

Abstract

Indonesia as a developing country is characterized by informality. Informal workers are mostly associated with economic vulnerability and that they lack access to social protection schemes. A rising question is whether or not the informal and formal labor markets are segmented. This study explores this question by estimating the differences in the returns to human capital investments, namely schooling and on-the-job training, between informal and formal workers, where a large difference of the returns would generate arbitrage opportunities for one of the two groups of workers to acquire higher wages by moving to the opposing labor market that offers higher wages if mobility is unrestricted, indicating segmentation of the labor markets. The dataset used in this study is a longitudinal sample of individuals from the 2007 and 2014 waves of the Indonesian Family Life Survey (IFLS). An extended Mincer model is used in this study, involving an additional regressor that represents selection into informal employment, calculated from a logit regression, to correct for selectivity bias. The fixed effects panel approach is also applied in the Mincer model to deal with ability bias. The results show that the returns to schooling and on-the-job training between the two groups of workers do not differ, shedding doubt that the two labor markets are segmented. Thus, to acquire higher wages, workers need to keep investing in human capital rather than move to the opposing labor market.

Keywords: informality, labor market segmentation, return to schooling, return to on-the-job training.