

The Role of MSME on Unemployment in Indonesia

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The Role of MSME on Unemployment in Indonesia

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Abstract: Unemployment is one of the main problems of complex socio-economic development. This paper aims to analyze Schumpeter's theory of economic development to examine the "Schumpeter effect" and the "refugee effect". This research analysed empirical data on the growth of MSMEs and the unemployment rate in Indonesia. The data dimension used is the time series ratio data after the 2008 economic crisis, quarterly data for the 2009-2019 Q3 period. The main analysis results show that the Schumpeter effect is valid, and the refugee effect is less valid. This means that the growth of MSMEs can significantly reduce the unemployment rate, and there is a high unemployment rate due to the low growth of MSMEs. However, the existence of a high unemployment rate is not automatically able to trigger the growth of MSMEs, except only for micro businesses because these businesses do not require much investment capital or working capital.

Keywords: MSME, Unemployment, Schumpeter effect and refugee effect.

1. Introduction

The three main problems in economic development are unemployment, poverty and inequality. Unemployment is an economic problem as well as a social problem. The impact of high unemployment is the root cause of poverty and crime. Thus, it must be overcome immediately (Ajaegbu, 2012; Britto *et al.*, 2020; Hussain *et al.*, 2020). In economic theory, the higher the number of the workforce if it is not followed by an increase in the availability of employment, it will result in unemployment. In addition, unemployment can occur due to job losses. If there is still unemployment, then the goal of full employment in macroeconomic theory is not achieved and the goal of economic development can be considered as a failure. This argument refers to the theory of Dudley Seers (1969) which states that if one or two or even all three of these main problems deteriorate, then development has not been successful even though per capita income has increased substantially. This is due to the essence and focus of attention in the theory of economic development Dudley Seers (1920–1983) is to emphasize the need for the meaning of social development.

According to Seer (1969), development is related to the level of poverty, unemployment, and inequality in a nation. If one or two of these variables are worse, especially if all three have worsened, then it would not be said the development exist even though per capita income has increased. The condition of the three variables in Indonesia shows a downward trend, although it is still high (Prasetyo & Kistanti, 2020). However, the conditions for these three variables in 2021 are currently increasing slightly due to the Covid-19 pandemic, even though the Indonesian economy may grow slightly (Saadah, 2021). One of the business sectors that is expected to reduce these three main problems in Indonesia is the industrial sector, especially the micro, small and medium enterprises (MSMEs) and entrepreneurship sector (Prasetyo, 2008, 2020a, 2020b; Suhaili, 2019). Creating policy for the business sector is logical because Indonesia has 64.7 million MSMEs or 99.99% of the total business units. From a total of 64.7 million business units, the number of micro businesses is still the largest, namely 63.35 million of micro businesses (98.68%), followed by small businesses 783,132 businesses (1.22%), and medium enterprises with 60,702 businesses (0.09%). Therefore, such a large number of MSMEs makes Indonesian economy can be called MSME-based economy.

Based on Schumpeter's theory of economic development, the problem of unemployment and MSMEs is related to what is known as the "Schumpeter effect" vs the "refugee effect". The Theory of Schumpeter Effect (TSE) theory or called the attractiveness effect, is a basic logical concept that explains that entrepreneurship and unemployment are negatively related, or inversely related. This means that the emergence of new entrepreneurship will have an impact on reducing unemployment and conversely, there is a high unemployment rate associated with a low level of entrepreneurial activity. Meanwhile, the Theory of Refugee Effect (TRE) theory or it can be called the push effect, is the basic concept of a theoretical model which states that the positive unemployment phenomenon will encourage a greater tendency for the community to start creating new businesses. This means that unemployment will stimulate various entrepreneurial activities among them to have jobs in the economy.

Meanwhile, empirically, studies and policies on the development of MSMEs have broad regional and global potential for the phenomenon of unemployment and the achievement of sustainable development goals (SDGs). The latest research that has been carried out by the OECD, in 2017, every enterprise contributed to 53% to 86% of employment in OECD countries such as the UK and Greece. Meanwhile, in developing countries such as Peru, 98%

of private companies are MSMEs, contributing up to 42%. In addition, MSMEs also provide around 50% to 80% of employment in Cambodia and Kenya (Liu, 2017).

The novelty and urgency of the importance of this research empirically is to explain the important contribution of MSMEs to achieve broader socio-economic goals, especially related to reducing the problem of unemployment. Empirically, this study specifically aims to test J.A. theory of development of the basic concept of "Schumpeter" effect vs the "refugee" effect. This study is an effort to achieve sustainable development goals (SDGs). The argument is that job creation through MSMEs can often reduce poverty and crime problems. Hence, this method is more in line with the meaning of social development as referred to in the basic concepts of Dudley Seer's theory of development.

2. Literature review

There are at least three prominent figures in previous studies such as J.A. Schumpeter (1883-1950), Gunnar Myrdal (1898-1987), and Dudley Seer (1920-1983) who have explained the socio-economic development theory. The basis of the theory of economic development from Schumpeter, Myrdal, and Seers, is found to have in common and the tendency saying that development emphasizes more on aspects of social meaning, namely the importance of reducing poverty, unemployment, and inequality in income distribution. This is quite related with the theoretical basis used in this article. Gunnar Myrdal's basic theory about backwash effects and spread effects is more closely related to the problems of poverty and inequality. Meanwhile, in general, the objectives of Dudley Seer's social-economic development theory are more related to the three problems that are poverty, unemployment, and inequality. Meanwhile, Schumpeter's theory of entrepreneurship is more focused and related to solutions to unemployment problems. Therefore, the basic concept of the theory is applied as a reference for this research.

An important finding from previous relevant research mentions that there is a close relationship between the unemployment rate and newly established companies, including entrepreneurship (Aubry, 2015). Start-ups (including entrepreneurial startups and MSMEs) are primarily driven by the unemployment push effect which has consequences for new ventures in large parts of France. Meanwhile, the "Schumpeter effect only applies in a small part of the region, because it applies in the long term (Aubry, 2015). Meanwhile, the growth of new entrepreneurship and new MSMEs itself is predominantly driven by human capital and social capital factors (Prasetyo, 2020b; Prasetyo *at al.*, 2020a, 2020b). Further, the new distraction of youth is heavily influenced by current and previous youth unemployment (Mobit and Mbella, 2017). The results of research by Mobit and Mbella (2017) concluded that entrepreneurship has a direct effect on youth unemployment.

The results of other research show that there is an inverse relationship between entrepreneurship and unemployment in Turkey (Apaydin, 2018). However, the results of this research conclude that the Schumpeter effect is valid, while the refugee effect is invalid (Apaydin, 2018). Another main finding states that the potential for high economic growth is due to entrepreneurship which has a different explanatory effect in each country, so that entrepreneurship promotion policies including MSMEs need to be targeted (Kam, 2016; Prasetyo, 2020a, 2020b; Prasetyo, 2019). However, the tendency for high entrepreneurial participation does not by itself guarantee an improvement in economic performance because there are entrepreneurs that do not contribute to growth. For example, entrepreneurship which creates "refugee effects" or "shopkeeper effect", where entrepreneurship provides employment for business owners, but only generates a few jobs (Kam, 2016).

Previous researchers have focused their research on the "refugee" and "Schumpeter" effect sizes. The results are mixed, and they mostly fail to measure the real dimensions of these two effects because they analyze the relationship from a static perspective (Aubry, 2015; Langroodi, 2017). However, a study (Aubry, 2015) has found that the unemployment rate and start-up of new companies are closely related, and this occurs in the short and long term and his research shows evidence of a "refugee" effect and a "Schumpeter" effect. There are still many studies that try to ascertain the relationship between unemployment and entrepreneurship which has produced ambiguous results. Some studies have found a positive relationship (refugee effect) between unemployment and entrepreneurship. Meanwhile, other studies find evidence and support a negative relationship (Schumpeter effect). Therefore, it is interesting to find out the relationship between MSMEs and unemployment in Indonesia.

3. Research methods

Based on the background and literature study, this article tries to explain Schumpeter's theory of economic development with its main features of "Theory Schumpeter Effect (TSE) and Theory Refugee Effect" (TRE). The data employed is time series economic data after the 2008 global economic crisis of 2009-2019 Q3 period (Prasetyo, 2020a). To measure the dimensions for all variables, a ratio scale is employed. The main subjects and variables in

this research are the growth variables of the Indonesian MSME sector and the unemployment rate variable (UN_e). Furthermore, the method of analysis in this paper uses the Ordinary Least Square (OLS) multiple linear regression analysis method.

Each stage of the activities conducted in this research have been carried out through rigorous, thorough, and careful experimental methods. The next step is to select an analytical model that is best, unbiased and in accordance with the research objectives. Scientifically and econometrically, the test stages of this model have been carried out through the specification of the model which is then considered the best selected model. This model is referred to as the empirical model. The purpose of using the empirical model is to evaluate the basic concepts of TSE and TRE theory whether the basic concept of the theory is still empirically valid in Indonesia. Due to the purpose of this research is more focused on testing the theory, the focus of a deeper discussion is also focused on analyzing the main variables of the growth of MSMEs and the variable rate of unemployment (UN_e). Where for the MSMEs variable {(micro business = UM_i) + (small business = UK_e) + (medium business = UM_e)} can be described as follows.

$$MSME_s = \sum_1^3 (UM_i) + (UK_e) + (UM_e)$$

$$UN_e = \alpha_0 + \alpha_1 \text{Log } UM_i + \alpha_2 \text{Log } UK_e + \alpha_3 \text{Log } UM_e + \alpha_4 \text{Log } Gov_{Expd} + \alpha_5 \text{Log } PDB + \alpha_6 \text{Log } INV + \alpha_6 \text{Log } MK + \varepsilon_1 \dots \dots \dots (1)$$

$$UN_e = \alpha_0 + \alpha_1 UM_i + \alpha_2 UK_e + \alpha_3 UM_e + \alpha_4 Gov_{Expd} + \alpha_5 PDB + \alpha_6 INV + \alpha_6 MK + \varepsilon_2 \dots \dots \dots (2)$$

$$UN_e = \alpha_0 + \alpha_1 UM_i + \alpha_2 UK_e + \alpha_3 UM_e + \alpha_4 \text{Log } Gov_{Expd} + \alpha_5 \text{Log } PDB + \alpha_6 \text{Log } INV + \alpha_6 \text{Log } MK + \varepsilon_3 \dots \dots \dots (3)$$

$$MSME_s = \alpha_0 + \alpha_1 \text{Log } Gov_{Expd} + \alpha_2 \text{Log } PDB + \alpha_3 \text{Log } UN_e + \alpha_4 \text{Log } INV + \alpha_5 \text{Log } MK + \varepsilon_4 \dots \dots \dots (4)$$

$$MSME_s = \alpha_0 + \alpha_1 Gov_{Expd} + \alpha_2 PDB + \alpha_3 UN_e + \alpha_4 INV + \alpha_5 MK + \varepsilon_5 \dots \dots \dots (5)$$

$$MSME_s = \alpha_0 + \alpha_1 \text{Log } Gov_{Expd} + \alpha_2 \text{Log } PDB + \alpha_3 UN_e + \alpha_4 \text{Log } INV + \alpha_5 \text{Log } MK + \varepsilon_6 \dots \dots \dots (6)$$

4. Results and discussion

Both theoretically and empirically, job creation can be achieved by empowering entrepreneurs or MSMEs. It is a direct effort to reduce unemployment and is proven to simultaneously reduce poverty and income inequality as well as increase economic growth (Prasetyo, 2008). This research focuses more on the problem of the relationship between MSMEs growth and the unemployment rate. It aims to explain empirically whether the basic concepts of TSE and TRE theory are still relevant and applicable in Indonesia. Table-1 and table-2 show the results that the role of MSMEs plays a significant effect on the unemployment rate (UN_e). Particularly, in the small business sector (UK_e) and medium enterprises (UM_e), it is increasingly apparent that they have a negative and significant effect on the confidence level above 95% on the unemployment rate (UN_e). This means that the basic concept of the TSE theory which states that there is a negative relationship between MSMEs, and unemployment is valid and acceptable. The results of this research support previous research (Prasetyo & Kistanti, 2020b). However, specifically at the level of micro enterprises (UM_i), it has a significant positive effect on the unemployment rate.

There is an interesting critical argument related to the positive influence on the level of micro-enterprises empirically on the unemployment rate. This is due to the large number of micro-businesses in Indonesia is generally only considered a side business which means that it is not the main source of income for living. They do not consider their businesses as a permanent economic activity. Nonetheless, their side hustle business has proven to generate income for them. Therefore, this side business is considered crucial in improving the family income. Hence, the micro-business is proven to be economically important regardless how the people see it whether as a permanent or side business. Meanwhile, in terms of social equity, the contribution of micro enterprises is still considered only as a non-prestigious domestic job. To open a micro business is also easy and it does not require large investment and working capital. Therefore, even though this micro business is technically efficient, from the feasibility level, this micro business is quite low and economically inefficient. Furthermore, the experimental test results when this micro business is combined with small and medium enterprises (MSMEs), has an insignificant impact on unemployment.

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Table-1: Results of empirical regression on the role of MSME growth on the unemployment rate

Dependent Variable: UN_e				
Method: Least Squares				
Sample: 2009.Q1 2019.Q4				
Included observations: 44				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	50.08753	13.70576	3.654488	0.0008
Log UM_i	1.625102	0.300016	5.416711	0.0000
Log UK_e	-1.017901	0.343626	-2.962231	0.0054
Log UM_e	-3.115746	0.890043	-3.500671	0.0013
Log Gov_Expd	-0.002828	0.125632	-0.022510	0.9822
Log PDB	-1.178511	1.533721	-0.768400	0.4473
Log INV	-0.037365	0.094335	-0.396092	0.6944
Log MK	0.459171	1.121103	0.409570	0.6845
R-squared	0.965613	Mean dependent var	6.752273	
Adjusted R-squared	0.958927	S.D. dependent var	1.225625	
S.E. of regression	0.248391	Akaike info criterion	0.215340	
Sum squared resid	2.221131	Schwarz criterion	0.539739	
Log likelihood	3.262509	Hannan-Quinn criter.	0.335643	
F-statistic	144.4167	Durbin-Watson stat	1.402873	
Prob(F-statistic)	0.000000			

As discussed earlier, the economic inefficiency has led SMEs (small and medium enterprises) has a significant level of relationship and negative influence on the unemployment rate (Al-Haddad *et al*, 2019). This phenomenon supports the basic valid concept of TSE. However, SMEs is often constrained by the level of investment and working capital. Meanwhile, micro businesses themselves do not receive assistance from the government and related institutions. The results of this research strongly support previous research (Prasetyo, 2020a). The research results (2020a) state that the role of government spending is insignificant in the existence of micro and MSMEs. However, the role of government spending has a positive and significant effect on small and medium enterprises (SMEs). This means that even though this micro-business can provide a positive and good value chain for new product development and economic welfare of the community, it still does not have a positive impact on social equity (Prasetyo & Dzaki, 2020). Therefore, to overcome this phenomenon, it must be based more on increasing the capacity of human capital and social factors as well as the quality of related institutions (Prasetyo & Kistanti, 2020b; Prasetyo *et al*, 2020a, 2020b).

Table-1 and table-2 show empirical evidence that the factors of government spending, GDP, investment and working capital are not significant in reducing the unemployment problem. The problems of unemployment, poverty and income inequality in Indonesia have become more complex and costly problems. Even though it has shown a decreasing tendency, in terms of social equity, it still appears very high and costly (Prasetyo and Kistanti, 2020a). One of the reasons is the lack of serious attention to the potential of MSEs. Because the number of MSMEs in Indonesia is large and their main function is to open employment. However, MSMEs can grow and develop independently more because of their creativity and innovation, and not because of the facilities provided by banks or government. Meanwhile, the main function of large enterprises, which is more focused on increasing production can grow and develop because banks and the government provide more facilities for them.

Table-2: Results of the empirical regression model on the role of the MSME level on the unemployment rate

Dependent Variable: UN_e				
Method: Least Squares				
Sample: 2009.Q1 2019.Q4				
Included observations: 44				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	10.20535	1.007755	10.12681	0.0000
UM_i	1.50E-05	1.89E-06	7.913657	0.0000
UK_e	-8.77E-06	1.53E-06	-5.749770	0.0000
UM_e	-1.70E-05	4.45E-06	-3.811336	0.0005
GovExpd	3.28E-07	7.28E-07	0.451012	0.6547

PDB	-1.01E-06	8.98E-07	-1.127097	0.2672
INVESTMENT	-4.67E-08	1.22E-07	-0.383201	0.7038
WORKING CAPITAL	5.47E-06	2.87E-06	1.906430	0.0646
R-squared	0.952711	Mean dependent var		6.752273
Adjusted R-squared	0.943516	S.D. dependent var		1.225625
S.E. of regression	0.291285	Akaike info criterion		0.533940
Sum squared resid	3.054499	Schwarz criterion		0.858338
Log likelihood	-3.746669	Hannan-Quinn criter.		0.654242
F-statistic	103.6119	Durbin-Watson stat		1.407695
Prob(F-statistic)	0.000000			

Table-1 and table-2 illustrate a significant negative relationship between SMEs and unemployment. This means that the TSE concept is empirically valid. Furthermore, the contribution of SMEs is believed to be able to increase income and economic growth and be accepted globally as a tool towards the goals of sustainable development (SDGs). Therefore, it is interesting to further evaluate the relationship and impact of SMEs on unemployment, poverty, and economic growth. This study is in line with the results of research conducted by Ogunjimi (2021) stating that the role of SMEs can overcome unemployment in Nigeria with a special emphasis on the sustainability of employment generated by SMEs. However, unfortunately, the research shows the jobs generated by SMEs in Nigeria are not sufficient to permanently solve the unemployment challenge in Nigeria (Ogunjimi, 2021).

There is a fact in Zimbabwe massive youth unemployment rate occurred and SMEs can become an integral part of creating jobs for youth (Gukurume, 2018). The results of this research are in line with the empirical conditions in Indonesia that there was massive youth unemployment during economic crisis and during the Covid-19 pandemic. However, this does not happen to young people who have the capacity of creative and innovative human resources. Because in fact, only those who can adapt quickly and want to transform themselves can survive in times of crisis. Based on data from BPS, there are still a lot of high unemployment among young people around the age of 20-29 years or equivalent to high school graduates, and during the 2020-2021 pandemic it has increased even more. According to the BPS report, specifically in 2021, unemployment will increase by 1.1 million people due to the impact of Covid-19 and around 2.6 million people are the new workforce. Hence, the total increase in unemployment in 2021 is 3.6 million people. This large number of youth unemployment shows that there are still many complex problems in job creation in Indonesia. This has made it difficult to reduce the unemployment. Thus, the existence of MSMEs brings a new hope because of its potential as a solution to reduce unemployment (Prasetyo, 2008). Therefore, commitment to overcome the problems through policies are still needed to restructure Indonesian MSMEs to be more resilient, productive, competitive, and independent.

Table-3: The regression results of the role of the unemployment rate on the growth rate of MSMEs

Dependent Variable: MSME				
Method: Least Squares				
Sample: 2009Q1 2019Q4				
Included observations: 44				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	6477236.	5624623.	1.151586	0.2567
Log Gov _{Expd}	102783.3	53555.90	1.919177	0.0625
Log PDB	-1528450.	584990.9	-2.612776	0.0128
UN _e	99375.22	56133.81	1.770328	0.0847
Log INV	43267.72	40463.75	1.069296	0.2917
Log MK	1079056.	341671.5	3.158168	0.0031
R-squared	0.478241	Mean dependent var		665803.3
Adjusted R-squared	0.409589	S.D. dependent var		147567.7
S.E. of regression	113388.4	Akaike info criterion		26.24115
Sum squared resid	4.89E+11	Schwarz criterion		26.48445
Log likelihood	-571.3053	Hannan-Quinn criter.		26.33138
F-statistic	6.966117	Durbin-Watson stat		0.500057

Prob(F-statistic)	0.000105		
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On the other hand, the basic concept of TRE is a theoretical one which states that the phenomenon of unemployment positively will encourage a greater tendency for the community to start creating new businesses. This means that unemployment will stimulate various entrepreneurial business activities. MSMEs can create jobs. Table-3 can provide little evidence for the basic concept of this theory. Table-3 shows a positive and significant effect of the unemployment rate on the MSME level with a real level of 8.47% or at a confidence level of 91.53%. However, table-3 are still slightly biased in specifications, so that the interpretation of this model is yet not perfect. This means that in the case of the relationship between abortion and MSMEs, the TRE concept is not fully valid. Thus, the results of this research support previous research which states that the role of TSE is bigger and stronger than the role of TRE (Prasetyo & Kistanti, 2020b).

From the experimental results in the model as presented in the above research method, there is no better and valid model that supports the TRE concept. The test results of other experimental models between unemployment and SMEs as well as unemployment and entrepreneurship do not show a better result of the research model. The critical note is that during the Covid-19 pandemic, unemployed youth in Indonesia, who have good human capital capacity, are more supportive of the TRE concept in the form of a food and business plan. Meanwhile, most of the other unemployed are less adaptive and do not support this basic concept of TRE. Therefore, a more serious policy is needed to rearrange the structure, behavior, and performance of Indonesian MSMEs that are more resilient, productive, adaptive, competitive, and independent. This means, in this empirical phenomenon, there are two possibilities that could occur. First, the existence of unemployment can actually be a barrier to the business itself and in turn it becomes a problem for existing businesses. However, second, unemployment can force someone who has more capacity to be more creative, innovative, and adaptive, to immediately start his own business in any way they to at least help himself. Thus, according to the author, this interaction occurs in Indonesia empirically, not just a matter of "Schumpeter effect" VS "Refugee effect". However, it is more due to a more important factor, namely, socio-economic-cultural entrepreneurship and social entrepreneurship in the labor market and economic activities (Prasetyo, 2020a, 2020b).

5. Conclusions

In the labour market, the problem exists in the relationship between MSMEs and unemployment. Empirical research in Indonesia shows that this problem occurs not only due to problems in the TSE and TRE concepts, but also from the other factors which are the socio-economic-cultural factors of entrepreneurship and social entrepreneurship. The main role of social entrepreneurship is to complement efforts that cannot be facilitated through government policies. Empirically, in Indonesia the interdependence between MSMEs and unemployment tends to be stronger in terms of attractiveness (Schumpeter effect) than force (refugee effect). Furthermore, the strengthening factor between the attractiveness and compulsion is due to the socio-economic factor of the entrepreneurial culture of the local community.

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