

The Role of the Informal Sector as a Buffer of Employment Absorption in Indonesia

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ARTICLE INFO

Keywords: Informal Sector, Employment, Political Economy, Development, Indonesia

Received : 06 September

Revised : 06 October

Accepted: 19 November

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ABSTRACT

This study aims to analyze the role of Indonesia's informal sector as a buffer for employment absorption within the political economy of development framework. Using a qualitative descriptive approach and secondary data from BPS, ILO, and World Bank, the study finds that 59.40% of Indonesia's workforce is employed in the informal sector, serving as a crucial absorber during economic shocks. However, informal workers face unstable income and limited access to protection. Based on Elite Theory, the findings reveal that elite power concentration and limited resource access perpetuate structural inequality. Therefore, inclusive public policies are needed to strengthen protection and formalization.

INTRODUCTION

There is still a structural imbalance in the Indonesian labor market that favors informal work over the growth of formal jobs. Recent data reveal that informality remains a persistent structural challenge in Indonesia's labor market. The informal sector employs approximately 59.31% of the total workforce, with particularly high concentrations in rural provinces such as Papua (84.11%), West Sulawesi (77.25%), and West Nusa Tenggara (75.36%) (Modern Diplomacy, 2023). According to the World Bank (2023), informal employment and output together contribute around 36% of Indonesia's GDP, underscoring how informal work is deeply embedded in the country's economy.

This prevalence, while providing employment and resilience during crises, exposes millions of workers to instability, lack of access to credit, and limited social protection. The United Nations Development Programme (UNDP, 2023) emphasizes that more than half of Indonesia's 144 million workers operate outside formal arrangements, leading to significant productivity, education, and wage disparities.

From a governance perspective, high informality complicates certification, taxation, and regulatory supervision – including in programs like SEHATI (Halal Certification for MSMEs), which rely on collaboration between government, private actors, and civil society. This highlights the need for inclusive and coordinated policies that integrate informal actors into national development frameworks rather than treating them as residual sectors.

Of the 153.05 million employed people in February 2025, 86.58 million, or 59.40%, worked in the unorganized sector (BPS, 2025). This emphasizes how, especially in times of crisis like the COVID-19 epidemic, the informal sector acts as a *de facto* buffer when possibilities in the official sector decline.

A greater increase in open unemployment is avoided by the informal sector, which takes in extra labor that the formal economy is unable to handle. But this resilience has a price: workers must deal with unstable salaries, no social safety net, and restricted access to training and financing. According to political economics theory, the tenacity of informality is a reflection of more serious institutional shortcomings in allocating the gains of expansion and including underrepresented workers into national development plans.

Instead of treating the informal sector as a systematic aspect of a dualistic economy, existing research frequently views it as a residual category. It is still uncommon to find comprehensive strategies that close the gap between formal and informal education. Using Elite Theory to evaluate its function through key indicators and suggest a route towards inclusive formalization, this study seeks to examine the benefits and drawbacks of the informal sector as a buffer for employment in Indonesia's political economy of development.

Previous studies on Indonesia's labor market often treat the informal sector as a residual category or survival mechanism rather than an integral part of development (Sparrow et al., 2025; World Bank, 2023). However, few studies have linked informal employment with elite dominance and inequality within the political economy framework. This study fills that gap by analyzing how elite structures influence informal sector persistence and policy outcomes.

LITERATURE REVIEW

Studies on informal sector employment emphasize its dual role in providing resilience during crises and reflecting institutional weakness (Lewis, 1954; ILO, 2022). The Dual Economic Theory (Boeke, 1953; Lewis, 1954) explains the coexistence of modern and traditional labor markets, while the Political Economy of Development (Todaro & Smith, 2009) examines the state's structural biases favoring capital over labor. Furthermore, Elite Theory (Mills, 1956; Michels, 1911) argues that concentrated power restricts equitable resource access. Recent works (Ford & Honan, 2023; Fairwork, 2025) highlight similar patterns in Indonesia's gig economy, yet lack analysis linking elite dominance with informal employment persistence. This study integrates these perspectives to evaluate the informal sector's role as an employment buffer and its implications for inclusive policy transformation.

In the last five years, emerging literature has revisited the dynamics of informality in Indonesia by connecting traditional labor studies with contemporary digital transformation and governance debates. The World Bank (2023) highlights that more than 59% of Indonesia's workforce remains informal, primarily concentrated in agriculture and low-skill service sectors, while productivity and wage gaps between formal and informal workers persist due to limited institutional capacity and regulatory fragmentation. Complementing this, ILO (2022) underscores that informality not only represents employment resilience but also signals structural inequality within labor protection and access to finance.

A recent quantitative study by Badan Pusat Statistik and Sekolah Tinggi Ilmu Statistik (2023) identifies education level, gender, and regional development disparities as the main determinants of informal employment, showing that rural areas such as West Nusa Tenggara and Papua maintain informality rates above 70%. Meanwhile, the Manchester Centre for Digital Development (2024) finds that the expansion of digital platforms – such as ride-hailing and e-commerce – has partially formalized informal activities, yet reproduced precarious labor conditions under algorithmic management. This echoes the analysis by Ford and Honan (2023), who observed that Indonesia's gig economy reflects “platformized informality,” where digital inclusion coexists with labor insecurity and elite data control.

Recent socio-economic studies further elaborate on this phenomenon. The International Journal of Sociology (2024) notes that the rise of the digital economy in Indonesia reconfigures middle-class aspirations while deepening the divide between formal and informal labor. Similarly, Sparrow, Dartanto, and Hartwig (2025) explain that job creation in Indonesia emphasizes quantity over quality, as most new employment remains informal despite economic growth. Collectively, these findings reinforce that informality is not merely a transitional phase but a structural feature of Indonesia's development. Therefore, addressing it requires an integrated approach that combines inclusive governance, social protection, and digital transformation within the broader framework of political economy and elite influence.

METHODOLOGY

In the framework of Indonesia's political economy of development, this study employs a qualitative descriptive technique to demonstrate how the informal sector acts as a buffer for labor absorption. This method was selected because it enables in-depth investigation of intricate socioeconomic phenomena without requiring quantitative hypothesis testing, which makes it more appropriate for identifying the structural dynamics and policies that underlie the informal sector's dominance.

The secondary data used came from official and trustworthy sources, such as the Central Statistics Agency's (BPS) February 2025 National Labor Force Survey (Sakernas) report, the Ministry of Cooperatives and SMEs' 2023 national MSME statistics, the International Labor Organization's (ILO) Asia-Pacific Informal Employment Report, and the World Bank's Indonesia Employment Outlook 2024. Additionally, this research cites both recent and historical scholarly works on the political economy of development and dualistic economic theory.

A comprehensive literature research and compilation of national statistical indicators were used as data gathering methods. In order to guarantee the validity of the analysis, this procedure involved filtering data according to relevance, topicality, and source reliability. To support the conclusions, the data was then analyzed utilizing source triangulation and thematic content analysis.

Three primary theoretical stances are included into the analytical framework. First, to comprehend how the state, markets, and labor interact to produce structural inequality, the Political Economy of Development (Todaro & Smith, 2009) is utilized. Second, the division between the traditional (informal) and contemporary (formal) sectors that defines emerging economies like Indonesia is explained by the Dual Economic Theory (Boeke, 1953; Lewis, 1954). Third, the Elite Theory, developed by thinkers like C. Wright Mills (1956) and Robert Michels (1911), is introduced to evaluate the role of the informal sector using the following indicators: limited resources, hierarchical influence, and concentration of power. According to this argument, these elites have a say in development policy, which restricts the access of informal workers to formal resources and opportunities. The analysis focuses on the mutual relationship between public policy regimes, employment structures, and the dynamics of the informal sector, including the rise of platform-based gig economies like Grab and Gojek, which serve as a contemporary illustration of the vulnerability and resiliency of informal workers.

Data analysis was carried out through thematic coding based on three core indicators of Elite Theory: concentration of power, hierarchical influence, and limited resources. Thematic patterns were then interpreted using source triangulation from national statistics, international reports, and scholarly literature to ensure empirical validity.

RESEARCH RESULT

A. Employment Conditions and the Informal Sector in Indonesia

Indicator	Value	Percentage
Total workforce	153.05 million	100%
Informal workers	86.58 million	59.40%
Formal workers	66.47 million	40.60%
Open unemployment	7.28 million	4.76%

Source:observerid.com

There is a clear separation between the official and informal sectors of the labor in the country, according to Statistics Indonesia (BPS) statistics from February 2025. Just 66.47 million (40.60%) of the 153.05 million workers are employed in the official sector, compared to 86.58 million (59.40%) in the informal sector. The open unemployment rate was 7.28 million, or 4.76% of the total population. Low entry barriers and inadequate productivity are reflected in the concentration of informal labor absorption in the retail trade (28%), personal services (19%), and agricultural (38%).

These findings are consistent with ILO (2022) and Ford & Honan (2023), who found that digital gig economies tend to reproduce informal vulnerabilities through algorithmic control and lack of worker protection.

B. The informal sector's role as a buffer economy

The economy's informal sector acts as a shock absorber. The informal sector kept unemployment from surpassing 9% in 2020–2021, despite the official sector losing 7.2 million jobs DII as a result of the pandemic (ILO, 2022). Its impact on the national economy is also noteworthy: MSMEs, the bulk of which operate in the unorganized sector, account for 61% of GDP and hire 97% of new employees each year (Ministry of Cooperatives and SMEs, 2023). Informal microbusinesses will play a significant role in GDP growth after the epidemic, accounting for 2.8% of GDP in 2023 (World Bank, 2024).

The gig economy, which is centered on online marketplaces like Gojek and Grab, provides a tangible illustration of this function. There are at least 4 million gig workers employed by these two platforms, mostly online motorcycle taxi (ojol) drivers and delivery couriers, the bulk of them (82.1%) were laid off or had their contracts terminated after working in the official sector. With Grab alone contributing Rp77.4 trillion (latest statistics, adjusted for growth), these platforms not only boost household spending and digital inclusion but also avert a spike in urban unemployment.

C. Challenge and policy implications

Informal workers—including those in the gig economy—face systemic vulnerabilities in spite of their crucial role. Just 11% are registered with the Social Security Agency (BPJS Ketenagakerjaan), 64% depend on unofficial loan sharks, and 72% make less than the provincial minimum salary. The Fairwork 2025 research revealed that the majority of motorcycle taxi drivers put in over 40 hours

a week without receiving social security, which led to widespread demonstrations between May and September 2025 seeking lower fares and algorithmic transparency. 35% of gig workers do not have access to social safety, 50% are not digitally literate, and 40% face financial instability.

Although they offer some help, policies like the SEHATI Program, the OSS (Owner-Scale Social Security), the Job Creation Law, and the People's Business Credit (KUR) are ill-coordinated and still complicate the formalization process. Fairer measures to combat "bogus employment" – where workers are statistically present but unprotected – are being called for.

D. Analysis of Development in Political Economy

A capital-intensive official sector and an informal sector with surplus labor coexist in Indonesia's traditional dual economy (Boeke). Informality is often sustained by state policies that favor large-scale investment over labor-intensive growth. From a political economics standpoint, instead of structural transformation, there is clientelistic redistribution through temporary subsidies and elite appropriation of formal possibilities.

This research incorporates C. Wright Mills' and Robert Michels' Elite Theory to evaluate the informal sector's function as a labor absorption buffer. The evaluation is carried out using specific key indicators, emphasizing how inequality in Indonesia's development setting is made worse by elite domination.

D1. Concentration of Power

Concentration of power happens when elites in the military, industry, and politics dominate important institutions and shape policies that serve their own interests, according to Mills (1956). The prevalence of gig economy platforms like Gojek and Grab, which are dominated by wealthy local and international investors, is a clear indication of this in Indonesia's informal sector. Government measures like the Job Creation Law tend to support the growth of huge firms rather than safeguard informal workers, despite the fact that these platforms contribute IDR 77.4 trillion to the economy (2025 statistics). As a result, the informal sector serves as a buffer, employing 59.40% of the workforce (BPS, 2025). However, workers' reliance on the elite is maintained since there is no equitable allocation of power. According to this analysis, the informal sector's function as a buffer actually makes elite power concentration stronger since it prevents structural changes that may lessen their domination.

D.2. Hierarchical Influence

Michels (1911) suggested the "iron law of oligarchy," which states that hierarchical systems allow a minority of elites to govern organizations. This signal is evident in Indonesia, where 4 million online motorcycle taxi (ojol) workers are impacted by the opaque algorithms of gig platforms that assign jobs and set prices hierarchically (Fairwork, 2025). With 40% of informal laborers enduring economic instability, widespread demonstrations in 2025 showed how this hierarchical influence oppresses them. The hierarchical dominance of elites in the informal sector exacerbates vulnerabilities like lack of access to the Social Security Agency (BPJS) (only 11% are registered), making it a weapon for

preserving economic stability without empowering workers. This indicates that without intervention, elite hierarchies inhibit the transition to inclusive formalization.

D.3. Limited Resources

According to elite theory, in order to keep power, elites limit disadvantaged populations' access to resources. Workers' restricted access to formal finance (64% rely on loan sharks) and lack of digital training (50% lack digital literacy) are clear indicators of this in Indonesia's informal sector. Despite the fact that 97% of new hires are employed in the informal sector (Ministry of Cooperatives and SMEs, 2023), its low resources prevent it from acting as a development engine. According to assessments, elites that place a higher priority on large-scale investment limit the informal sector's ability to act as a buffer for labor absorption, hence preserving structural inequality and impeding sustainable development. Workers in the gig economy depend on privileged platforms that lack algorithms or data rights, indicating resource disparities. However, collective worker organizations in 2025 marked a turning point, challenging these limitations through demands for legal protection.

D.4. Policy Reorientation toward Inclusive Formalization

Indonesia's challenge lies not only in recognizing the informal sector's contribution but also in transforming it into a foundation for inclusive and sustainable growth. Formalization must be understood as a dynamic process of integration—linking informal workers to digital markets, financial systems, and social protection networks.

The ILO (2022) identifies three pillars of sustainable formalization: regulatory simplification, institutional coordination, and participatory governance. In Indonesia, however, overlapping regulations between the Ministry of Manpower, the Ministry of Cooperatives and SMEs, and local governments still hinder coherent implementation. Programs such as SEHATI, KUR, and the Job Creation Law show early efforts to bridge informality, yet bureaucratic fragmentation and elite dominance continue to slow progress.

From the perspective of Elite Theory, fragmented bureaucracy often benefits political and business elites by maintaining dependency among informal actors. This pattern reinforces vertical inequality and obstructs democratization of access to resources. Therefore, inclusive policy reform must focus on reducing bureaucratic discretion, digitalizing public services, and ensuring inter-ministerial data integration.

Furthermore, empowering cooperative institutions and community-based organizations can serve as intermediaries for formalization. By transforming informal micro-enterprises into cooperatives, the government can expand the tax base, promote financial inclusion, and provide workers with collective bargaining power. This cooperative-based formalization model aligns with Indonesia's Long-Term Development Plan (RPJPN) 2025–2045, which envisions equitable prosperity supported by innovation and digital inclusion.

D.5. The Future of Work and Digital Transformation in the Informal Sector

The rapid advancement of digital technology presents both opportunities and challenges for Indonesia's informal workers. Digitalization enables micro-entrepreneurs to access new markets and customers, but also exposes them to algorithmic control and job insecurity. The ASEAN Secretariat (2025) reports that 68% of Indonesia's informal workers risk being left behind due to low digital literacy and limited access to devices or internet connectivity.

From a political economy perspective, digital platforms – while appearing to empower – often consolidate data and profits within elite-controlled corporations. This mirrors C. Wright Mills' concept of the modern power elite, who exert dominance not only through political institutions but also through control of digital infrastructure and information systems.

Therefore, Indonesia's development strategy should emphasize technological justice – ensuring fair access to digital tools, skills, and data rights. Government programs in collaboration with universities, cooperatives, and private platforms could provide digital literacy training, microcredit for digital startups, and protection of workers' data.

Reconceptualizing the informal sector as a continuum of employment, not a dichotomy between formal and informal, allows for gradual inclusion through hybrid models – where gig workers, small traders, and MSMEs participate in semi-formal digital ecosystems. If supported by transparent governance and cross-sector collaboration, the informal sector can evolve from a survival mechanism into a driver of equitable and innovative economic growth.

CONCLUSIONS AND RECOMMENDATIONS

This study concludes that Indonesia's informal sector plays a critical buffering role in employment absorption but simultaneously reinforces elite power structures that sustain inequality. Elite control limits the sector's transformative capacity, making informality a symptom of institutional imbalance rather than progress.

Policy implications highlight the need for universal social security coverage, algorithmic transparency, and formalization incentives through cooperative-based taxation schemes. Future research should employ mixed methods to capture workers' lived experiences and evaluate the effectiveness of inclusive labor reforms.

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