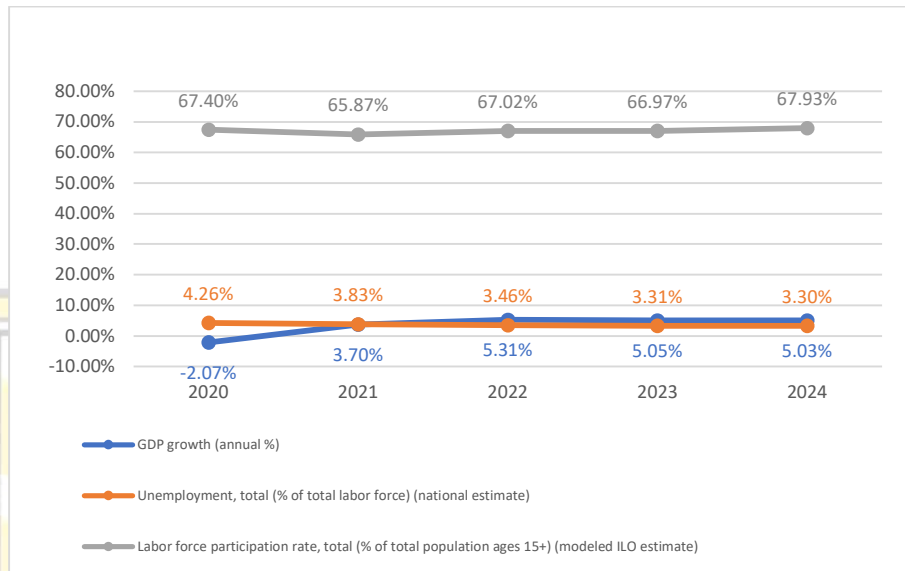


Figure 1.1 Economic Growth, Unemployment, and Labor Force Participation Overview in Indonesia

Source: World Development Indicator, 2025

As depicted in Figure 1.1 of the post-pandemic forecast of the Indonesian labour market, the economic growth, unemployment rate and labour force participation rate (LFPR) 2020-2024. Economic growth after the sharp contraction of the economy that happened in 2020 (-2.07%) came back and settled above 5% from 2022. Between 2020 to 2024, the unemployment rate fell from 4.26% to 3.30% (illustrating a gradual trend decline). It indicates the progressive enhancement of aggregate labor market absorption. Even though the economy grew faster and there was lower unemployment, the labor force participation did not rise as much. The LFPR was relatively stable but dipped from 67.40% (2020) to 66.97% (2023) before increasing to 67.93% (2024). The economic growth has recovered, and unemployment level of the economy has decreased. However, the case of the theory shows that most of the working-age population. In other words, the improvement of the economy doesn't really mean that more people will join the labor force.

However, the phenomenon where economic growth does not always go hand in hand with increased employment opportunities is known as *jobless growth*. This phenomenon refers to two main conditions: first, when the economy grows but fails to generate new jobs; and second, when economic recovery occurs after a recession, but it does not lead to a significant increase in the creation of decent employment (Butkus et al., 2024).

This case usually happens in many developing countries, where they can't offer enough jobs as their population grows, which leads to greater unemployment rates. One of the factors that makes this possible is because many developing countries implement macroeconomic policies that focus on increasing production output but do not always create productive jobs (Haider et al., 2023). In some cases, economic growth actually becomes jobless because this growth is not accompanied by an increase in the productive sector which can create more jobs, such as the manufacturing sector (Khan et al., 2023). In other words, economic growth that is not supported by an expansion of the industrial base and strengthened by productive investment tends to create a gap between economic progress and the availability of decent employment opportunities.

Does economic growth result in more employment? Clearly, the answer is no. The expansion of production activities should lead to increased demand of labour. This corresponds to the concept called derived demand. As per Borjas (2016), a firm's demand for labour depends on the demand of consumers for the firm's product. Nevertheless, the demand for labor is not occurring in this way. The economy of the country shows structural imbalances at play. The sectors of the economy which are driving growth are not necessarily labour-intensive or failing to absorb a significant number of new workers. The phenomenon puts the quality of growth in the nation into jeopardy. If growth does not create jobs and employment, it can impede social inequality especially among the working-age population.

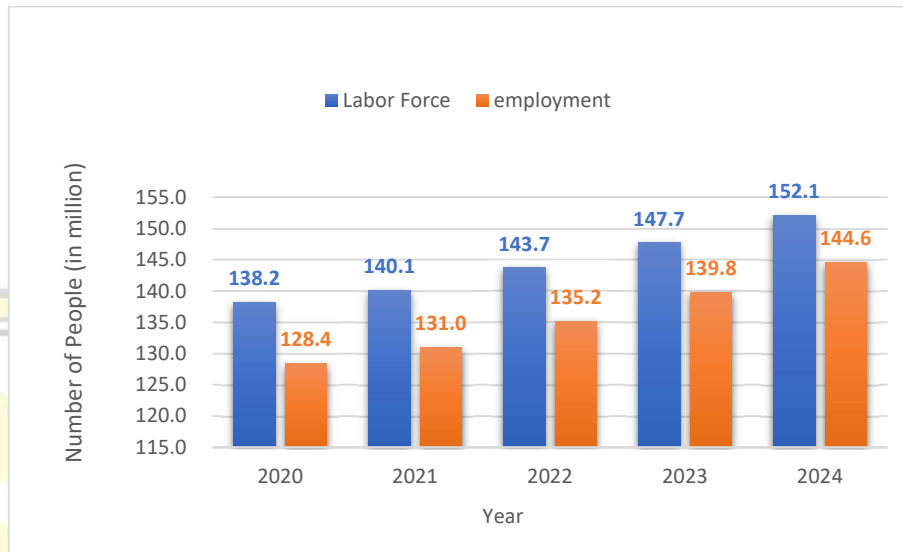


Figure 1.2 Labor Market Overview: Labor Force vs. Employment in Indonesia (2020-2024)

Source: Badan Pusat Statistik Indonesia, 2025

Based on data shown in Figure 1.2, the labor workforce in Indonesia continuously grew during 2020-2024. It rose from 138.2 million people in 2020 to 152.1 million during 2024. Meanwhile, there was also an increase in employment from 128.4 million to 144.6 million in 2020 and 2024 respectively. This indicates recovery in employment creation after being impacted by Covid-19. Nonetheless, job creation did not keep pace with labour force growth. There is a constant mismatch between the growth of working-age people and employment. This gap was particularly large in the early years following the pandemic in which the labour force growth outpaced that of employment. The gap does not disappear even though it narrows in 2000. This indicates that the labor market is improving in an absolute sense but proves insufficient to absorb the rapidly growing labor force. As stated by Pratomo & Manning (2022) the development of Indonesia's labour force has been occur, nevertheless the capacity to absorb these labour market entrants at present time remains limit. Formal job growth is mainly derived from new labor force entrants and not a sign of informal sector becoming formal, they argue.

Within the structure of Indonesia's economy, the industrial sector particularly manufacturing has been one of the main contributors to economic growth. The manufacturing industry sector, which was the source of the highest growth on the production side, grew by 5.2 percent (YoY) (Bappenas, 2023). However, its contribution to employment creation remains relatively low when compared to the services sector. The services sector has absorbed the largest share of the labor force, while the manufacturing sector accounts for only a small portion of total employment (Kuswardana et al., 2021). This condition may stem from the fact that Indonesia's industrial manufacturing base is generally not labor-intensive, which limits its ability to absorb large numbers of workers into the labor market. While the manufacturing sector is critically important for promoting economic modernization and productivity, its scope for generating employment is generally restricted to labor-intensive sub-sectors such as food processing and textiles (Sadik-Zada, 2021). It shows that sectors that generated employment opportunity are limited, as the diversity and expansion of labor-intensive manufacturing are still lacking.

Increasing foreign direct investment can ensure greater diversification and expansion of labour-intensive industries. Expanding FDI, particularly in sectors that drive industrialization, can play a significant part in addressing unemployment; FDI stimulates business development and industrial expansion, opening up opportunities for new employment (Khan et al., 2023). FDI can assist developing countries that face constraints in capital and technology by enhancing labor productivity. Chengying et al. (2023) highlight that FDI contributes to building physical capital, facilities technology transfer, and broadens employment opportunities within the host country.

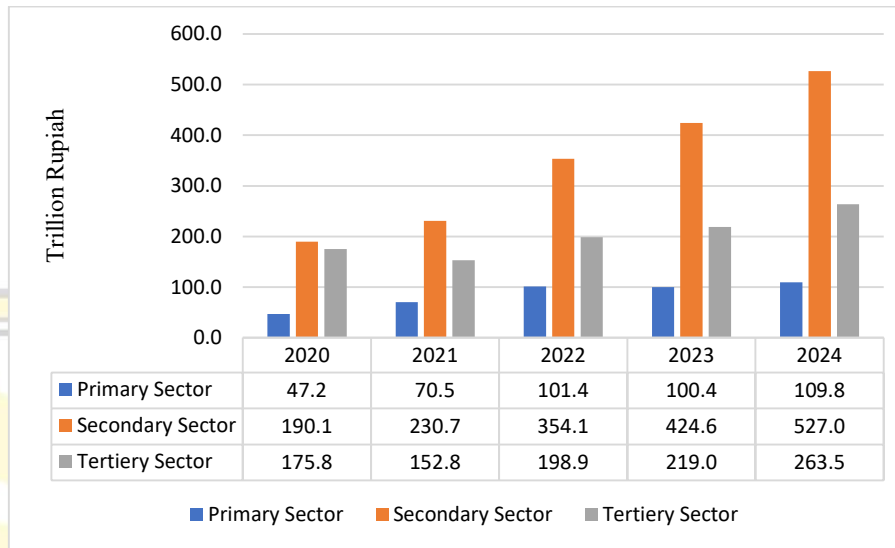


Figure 1.3 FDI Based on Sector in Trillion Rupiah (2020-2024)

Source: Kementerian Investasi, 2025

According to Indonesia’s sectoral FDI data from 2020-2024 the investment inflow continues to be dominated by the secondary sector covering a range of manufacturing and industry sectors. As depicted in Figure 1.3, the 190.1 trillion rupiah foreign direct investment into the secondary sector in 2020 increased to 527.0 trillion rupiah by 2024. This is coupled with an investment into the primary sector that increased from 47.2 trillion rupiah to 109.8 trillion rupiah and into the tertiary sector that increased from 175.8 trillion rupiah to 263.5 trillion rupiah over the six years. The Indonesian industry development pattern manifests a strong preference from investors, so it is not surprising that the industry is developing rapidly. Investment in the secondary sector does not have the same employment impact because, in addition to capital-intensive industry, it also consists of labour intensive manufacturing, such as textiles, footwear and food products. Therefore, an increasing inflow of FDI does not necessarily or automatically imply larger employment absorption. In this context, the composition of FDI says that whether rising investment or FDI is in the economy over a period.

Another way the economy can create the chance for employment is gross capital formation (GCF) along with foreign direct investment (FDI). The value of

the public sector organization and private sector investments made for the purpose of the operation is termed as GCF. These can be defined as addition infrastructures, facilities, equipment, or machinery, or other additions to existing capacity. Thus, a rise in GCF will give rise to newer economic units which will be able to absorb more workers in its operation. The development of a new building or establishment, a production facility is reflected in the growth of the economy and an increase in GDP. Thus, more workers are needed to complete new tasks, resulting in a rise in demand. A study Khan et al. (2023) finds that GCF makes a significant contribution to job creation in the short run and in the long run.

In the context of Indonesia's consistently growing economy, the issue of employment opportunity remains highly relevant and complex. Employment challenges in Indonesia not only pertain to creating jobs, but they are also an indication of the fact that while an increasing labor force with steady rates has the inclination to seek jobs, the actual increase in the number of people employed is not increasing in line with the rise in the labor force. In this context, the crucial factors from the viewpoint of understanding the macroeconomic scenario of Indonesia include the Labor Force Participation Rate (LFPR), which can be considered an indicator of the employment scenario. While the GDP growth has been steady in Indonesia during the past three decades, the LFPR has not shown a steady increase; however, the increasing levels of population, which have crossed the figure of 281.2 million, has created a significant challenge for the country as the growth in the population means a rise in the number of the working age group.

Thus, with so many variables influencing employment opportunities, whose effectiveness in the Indonesian context is under scrutiny, the present research title "The Influence of Macroeconomic Factors on Employment Opportunities in Indonesia" empirically examines the relationship among those variables by using a time series approach from 1981-2024 for the case of Indonesia.

1.2 Research Problem

The occurrence of jobless growth in Indonesia creates serious issues in the effectiveness of macroeconomic growth in creating fresh job opportunities. In this

context, the issue of the labor force becomes the key consideration. In this regard, it must be analyzed how some of the macroeconomic elements can affect the motivation of the young workforce of the country to seek jobs within the labor force of the country, and how those currently employed are motivated enough to continue the search for jobs because of the belief that such jobs exist.

Based on the problem presented, this study aims to address the following research questions:

1. How do macroeconomic factors such as economic growth, industrialization, FDI, GCF affect employment opportunities in Indonesia?
2. What are the short-run and long-run effects of those macroeconomic factors on labor force participation in Indonesia?

1.3 Research Objective

This study, titled “The Influence of Macroeconomic Factors on Employment Opportunities in Indonesia”, is conducted with following objective:

1. To analyze the effect of economic growth, industrialization, FDI, GCF on employment opportunities in Indonesia.
2. To estimate the short-run and long-run relationships between those variables and labor force participation using the ARDL approach.

1.4 Research Advantage

The research advantages are as follows:

1. This study contributes to academic knowledge by providing empirical evidence on how macroeconomic factors influence employment opportunities in Indonesia, a topic that remains underexplored within the context of jobless growth in developing economies.
2. The findings of this study may serve as a basic reference for future research that seeks to explore employment-related issues through a macroeconomic lens, especially in countries experiencing structural labor market challenges.