



# The Impact of Regional Minimum Wage Policies on Formal Workers' Welfare: A Literature Review

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## Abstract

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The welfare of formal workers serves as a crucial indicator for evaluating the effectiveness of employment policies in Indonesia. One key policy to safeguard this welfare is the Regional Minimum Wage (*Upah Minimum Regional/UMR*), designed to ensure that workers receive a living wage aligned with their basic needs. This study seeks to examine comprehensively the influence of UMR determination on formal workers' welfare using a qualitative literature review approach. The data relied upon are secondary sources, including academic books, peer-reviewed journals, policy reports, and other relevant publications. The findings reveal that UMR has the potential to strengthen purchasing power, minimize wage exploitation, enhance productivity, and promote gender equality in wages. Nonetheless, several challenges remain, such as regional disparities, employer non-compliance, inflationary pressures, and limited parameters in defining Decent Living Needs (*Kehidupan Hidup Layak/KHL*), all of which hinder the optimal realization of UMR's benefits. Hence, a reformulation of UMR policy is required, adopting a more holistic and adaptive approach to socio-economic dynamics, so that this policy can effectively serve as an instrument for sustainably improving workers' welfare.

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## 1. Introduction

The welfare of formal workers is a crucial foundation for achieving fair and inclusive national as well as regional economic development. Within Indonesia's economic structure, formal workers hold a strategic role as drivers of productivity, household consumption stability, and the sustainability of the social protection system. According to data from the Central Statistics Agency (*Badan Pusat Statistik*/BPS), as of February 2024, approximately 55.12 million people were employed in the formal sector out of a total workforce of 139.84 million, meaning about 39.4% of the workforce belonged to this sector. The growing number of formal workers highlights the need for stronger protection of their wages and welfare (Tampubolon et al., 2023).

One of the key instruments to safeguard this welfare is the Regional Minimum Wage (*Upah Minimum Regional*/UMR), legally referred to as the Provincial Minimum Wage (*Upah Minimum Provinsi*/UMP) and Regency/City Minimum Wage (*Upah Minimum Kota*/UMK). The UMR is determined annually by the government, taking into account factors such as inflation, economic growth, and specific indexes that represent the Decent Living Needs (*Kehidupan Hidup Layak*/KHL). This policy is intended not only to provide social protection for workers but also to serve as an economic tool for maintaining fair employment relations between employees and employers. However, in practice, the implementation of UMR often becomes a point of contention due to conflicting interests between workers and employers.

In theory, an increase in the Regional Minimum Wage (UMR) should enhance workers' purchasing power, strengthen social stability, and improve household

economic welfare. Yet, in practice, the outcomes are not always consistent. A persistent issue is the gap between the nominal UMR and the Decent Living Needs (KHL) in many regions. For instance, in 2024 the DKI Jakarta UMP was set at IDR 5,067,381, while a Workers' Union survey indicated that KHL in Jakarta exceeded IDR 6.5 million per month, particularly for workers with family responsibilities. A similar situation occurred in East Java, where the 2024 Surabaya UMK was IDR 4,725,479, whereas workers estimated their KHL to be around IDR 5.5 million. Furthermore, a 2023 Ministry of Manpower report revealed that only about 56% of formal companies complied with UMR regulations, with compliance rates in labor-intensive industries being even lower. This clearly illustrates the gap between policy and its implementation. In addition, many formal workers who earn minimum wages still lack access to social security programs such as BPJS Health and Employment, which ideally should support their overall welfare.

This situation became even more complex following the COVID-19 pandemic. The resulting economic downturn compelled many companies to cut production costs, often at the expense of workers. In fact, during 2021–2022, several regions decided not to raise the minimum wage as a compromise between business sustainability and worker protection. However, in the post-pandemic era, inflationary pressures and rising prices of essential goods have necessitated significant adjustments to minimum wage levels (Azzahra et al., 2024). At this juncture, minimum wage policy stands at a crossroads: while raising wages provides stronger protection for workers, it simultaneously risks increasing financial pressure on companies, particularly micro, small, and medium enterprises (MSMEs) that

employ more than 60% of Indonesia's workforce. This dilemma raises fundamental questions about the real effectiveness of the minimum wage policy in enhancing formal workers' welfare. Across different regions, higher minimum wages do not always directly correlate with better welfare, as other factors such as living costs, access to public services, and working conditions also play crucial roles. In some cases, wage increases have even coincided with reductions in formal employment, as companies resort to short-term contracts or outsourcing arrangements.

Previous academic research has largely concentrated on the effects of the Regional Minimum Wage (*Upah Minimum Regional/UMR*) on unemployment, business efficiency, and investment, rather than on the broader dimensions of worker welfare (Harsono et al., 2023). Some studies suggest that UMR contributes positively by raising real income and reducing worker poverty. Conversely, other studies reveal that UMR may encourage informal employment or limit job opportunities for new entrants to the labor market. These contrasting results highlight inconsistencies in the literature, underscoring the need for synthesis to achieve a more comprehensive understanding.

Moreover, only a limited number of studies specifically explore the relationship between UMR and worker welfare by incorporating multidimensional factors such as income, access to social security, workplace conditions, and work-life balance. In this regard, a literature review is necessary not only to emphasize quantitative correlations but also to examine the theoretical and conceptual frameworks that explain these dynamics. Accordingly, this study seeks to identify and analyze scholarly works that discuss the economic implications of UMR policies

for formal workers' welfare, reviewing both theoretical and empirical perspectives in depth. The study also aims to synthesize existing findings to better capture the consistency and diversity of previous research outcomes, while providing directions for more focused and contextual future research. Ultimately, this literature review is intended to serve as a foundation for developing a deeper understanding of how UMR policies function as instruments to improve the welfare of formal workers in Indonesia.

## **2. Methods**

This study applies a qualitative approach using literature research (library study) as the main method for collecting and analyzing data. The qualitative approach was chosen because the study does not aim to test hypotheses statistically, but instead seeks to explore, understand, and describe phenomena in depth based on theoretical perspectives and empirical findings from relevant scientific sources. The data used are secondary, meaning they are obtained indirectly from published documents and academic works. These include textbooks, national and international journal articles, research reports, government policy documents, and credible online publications relevant to the research topic. All collected data were carefully selected to ensure contextual relevance, content validity, and up-to-date information, so that the analysis process remained accurate.

The focus of this research is the relationship between two main variables: (1) the determination of the Regional Minimum Wage (UMR) as the independent variable (X), which represents an economic policy set by central and regional

governments to guarantee minimum wages in each region; and (2) the welfare of formal workers as the dependent variable (Y), which covers aspects such as income, purchasing power, access to social security, decent working conditions, and household economic stability. The purpose of the study is to examine how UMR determination influences the welfare of formal workers by reviewing and synthesizing the results of prior studies. Literature searches were conducted through several academic databases, including Google Scholar, Scopus, ResearchGate, and Portal Garuda, using keywords such as “minimum wage”, “labor welfare”, “UMR and formal workers”, and “employment policy”. The inclusion criteria required sources to be published within the last ten years, apply reliable scientific methods, and specifically address the research variables.

The data analysis was carried out descriptively and qualitatively by mapping key findings, arguments, and conclusions from the selected studies. A thematic synthesis was then performed to identify recurring patterns, contradictions, and theoretical contributions that could enhance understanding of the impact of UMR on formal workers’ welfare. This study also considers the Indonesian socio-economic context, including differences in regional characteristics, industrial sectors, and the dynamics of labor policies at both national and regional levels.

### **3. Results**

#### **3.1. The Role of Regional Minimum Wage in Shaping Formal Workers' Welfare**

The Regional Minimum Wage (UMR) is a labor policy aimed at providing a safety net for formal workers in Indonesia, ensuring they are able to achieve decent living standards. It represents the lowest monthly wage set by provincial or regency/city governments, regulated under Law No. 13 of 2003 on Manpower and later updated through Law No. 6 of 2023 on Job Creation. In determining UMR, several factors are considered, including economic growth, inflation, labor productivity, and Decent Living Needs (KHL). The KHL covers essential aspects such as food, clothing, housing, transportation, education, healthcare, and even recreation, reflecting what is expected to constitute a reasonable standard of living for workers in each region.

The welfare of formal workers, as influenced by UMR, refers to their ability to meet physical, social, and psychological needs. It is not only measured by income or purchasing power but also by access to education, healthcare, social security, income stability, and a sense of safety and recognition at work. This welfare becomes a vital indicator for assessing UMR policy effectiveness, as fair wages are expected to improve workers' quality of life, enhance family well-being, and reduce social as well as economic inequality.

The link between UMR and workers' welfare has been widely studied, with findings highlighting both advantages and challenges. One of the main benefits of UMR is improving purchasing power. As noted by Ansari et al. (2022), UMR serves

as a wage threshold that allows workers to meet their essential needs, thereby reducing wage inequality and improving welfare. This view is also supported by studies from Arango and Flórez (2021), Taqwa (2023), and Azzahra et al. (2024), which show that UMR adjustments directly raise workers' income and improve access to necessities such as food, housing, healthcare, and education. Adequate UMR helps workers fulfill KHL components, including nutritious meals, safe housing, proper clothing, transportation, and even modest recreation. These improvements contribute not only to higher living standards but also to financial security, which is an important element of psychological well-being.

In addition, UMR acts as protection against wage exploitation. Law No. 13 of 2003 strictly prohibits employers from paying below the UMR, giving legal security to workers, particularly those in industries with weak bargaining power like manufacturing, services, and retail. Evidence shows that such protection is effective, especially for low-level workers, as it ensures income stability and safeguards welfare from exploitative practices.

Another important dimension is the connection between UMR and productivity, which aligns with efficiency wage theory. This theory argues that better wages can raise workers' motivation and performance because they feel more valued and are incentivized to work harder. In Indonesia's manufacturing sector, Rahmi's research indicates a spillover effect, where increases in UMR not only improve contract workers' wages but also push up the wages of permanent employees. This drives higher motivation, which enhances company productivity. As firms generate

more profits, they may extend benefits or bonuses to employees, further supporting welfare.

Finally, UMR contributes to promoting gender equality in the workplace. According to Buana and Budiman (2022), UMR can encourage greater female participation in the labor market by reducing wage discrimination. By guaranteeing equal pay for equal work, the policy represents a step toward more inclusive welfare. This principle is reinforced in the Job Creation Law (2023), which emphasizes that UMR determination must consider KHL, inflation, and economic growth to better reflect local economic realities. This ensures stronger protection for workers, especially in regions where living costs are high.

### **3.2. Challenges in Applying UMR and Strategies for Improvement**

Despite its benefits, the implementation of the Regional Minimum Wage (UMR) also faces a number of challenges that can reduce its effectiveness in improving formal workers' welfare. One of the main issues is its impact on employment absorption. Research by Azzahra et al. (2024) shows that significant increases in UMR raise production costs for companies, particularly in low-margin sectors such as construction and small or medium enterprises (SMEs). This situation often leads to reduced recruitment or even layoffs, especially for low-skilled workers and new job seekers. Similarly, Dube and Lindner (2021) argue that higher UMR tends to disadvantage job seekers more than existing workers, thereby limiting employment opportunities in the formal sector.

Another challenge lies in the inadequacy of UMR standards. Since it is still largely based on Minimum Living Needs (KHM), it often fails to keep pace with rapid socio-economic changes. Many workers feel that their wages cannot meet rising living costs, resulting in low purchasing power and limiting their ability to save or invest in long-term needs such as children's education and healthcare. Furthermore, the parameters of Decent Living Needs (KHL) remain unclear. Although KHL includes components like food, clothing, housing, and recreation, the "minimum" concept used in UMR often does not reflect what constitutes a truly decent standard of living. Scholars therefore recommend shifting toward broader definitions of KHL, which incorporate the cost of quality education, adequate healthcare, and social participation. Without such adjustments, UMR in many regions particularly those with higher living costs remains insufficient to meet workers' real needs.

Regional inequality also complicates the policy. UMR varies across provinces and cities, reflecting local conditions. However, this does not always align with actual differences in living costs. For example, while Jakarta has a much higher UMR than rural areas, its living costs are also significantly higher. Coviello et al. (2022) highlight that the formula for UMR, which only considers inflation and economic growth, often fails to fully capture local realities, thereby widening disparities in welfare between regions. Employer non-compliance is another pressing issue. Although the Manpower Law prohibits wages below UMR, some companies particularly SMEs continue to pay below-standard wages or avoid regulations by outsourcing and short-term contracts. This reduces the policy's impact on worker welfare. Hence,

stricter supervision and firm sanctions are needed to ensure that UMR truly benefits workers.

The effect of inflation must also be considered. When UMR increases are not matched by price stability, companies tend to raise product prices to cover higher labor costs. Research from Central Java (2008–2011) shows that while inflation and growth influence UMR determination, wage increases without controlled inflation erode purchasing power, offsetting welfare gains. Experts also provide additional perspectives. Opone and Kelikwuma (2021) emphasize that UMR can reduce wage inequality and promote welfare, but only with strong oversight. Harsono et al. (2023) warn that wage increases may reduce labor absorption in low-margin sectors. Rahmi stresses the importance of skill development and training so that workers can maximize the benefits of efficiency wages. Tambe et al. (2019) underline UMR's role in supporting gender equality, while Tampubolon et al. (2023) note that its impact on welfare depends heavily on external factors such as economic growth and price stability.

To address these issues, several strategies are suggested. First, reformulating the basis of wage setting from KHM to KHL with more comprehensive parameters is necessary. Second, establishing structured wage scales based on job level, tenure, education, and competence can create fairer distribution and support long-term welfare. Third, stricter government monitoring and sanctions are needed to enforce employer compliance. Fourth, tripartite dialogue between government, employers, and labor unions should be strengthened to encourage constructive negotiations rather than conflicts. Finally, economic stability especially through inflation control

must be maintained to ensure that wage increases actually translate into higher purchasing power. In summary, UMR has strong potential to improve welfare by boosting purchasing power, preventing exploitation, enhancing productivity, and promoting gender equality. However, challenges such as reduced labor absorption, inadequate KHL standards, regional disparities, weak compliance, and inflation risks may limit these benefits. A more holistic and adaptive approach combining policy reform, strict oversight, wage structuring, inclusive dialogue, and stable economic conditions is required to maximize the effectiveness of UMR in sustainably improving workers' welfare.

#### **4. Conclusion**

The Regional Minimum Wage (UMR) is an essential employment policy in Indonesia, designed to ensure that formal workers receive a fair and decent minimum wage. This policy plays a key role in improving workers' welfare, particularly by increasing purchasing power, preventing exploitation, enhancing productivity, and promoting gender equality in wages. Since UMR is determined by considering Decent Living Needs (KHL), inflation, and economic growth, it is expected to help workers meet their basic needs and achieve better living standards.

Nevertheless, the effectiveness of UMR in enhancing welfare is still constrained by several challenges. Wage increases may raise production costs for businesses especially small and medium-sized enterprises potentially reducing employment opportunities. Other limitations include narrow parameters in defining KHL, regional disparities, weak employer compliance, and inflationary pressures.

To ensure that UMR truly benefits formal workers, a more holistic and adaptive policy approach is required. This includes shifting the wage standard from Minimum Living Needs (KHM) to Decent Living Needs (KHL), applying a fair wage structure and scale, strengthening enforcement of employer compliance, and fostering constructive tripartite dialogue among government, employers, and labor unions. Furthermore, maintaining economic stability, particularly through inflation control, is equally important to maximize the positive impact of UMR on workers' welfare.

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