

# The Role of the Job Creation Law Policy in Overcoming Indonesia's Middle Income Trap: Analysis of the Effects of FDI, HDI, and Minimum Wages on the Open Unemployment Rate

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## KEYWORDS

Economics, Foreign Direct Investment, Human Development Index, Open Unemployment Rate, Regional Minimum Wage

**ABSTRACT** This study analyzes the effect of Foreign Direct Investment (FDI), Human Development Index (HDI), and Regional Minimum Wage (RMW) on the Open Unemployment Rate (OUR) in Indonesia within the context of the implementation of the Job Creation Law policy. The study aims to examine the role of these variables in supporting Indonesia's efforts to overcome the Middle-Income Trap. This research employs a quantitative descriptive approach using secondary time series data covering the period 1990–2024. The analysis method applied is the Autoregressive Distributed Lag (ARDL) model to identify both short-run and long-run relationships among variables. The results indicate that FDI has a significant effect on the Open Unemployment Rate in both the short run and long run. In the short run, FDI initially reduces unemployment; however, its lagged effects show a temporary increase in unemployment due to labor market adjustments and the capital-intensive nature of foreign investment. In the long run, FDI significantly reduces unemployment through industrial expansion, productivity growth, and employment creation. Meanwhile, the Human Development Index has a negative but statistically insignificant effect on unemployment, indicating that improvements in human development have not yet been fully aligned with labor market demands. The Regional Minimum Wage also shows a positive but insignificant effect on unemployment, suggesting that wage increases are not the primary determinant of unemployment in Indonesia. Furthermore, the Error Correction Term (ECT) confirms the existence of a long-run equilibrium relationship with a relatively rapid adjustment process. Overall, the findings suggest that productive investment, labor market reforms, and improvements in human capital quality are essential to reducing unemployment and supporting Indonesia's transition toward a high-income economy.

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## 1. INTRODUCTION

Indonesia is one of the developing countries in Southeast Asia that has been categorized as an

upper-middle-income country since 2023. Based on World Bank data in 2025, Indonesia's Gross

National Income (GNI) per capita ranges from approximately US\$5,027 to US\$5,500. However, to attain the status of a high-income country, Indonesia must achieve a GNI per capita exceeding US\$14,005. In the process of advancing toward developed-country status, Indonesia faces the challenge of the Middle-Income Trap (MIT), a condition in which a country experiences a slowdown in economic growth after reaching the middle-income level, making it difficult to transition into a high-income economy. This phenomenon is generally caused by low productivity, limited innovation, and the suboptimal quality of the labor force in supporting sustainable economic growth.

According to the Asian Development Bank, (2020), slowing productivity growth, dependence on low-technology sectors, and limited creation of quality employment opportunities are the main indicators of the risk of a Middle-Income Trap in Indonesia. Limited job opportunities increase the Open Unemployment Rate (OUR), as the number of workers seeking employment exceeds the available job opportunities (Todaro & Stephen C. Smith, 2015). Research by Lisayoana & Tasriah, (2024) states that unemployment can increase the likelihood of middle-income countries falling into the Middle-Income Trap. In line with this, Permatasari & Pasaribu, (2019) explain that high unemployment reflects the inability of the economic structure to absorb labor productively and sustainably, thereby slowing improvements in productivity and national income.

Indonesia's labor market conditions continue to face various structural problems, such as the dominance of the informal sector, low labor productivity, and disparities in the quality of human resources across regions. When improvements in productivity and innovation do not progress optimally, the industrial sector tends to stagnate and becomes unable to develop competitively. As a result, the labor absorption capacity remains limited and is unable to keep pace with the growth of the labor force. This condition ultimately leads to higher unemployment, particularly among the productive-age population, which should serve as the main driver of economic growth. Therefore, policies are needed to encourage productive investment, improve the quality of human resources, and create a more flexible and

adaptive labor market so that Indonesia can escape the middle-income trap.

The highest unemployment rate in Indonesia occurred in 2007, reaching 8.06 percent of the total labor force. The fluctuations in the Open Unemployment Rate, which tend to increase during periods of economic crisis and decline during periods of economic stability, indicate that unemployment is highly influenced by national macroeconomic conditions. In response to these issues, the government enacted Law Number 11 of 2020 concerning Job Creation (Omnibus Law), which was signed by President Joko Widodo on November 2, 2020. This policy aims to create broader employment opportunities, increase investment, and improve the business climate in order to reduce unemployment in Indonesia. Article 3 and Article 81 of the Job Creation Law emphasize that job creation is intended to expand employment opportunities for the workforce and improving the quality of the workforce constitutes one of the primary objectives of the policy.

One of the key factors that can accelerate economic transformation and job creation is Foreign Direct Investment (FDI). In economic growth theory, FDI is regarded as a source of financing capable of promoting industrialization, technology transfer, and the improvement of labor skills (Borensztein et al., 1998). The presence of foreign investment enables higher productivity and greater integration of the domestic economy into global value chains. Therefore, policies that support foreign investment are expected to enhance economic productivity and expand employment opportunities as part of efforts to reduce the risk of the Middle-Income Trap in Indonesia.

The development of FDI in Indonesia demonstrates dynamics influenced by both global and domestic economic conditions. During the 1990–1997 period, FDI increased from 1.03 percent to 2.72 percent, reflecting a favorable investment climate prior to the Asian financial crisis. However, during the 1998–2001 period, FDI declined sharply and even recorded negative values, reaching its lowest point at -2.76 percent in 2000 due to the economic crisis and declining investor confidence. Subsequently, in the 2002–2009 period, FDI began to recover and returned to positive territory, reaching 2.92 percent in 2005. During the 2010–2019 period, FDI remained

relatively stable within the range of 1.8–2.8 percent, peaking at 2.82 percent in 2014. Meanwhile, during the 2020–2024 period, FDI experienced a temporary decline due to the COVID-19 pandemic but later stabilized within the range of 1.5–1.8 percent, indicating Indonesia's economic resilience to global shocks.

Foreign investment plays an important role in increasing production capacity through capital inflows, technology transfer, and the improvement of labor skills (Todaro & Stephen C. Smith, 2015). Research by Novika & Ida Budiarty, (2026) shows that FDI has a negative and significant effect on unemployment, meaning that an increase in foreign investment is capable of creating employment opportunities both directly and indirectly. Direct employment is generated during the construction and operational stages of companies, while indirect effects arise through the economic multiplier effect that increases demand for supporting goods and services from domestic sectors. Therefore, FDI becomes one of the key factors in supporting economic growth and reducing unemployment as part of efforts to prevent the Middle-Income Trap in Indonesia an important instrument in strengthening economic growth while simultaneously reducing the unemployment rate in Indonesia.

In addition to investment, the quality of human capital is also an important factor in determining a country's success in escaping the Middle-Income Trap. In human capital theory, Gery Becker, (1964) explains that education and labor skills are the main determinants of productivity and long-term economic growth. In this context, the Human Development Index (HDI) is used as a comprehensive indicator to assess the quality of human capital through the dimensions of education, health, and a decent standard of living. The development of Indonesia's HDI shows a relatively stable upward trend, although it experienced a slowdown during the 1998–2002 economic crisis and declined again in 2020 due to the COVID-19 pandemic. However, during the 2022–2024 period, the HDI increased significantly again, reflecting the recovery of human development quality in the post-pandemic period.

A high HDI reflects a workforce that is healthier, more educated, and more productive, enabling it

to adapt to the demands of modern industries. However, the high level of educated unemployment also indicates the existence of a skill mismatch between labor competencies and labor market demands (Todaro & Stephen C. Smith, 2015). Research by Saputra et al., (2025) states that improvements in HDI can reduce the Open Unemployment Rate when accompanied by sustainable labor market strategies. In contrast, research by Sutrisno et al., (2024) found that increases in HDI have not been fully effective in reducing open unemployment. These differences in research findings indicate that the relationship between the quality of human resources and unemployment still requires further study.

In addition to the quality of human resources, the Regional Minimum Wage (RMW) policy also plays an important role in economic development and employment in Indonesia. In Keynesian theory, John Maynard Keynes Keynes, (1936) explains that wages are not only viewed as production costs but also as a source of income that determines the level of aggregate consumption. An increase in the minimum wage can enhance people's purchasing power and stimulate aggregate demand, thereby encouraging companies to increase production and expand employment opportunities. However, theoretically, an increase in the minimum wage that exceeds labor productivity may also reduce labor demand and increase unemployment. Research by Qamariyah et al., (2022) shows that the impact of minimum wage policies on unemployment is highly influenced by economic conditions, labor market flexibility, and the productivity level of the workforce economic growth and industrial capacity in each region. Economic growth is a key indicator of the success of national development. Various studies indicate that economic growth which is neither inclusive nor productivity-based risks reinforcing the Middle-Income Trap (Gill & Kharas Homi, 2007). Based on data from the Badan Pusat Statistik, (2025), Indonesia's highest economic growth reached 6.43 percent in 1995, while the deepest contraction occurred in 1998 at -14.49 percent due to the economic crisis. In addition, economic slowdown also occurred during the COVID-19 pandemic. Nevertheless, after experiencing contraction, Indonesia's economic growth once again showed a recovery trend with positive growth in the following periods. Based on the above explanation, it can be understood that unemployment, FDI, HDI, RMW, and economic growth are closely interconnected in

determining Indonesia's ability to escape the Middle-Income Trap. Therefore, research on the influence of FDI, HDI, and RMW on the Open Unemployment Rate within the context of the implementation of the Job Creation Law is important to provide an empirical overview of the effectiveness of government policies in promoting economic growth and supporting the transformation toward a developed country.

## 2. LITERATURE REVIEW

According to John Maynard Keynes, (1936), the level of output and employment opportunities in an economy is largely determined by aggregate demand, which consists of consumption, investment, government expenditure, and net exports. When aggregate demand is low, firms tend to reduce production, which ultimately leads to a decline in labor demand and an increase in unemployment. Thus, unemployment from the Keynesian perspective is categorized as involuntary unemployment, namely a condition in which workers are willing to work at the prevailing wage level but are unable to obtain employment.

Foreign Direct Investment (FDI), within the framework of the Eclectic Paradigm (OLI Theory) proposed by John H. Dunning, (1993), refers to investment undertaken by multinational corporations outside their home countries when three main advantages are fulfilled simultaneously, namely ownership advantages, location advantages, and internalization advantages. When these three components are met, FDI not only encourages corporate expansion but also contributes to job creation and productivity improvement in the host country.

Human Capital Theory, according to Gary S. Becker, (1964), states that education, skills, and health are forms of investment that can enhance individual productivity, thereby affecting income growth and employment opportunities. Investment in human capital improves skills and productivity, which in turn increases individuals' competitiveness in the labor market.

According to John Maynard Keynes, (1936), wage levels are not solely determined by labor market mechanisms (demand and supply), but are also influenced by macroeconomic conditions, particularly aggregate demand. In his view, wage reductions do not necessarily increase labor absorption because the main cause of unemployment is the lack of demand for goods and services, rather than high wage levels.

Arthur Okun's Law (1962), as cited in Abel et al., (2017), states that when economic growth

increases rapidly, the unemployment rate tends to decline. Conversely, when economic growth slows down or becomes negative (recession), unemployment will increase. When companies increase the production of goods and services, they require more workers. This rise in production demand encourages firms to recruit unemployed individuals, thereby reducing the national unemployment rate.

The Middle-Income Trap, according to (Gill & Kharas Homi, 2007), refers to a condition in which middle-income countries have successfully achieved rapid growth and escaped the low-income category, but subsequently lose the momentum needed to advance into the high-income category. Countries caught in the Middle-Income Trap lose their previous competitive advantages, making them unable to compete with low-income countries in the manufacturing industry. At the same time, they have not yet developed new competitive advantages, preventing them from competing with developed countries in terms of high-technology innovation and knowledge-based industries.

## 3. METHODS

This study is descriptive quantitative in nature and utilizes secondary data. Secondary data refers to data obtained from publications issued by institutions or agencies related to the research topic. In this study, there are three independent variables, namely Foreign Direct Investment (FDI), Human Development Index (HDI), and Regional Minimum Wage (RMW), as well as one dependent variable, namely the Open Unemployment Rate. The scope of this research covers Indonesia during the period 1990–2024, with one dummy variable representing the implementation of the Job Creation Law policy in 2020.

This study uses time series data, namely data arranged chronologically based on a sequence of time from 1990 to 2024, employing the Autoregressive Distributed Lag (ARDL) method.

## 4. RESULT AND DISCUSSION

In this study, testing was conducted using several ARDL model specifications. The differences among the models were intended to obtain the best model that satisfies econometric criteria, such as model stability, parameter significance, and the existence of a long-run relationship (cointegration).

### 3.1 Unit Root Test

To test the stationarity of time series data, a unit root test is employed. If the time series data are non-stationary, this indicates the presence of a unit root

problem. The existence of a unit root problem can be confirmed by comparing the t-statistic value obtained from the regression results with the results of the Augmented Dickey-Fuller (ADF) test at the level form.

**Table 1. Unit Root Test**

Augmented Dicky-Fuller Test					
Variabel	Level		First Difference		Ket.
	t-statistic	Prob.	t-statistic	Prob.	
TPT	-1.337261	0.6008	-5.078251	0.0002	I(1)
FDI	-2.283336	0.1828	-5.552825	0.0001	I(1)
IPM	-1.925124	0.3171	-5.917437	0.0000	I(0)
LUMR	-3.448610	0.0160	-4.467839	0.0012	I(1)

Source: output *EViews 12*

The tested variables were found to be stationary at the first difference level. According to the ADF test, all variables used in this study are integrated at the first difference because the probability value of each variable is below 0.05 or  $\alpha = 5\%$ .

### 3.2 Cointegration test

The ARDL Bounds Cointegration Test is conducted to determine whether there is a long-run equilibrium relationship in this study. The decision rule for this test is that if the F-statistic value is greater than the upper bound value, cointegration exists. This implies that the variables used in the study have a long-run relationship.

**Table 2. Uji Kointegrasi**

Test Statistic	Value	Significant Level	Bound Critical Value	
			I(0)	I(1)
F-statistic	8.206738	10%	2.37	3.2
K	3	5%	2.79	3.67
		2.50%	3.15	4.08
		1%	3.65	4.66

Source: output *EViews 12*

The results of the cointegration test using the Bounds Test approach show that the F-statistic value is 8.206738. This value is greater than the upper bound value at the 5% significance level, which is 3.67. Therefore, it can be concluded that Foreign Direct Investment, the Human Development Index, and the logarithm of Regional Minimum Wage have a long-run relationship with the Open Unemployment Rate.

### 3.3 Optimal lag test

The optimal lag selection results indicate that the chosen lag structure in this study is ARDL (1, 4, 0, 0). Therefore, the best lag combination for this model consists of a maximum lag of 1 for the dependent variable, the Open Unemployment Rate, a maximum lag of 4 for the independent variable Foreign Direct Investment, and zero lag for the independent variables Human Development Index and the logarithm of Regional Minimum Wage.

### 3.4 ARDL Short-Run

**Table 3. ARDL Short Run**

Variabel	Koefisien	Std. Error	t-Stat	Prob.
D(FDI)	-0.138039	0.067744	-2.037649	0.0538
D(FDI(-1))	0.240784	0.074617	3.226917	0.0039
D(FDI(-2))	0.214970	0.071560	3.004030	0.0065
D(FDI(-3))	0.379913	0.071206	5.335444	0.0000
ECT*	-0.307251	0.044121	-6.963789	0.0000

Source: output *EViews 12*

The estimation results from EViews show that the Error Correction Term (ECT) in Table 4.6 is -0.307251 with a highly significant probability value of 0.0000. The ECT coefficient is considered valid as it satisfies two main requirements: it is negative and statistically significant at the 5% significance level ( $0.0000 < \alpha = 0.05$ ). These validity conditions for the ECT in the ARDL (1, 4, 0, 0) model are met, indicating the existence of an error correction mechanism toward long-run equilibrium. Thus, it can be concluded that the ECT value of -0.307251, significant at the 1% level, implies that approximately 30.7% of long-run disequilibrium is corrected within one year, indicating a relatively fast adjustment process toward equilibrium.

### 3.5 ARDL Long-Run

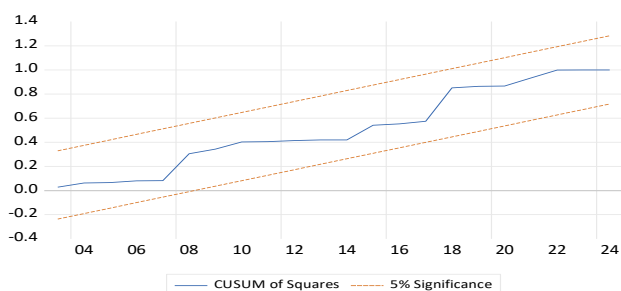
**Table 4. ARDL Long Run**

Variable	Coefficient	Std. Error	t-Statistic	Prob.
FDI	-1.225364	0.384328	-3.188326	0.0042
IPM	-0.183669	0.330196	-0.556243	0.5837
LUMR	0.535743	3.542838	0.151219	0.8812
C	15.74473	3.585556	4.391153	0.0002

Source: output *EViews 12*

After completing the previous stages and confirming the existence of a long-run cointegration relationship, the next step is to estimate the long-run coefficients of the ARDL model.

### 3.6 Uji CUSUM of Squares



The results of the CUSUM of Squares (CUSUMSQ) test show that the CUSUMSQ statistic line moves within the 5% significance bounds throughout the observation period. This indicates that the variance of the residuals in the model is stable and that no significant structural breaks occurred during the study period.

### 3.7 F- Test

The decision rule is as follows: if the resulting p-value is smaller than the significance level  $\alpha = 0.05$  (or 5%), it

can be concluded that the independent variables jointly have a significant effect on the dependent variable.

The F-statistic test results in the ARDL model for both short-run and long-run parameter estimation show an F-value of 45.73685 with a probability of 0.00000, which is far below the conventional 5% significance level. This indicates that all independent variables used in the model, namely FDI, HDI, Log\_RMW, along with their lags, simultaneously have a significant effect on the Open Unemployment Rate.

### 3.7 t Test

**Table 5. ARDL Long-Run**

Variabel	Koefisien	t-Statistic	P-value	H <sub>0</sub>	Keterangan
FDI	-1.225364	-3.188326	0.0042	Rejected	Significant (5%)
IPM	-0.183669	-0.556243	0.5837	Accepted	No Significant
LUMR	0.535743	0.151219	0.8812	Accepted	No Significant
C	15.74473	4.391153	0.0002	Rejected	Significant (5%)

Source : output Eviews 12

**Table 6. ARDL Short-Run**

Variabel	Koefisien	t-Stat	P-value	H <sub>0</sub>	Keterangan
D(FDI)	-0.138039	-2.037649	0.0538**	Rejected	Significant(10%)
D(FDI(-1))	0.240784	3.226917	0.0039*	Rejected	Significant(5%)
D(FDI(-2))	0.214970	3.004030	0.0065*	Rejected	Significant(5%)
D(FDI(-3))	0.379913	5.335444	0.0000*	Rejected	Significant(5%)

\*Sig 5% = 0.05

\*\*Sig 10% = 0.10

Source : Output Eviews 12

## Discussion

### 1. The Effect of Foreign Direct Investment (FDI) on the Open Unemployment Rate (OUR)

The ARDL estimation results show that Foreign Direct Investment (FDI) has a significant effect on the Open Unemployment Rate (OUR) in both the short run and the long run, although with different directions of impact. In the short run, the D(FDI) variable has a negative coefficient of -0.138039 and is significant at the 10 percent level, meaning that an increase in FDI is able to reduce unemployment through production activities and the absorption of new labor. However, at the first to third lags, FDI has a positive and significant effect on the Open Unemployment Rate (OUR), indicating that foreign investment initially has not been fully effective in reducing unemployment. This is because most foreign investment is capital-intensive, utilizes modern technology, and requires specific skills, leading to labor market adjustments and a time lag in labor absorption.

Meanwhile, in the long run, FDI has a negative and significant effect on the Open Unemployment Rate (OUR) with a coefficient of -1.225364, meaning that an increase in foreign investment is able to reduce unemployment more optimally through industrial growth, technology transfer, productivity improvement, and the expansion of employment opportunities. These findings are consistent with the Harrod-Domar theory and neoclassical growth theory, which state that investment plays an important role in

increasing production capacity, economic growth, and job creation.

### 2. The Effect of the Human Development Index (HDI) on the Open Unemployment Rate (OUR)

The long-run estimation results show that the Human Development Index (HDI) variable has a negative coefficient of -0.183669 but is not statistically significant, with a probability value of 0.5837. Theoretically, an increase in HDI reflects improvements in the quality of human resources through better education, health, and living standards, which should enhance labor productivity and expand employment opportunities, thereby reducing unemployment.

The negative relationship observed in this study indicates that an increase in HDI tends to be associated with a decline in the Open Unemployment Rate; however, this effect is not statistically significant. This suggests that improvements in human development have not yet been able to exert a meaningful impact on reducing unemployment in the long run. This condition may be caused by a mismatch between labor skills and labor market needs (labor market mismatch), where improvements in education levels are not matched by the availability of suitable job opportunities, leading to educated unemployment. In addition, HDI is a broad indicator that covers education, health, and income dimensions, so its impact on unemployment tends to be indirect and requires support from other economic policies in order to significantly reduce the unemployment rate.

### 3. The Effect of the Regional Minimum Wage (RMW) on the Open Unemployment Rate (OUR)

The long-run estimation results show that the Regional Minimum Wage (RMW) variable has a positive coefficient of 0.535743 with a probability value of 0.8812, indicating a positive but statistically insignificant effect on the Open Unemployment Rate (OUR). The positive relationship suggests that an increase in the minimum wage tends to be followed by an increase in unemployment, as higher wages may raise firms' production costs, leading companies to implement efficiency measures such as reducing labor, limiting new hiring, or even conducting layoffs or business closures due to capital constraints, business competition, and higher wage obligations. In some cases, firms may also substitute labor with technology or machinery to reduce operational costs.

However, the effect of RMW on unemployment is not statistically significant, indicating that changes in the minimum wage are not a major determinant of the Open Unemployment Rate in Indonesia compared to other factors such as investment, industrial growth, macroeconomic conditions, and the capacity of the business sector to absorb labor. In addition, increases in the minimum wage may also generate positive effects through higher purchasing power, which can stimulate consumption, economic activity, production growth, and potentially create new employment opportunities in the long run.

#### 4. CONCLUSION

Based on the results of the study on the effect of Foreign Direct Investment (FDI), Human Development Index (HDI), and the logarithm of Regional Minimum Wage (LUMR) on the Open Unemployment Rate (OUR) using the Autoregressive Distributed Lag (ARDL) method, it can be concluded that in the short run, FDI has a significant effect on OUR. At the current period, FDI has a negative and significant effect, meaning it is able to reduce unemployment through the creation of new job opportunities. However, at the first to third lags, FDI has a positive and significant effect on OUR, indicating that foreign investment initially has not been fully effective in reducing unemployment due to its capital-intensive nature and reliance on advanced technology, which limits labor absorption. In the long run, FDI has a negative and significant effect on OUR, showing that an increase in foreign investment is able to reduce unemployment through industrial growth, increased economic activity, and expanded employment opportunities. Meanwhile, the HDI variable has a negative but insignificant effect on OUR, indicating that improvements in human resource quality have not yet produced a significant impact on reducing unemployment due to a mismatch between labor skills and labor market needs as well as limited job opportunities. The LUMR variable also shows a positive but insignificant effect on OUR, suggesting that increases in the minimum wage tend to raise unemployment, although the effect is not statistically strong, meaning that changes in the minimum wage are not the main determinant of the Open Unemployment Rate. In addition, the Error Correction Term (ECT) value of -0.881479 and its significance indicate that the ARDL model satisfies long-run equilibrium conditions. Approximately 88.15% of short-run disequilibrium is corrected toward long-run equilibrium within one period, implying a rapid adjustment process and confirming that the model is stable in explaining the relationship between the independent variables and the Open Unemployment Rate (OUR).

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