

ENFORCING OMNIBUS LAW: FORMALIZING MICRO, SMALL, AND MEDIUM ENTERPRISES IN INDONESIA USING BEHAVIOURAL SCIENCE

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ABSTRACT

Micro, small, and medium enterprises (MSMEs) play a significant role in creating approximately 90% of businesses worldwide. Indonesia has also been dependent on the MSMEs. However, MSMEs have been dealing with obstacles to maintain their sustainability. Their lack of formality results in their inability to keep their business, obtain funding, and low productivity. The government responds to this problem by enacting Law No. 11 of 2020 on Job Creation. This paper examines the importance of MSMEs' formalization, which is limited to registering their business or securing their entity in this case. This paper uses the normative juridical method, which shows that the government needs to use behavioural science as a new approach to implementing the Job Creation Law successfully by using nudge, which is a strategy to boost formalization that relies on simplifying procedures, delivering information that focuses on promoting the benefit, and utilizing social influence to encourage people to formalize.

Keywords: MSMEs, Formalization, Behavioural Science.

A. Introduction

Micro, Small, and Medium Enterprises (MSMEs) have long been contributing to global economy. The problem, however, is that they have an issue maintaining its continuity. The business can fluctuate quickly due to its informality, and they appear to be comfortable to remain informal. MSMEs will be encouraged to formalize their business if they discern

its advantages. The formalization mechanism is designed as quickly as possible to the point it does not feel like they deliberately formalize it.

MSMEs are important in bolstering up the global economy. According to World Bank, about 90% of businesses worldwide are MSMEs, and they contribute to absorbing more than 50% labor force in 2020.¹ This number is limited only to

1 The World Bank, "Small and Medium Enterprises (SMES) Finance: Improving SMEs' access to finance and finding innovative solutions to unlock sources of capital." The World Bank Group <https://www.worldbank.org>.

formal MSMEs, excluding the actual contribution from informal MSMEs. The potential of informal MSMEs is relatively unknown, but we can safely assume that they significantly contribute to the world economy. Especially in developing countries.²

Indonesia in recent decades has also been dependent on the MSMEs sector.³ MSMEs are an integral part of Indonesia's economic democracy.⁴ The influential role of MSMEs in the domestic economy was recognized, especially since the 1997 national crisis. During the monetary crisis in 1998, MSMEs are miraculously showing their resilience

to survive since many large businesses were too dependent on foreign loans.⁵ In 2017, Taufik claimed that MSMEs have a strategic role in Indonesia's economic structure since approximately 99,9% of the business unit in Indonesia were MSMEs.⁶

There are different classifications of MSMEs in every country. For example, in the EU, the type of MSMEs is determined by labor, annual turnover, or annual balance sheet.⁷ Meanwhile, Indonesia classifies the MSMEs category using net worth excluding land and property owned and yearly turnover.⁸

Table 1: MSMEs Criteria In EU

Category	Number	Annual Turnover	Annual Balance Sheet
Micro	< 10	≤ € 2 m	≤ € 2 m
Small	< 50	≤ € 10 m	≤ € 10 m
Medium	< 250	≤ € 50 m	≤ € 43 m

(Source: European Commission "Entrepreneurship and SMEs: SMEs Definition," EU Internal Market, Industry, Entrepreneurship and SMEs, https://ec.europa.eu/growth/smes/sme-definition_en accessed 21 May 2021)

org/en/topic/smefinance (Accessed 1 May 2021).

2 *Ibid.*

3 Fahrurrozi Muhammad, "Mendukung Kemudahan Berusaha Bagi Usaha Mikro, Kecil, dan Menengah Berbadan Hukum Dengan Gagasan Pendirian Perseroan Terbatas Oleh Pemegang Saham Tunggal". *Jurnal Rechtsvinding: Media Pembinaan Hukum Nasional* 7 (3) (2018): 445-464.

4 Bank Indonesia, "Kajian Inkubator Bisnis dalam rangka Pengembangan UMKM", Kajian dan Publikasi Sektor Riil Bank Indonesia, <http://www.bi.go.id/id/umkm/penelitian/nasional/kajian/Pages/riil6.aspx>. (Accessed 1 May 2021).

5 *Ibid.*

6 Ade Irawan Taufik, "Evaluasi Regulasi Dalam Menciptakan Kemudahan Berusaha Bagi UMKM", *Jurnal Rechtsvinding*, 6 (3) (2017): 369-385.

7 EU Internal Market, Industry, Entrepreneurship and SMEs, "Entrepreneurship and SMEs," *Ibid.*

8 Government Regulation No. 7 of 2021 on Ease, Protection, and Empowerment Cooperation and Micro, Small, and Medium Enterprises. Article 35.

Table 2: MSMEs Criteria In Indonesia

Category	Net Worth	Annual Turnover
Micro	≤ IDR 1.000.000.000	≤ IDR 2.000.000.000
Small	IDR 1.000.000.000 – IDR 5.000.000.000	IDR 2.000.000.000 – IDR 15.000.000.000
Medium	IDR 5.000.000.000 – IDR 10.000.000.000	IDR 15.000.000.000 – IDR 50.000.000.000

(Source: Government Regulation No. 7 of 2021 on Ease, Protection, and Empowerment Cooperation and Micro, Small, and Medium Enterprises. Article 35)

Despite the differences in determining the criteria of MSMEs, they are defined mainly by the amount of capital, asset, or profit.⁹ And while that difference in measures exists, it is not statistically significant in terms of how MSMEs in different countries manage their business.¹⁰

OECD classifies MSMEs and entrepreneurship as similar entities. They share the same purposes: supporting economic growth, creating jobs, and being responsible for social integration.¹¹ European Union, meanwhile, claims

the existence of MSMEs can be an effective way to boost entrepreneurship. MSMEs are different from old-fashioned entrepreneurship patterns.¹² For example, young people are keen to establish a ‘startup’ business without having any capital, experience, or even skillset on the company they are about to run.¹³ Also, the existence of crowdfunding helps MSMEs a lot these days.¹⁴ Unlike old-fashioned entrepreneurship, you do not need specific skills, capital, or products ready to offer.

- 9 There is also an opinion that suggests MSMEs can be classified by the number of employees. However, it is really important to see the bigger picture in defining MSMEs. With the emergence of artificial intelligence and other advanced technology, it is possible for a single person to run a business alone but has profit or asset that goes beyond MSMEs ceiling. Muhammad, “Mendukung Kemudahan”.
- 10 Oya Pinar Ardic, Nataliya Mylenko, Valentina Saltane, “Small and Medium Enterprises: A Cross-Country Analysis with a New Data Set,” The World Bank Policy Research Working Paper 5538, <http://documents1.worldbank.org/curated/en/967301468339577330/pdf/WPS5538.pdf> (Accessed 1 May 2021).
- 11 OECD, “OECD Studies on SMEs and Entrepreneurship”, OECD iLibrary, https://www.oecd-ilibrary.org/industry-and-services/sme-and-entrepreneurship-policy-in-israel-2016_9789264262324-en (Accessed 1 May 2021).
- 12 Growth: Internal Market, Industry, Entrepreneurship and SMEs, “Promoting entrepreneurship” European Union, https://ec.europa.eu/growth/smes/promoting-entrepreneurship_en (Accessed 1 May 2021).
- 13 Stephanie Burns, “No Business? You Can Still Start A Successful Company,” Forbes, <https://www.forbes.com/sites/stephanieburns/2020/04/10/no-business-experience-you-can-still-start-a-successful-company/?sh=1f260fbc26f5> (Accessed 1 May 2021).
- 14 Alma Pekmezovic and Gordon Walker, “The Global Significance of Crowdfunding: Solving the SME Funding Problem and Democratizing Access to Capital (2016). *Wm. and Mary Bus. L. Rev.* 7 (2016): 347., <https://heinonline.org/HOL/LandingPage?handle=hein.journals/wmaybur7and div=14and id=and page=> (Accessed 2 May 2021).

The rise of many “unicorns,” even “decacorns” that came from small-scale businesses first, is not an easy task. Many MSMEs who started from scratch, despite their promising potential, failed to live up to expectations.¹⁵ Hence, in promoting entrepreneurship one must be fully aware of the importance of smaller-scale business characteristics in MSMEs. As such, the effort will not be only limited to helping them sell their products or services but effectively giving them protection by understanding their risks.¹⁶

This paper focuses on the urgency of formalizing MSMEs. However, formalization has various definitions, such as establishing the firm, registering taxpayer numbers, opening a bank account, and obtaining licenses. According to the World Bank EoDB report, in 2020, Indonesia has at least 11 procedures to start a business formally.¹⁷ In this paper, I narrow the definition of formalization

into its first official registration through government agencies.¹⁸

The enactment of Law No. 11 of 2020 on Job Creation or known as ‘Omnibus Law’ makes it essential to use behavioural science as the primary weapon to persuade MSMEs to formalize their business voluntarily. To achieve this, traditional regulatory tools which focus on command-and-control mechanisms, such as coercion, bans, authorizations, punishment, are not relevant.¹⁹ Rangone says that voluntary compliance is the key to motivate people to obey the rules while not necessarily dismissing the traditional tools.²⁰ This paper analyzes key strategies to successfully achieving formalization as per *Omnibus Law* objectives.

B. Research Method

This paper uses the normative juridical method, which focuses on secondary

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- 15 Denise Lee Yohn, “Why Startups Fail,” *Forbes*, <https://www.forbes.com/sites/denisejohn/2019/05/01/why-start-ups-fail/?sh=4f5df53e28a5> (Accessed 2 May 2021). See also Ranjay Gulati and Vasundhara Sawhney, “Why Your Startup Won’t Last,” <https://hbr.org/2019/12/why-your-startup-wont-last> (Accessed 2 May 2021).
 - 16 Jörg Freiling, “SME Management - What Can We Learn from Entrepreneurship Theory?” Available at SSRN: <https://ssrn.com/abstract=984658> or <http://dx.doi.org/10.2139/ssrn.984658> (Accessed 2 May 2021).
 - 17 “Ease of Doing Business in Indonesia,” The World Bank Group, <https://www.doingbusiness.org/en/data/exploreconomies/indonesia> (Accessed 2 May 2021).
 - 18 For example, Limited Liability Company (*Perseroan Terbatas*), Limited Partnership (*Persekutuan Komanditer*), Firm Partnership (*Persekutuan Firma*), and Partnership (*Persekutuan Perdata*) are officially registered after their Deed of Establishment is issued by The Ministry of Law and Human Rights. Although in Indonesian private law, Partnership exists after two founders agree to create it. However, this type of formal registration does not make a company can just instantly run its business. It needs to obtain other business permits such as Certificate of Company Domicile by the Municipal Government, Single Business Number by Online Single Submission, and Taxpayer Numbers by Tax Office. *Ibid*.
 - 19 Alberto Alemanno and Alessandro Spina, “Nudging legally: On the checks and balances of behavioural regulation.” *International Journal of Constitutional Law*, 12(2) (2014), 429–456. doi:10.1093/icon/mou033 (Accessed 2 May 2021).
 - 20 Nicoletta Rangone. “Making Law Effective: Behavioural Insights into Compliance”, *European Journal of Risk Regulation*, 9(3) (2018), 483–501. doi:10.1017/err.2018.51 (Accessed 2 May 2021).

data.²¹ The primary sources of the data in this paper are regulations and other scientific research. The type of research in this paper is qualitative research with a descriptive approach.²² The theory is the behavioural science theorem, particularly the choice architecture and nudge, which was made famous by Richard Thaler and Cass Sunstein. This paper believes that choice architecture and nudge approach can optimize the compliance of Law No. 11 of 2020 on Job Creation, especially in bolstering up MSMEs formalization.

C. Discussions

The protection of MSMEs is a crucial aspect of formalization.²³ Despite their positive contributions and potentials to the economy, they still have a lot of weaknesses. National Development Planning Agency (BAPPENAS) highlights several main problems of MSMEs. First, the low quality of their work owing to low productivity. The main reason for this was the lack of competence in various aspects, such as managerial skills,

technology mastery, and marketing knowledge. Second, limited access to productive resources, particularly capital, technology, information, and markets. Informality caused difficulty in entering the market and expanding their business, classifying them as 'high risk' entities. Hence, banks would not be confident to give them a loan. Third, the unhealthy business climate. In 2013, business permits were far more complex than now, making MSMEs spend a lot of money to obtain those permission. Not to mention the lack of coordination between government agencies caused uncertainty in many ways.²⁴

MSMEs are also vulnerable in certain conditions. The covid-19 outbreak, for example, unlike other previous financial crises, destroyed MSMEs.²⁵ More than 60 million MSMEs in Indonesia were unable to recover through government financing or bank loans, as there are only 12% of them have access to government funding programs.²⁶ In conclusion, about 88% of MSMEs in Indonesia have been unable to get government assistance.²⁷

21 Sri Mamudji *et al.*, *Metode Penelitian dan Penulisan Hukum*, (Jakarta: Badan Penerbit Fakultas Hukum Universitas Indonesia, 2005), Page 6.

22 *Ibid*, Page 4.

23 ASEAN, "Formalisation of Micro Enterprises in ASEAN," ASEAN Policy Insight, <https://asean.org/storage/2012/05/Formalisation-of-Micro-Enterprises-in-ASEAN-POLICY-INSIGHT-2020-final-3.pdf> (Accessed 2 May 2021).

24 "Empowerment of Cooperatives and Micro, Small, and Medium Enterprise," National Development Planning Agency (BAPPENAS), <https://www.bappenas.go.id/files/8913/4986/4554/chapter-20-empowerment-of-cooperatives-and-micro-small-and-medium-enterprise.pdf> (Accessed 2 May 2021).

25 ASEAN, "Formalisation of Micro Enterprises".

26 Esther Samboh, "Bailing out SMEs is not enough. Boosting demand is more important" The Jakarta Post, <https://www.thejakartapost.com/academia/2020/07/17/smes-bailout-not-enough-demand-is-key.html> (Accessed 2 May 2021).

27 However, it is worth pointing out that one of the government assistances for MSMEs, such as Direct-

Since President Joko Widodo started his first term in 2014, one of his main objectives was to improve Indonesia's MSMEs environment. He saw MSMEs as a way of creating jobs or reducing unemployment, but he also wanted MSMEs as a critical cog in helping the export rate from Indonesia.²⁸ He asked his cabinet to get Indonesia into the Top 40 rank of Ease of Doing Business (EoDB) to achieve his ambition.²⁹

The performance of Indonesia in EoDB since President Joko Widodo took over his presidency has produced mixed results so far. On the one hand, to climb up 47 positions from 73rd into 120th shows the promising output.³⁰ On the other hand, Indonesia's performance is still way off

the target from the Top 40 as Joko Widodo had hoped. In addition, Indonesia is still behind other major ASEAN countries in the past five years. In response, President Joko Widodo and the legislators (Dewan Perwakilan Rakyat) decided to enact Law No. 11 of 2020 on Job Creation.³¹ This law amends many business regulations and abolishes many provisions, hoping that it will improve Indonesia's position on EoDB rank significantly and support MSMEs in a broader sense.

1. Formalization Matters

This paper firmly believes that MSMEs' informality has a lot of disadvantages. Loayza et al. argue that informality is businesses, workers, and

Cash-Assistance (*Bantuan Langsung Tunai*), requires several administrative requirements to avoid any kind of fraud or giving money to the wrong people. PR Team Depok, "Kesalahan Utama sehingga Gagal Dapatkan BLT UMKM Rp2,4 Juta," *Pikiran Rakyat Depok*, <https://depok.pikiran-rakyat.com/ekonomi/pr-091224988/kesalahan-utama-sehingga-gagal-dapatkan-blt-umkm-rp24-juta> (Accessed 2 May 2021).

- 28 Sapto Andika Candra, "Jokowi: Permudah Akses Ekspor Untuk UMKM", *Republika*, <https://republika.co.id/berita/qktbhw383/jokowi-permudah-akses-ekspor-untuk-umkm> (Accessed 2 May 2021).
- 29 EoDB is a program by the World Bank Group which measure how easy it is to conduct a business in 190 economies, using 10 indicators. The 10 indicators of EoDB are starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts, and resolving insolvency. High EoDB ranking means the regulatory environment in the country is more conducive to the starting and operation of a local firm. EoDB is exclusively focusing on how local firms operate their business, especially for MSMEs. This means EoDB has nothing to do with foreign investment directly. Hence, EoDB is a really pivotal program to boost MSMEs in Indonesia. Doing Business Team, "Doing Business 2020: Comparing Business Regulation in 190 Economies," The World Bank Group, <https://www.doingbusiness.org/en/reports/global-reports/doing-business-2020> (Accessed 2 May 2021). See also Adrian Wail Akhlaq, "Indonesia remains at 73rd in World Bank's Ease of Doing Business rankings," *The Jakarta Post*, <https://www.thejakartapost.com/news/2019/10/24/indonesia-remains-at-73rd-in-world-banks-ease-of-doing-business-rankings.html> (Accessed 2 May 2021).
- 30 Indonesia's position on EoDB rank since Joko Widodo appointed as President: 120th in 2015, 109th in 2016, 91st in 2017, 72nd in 2018, 73rd in 2019, and 73rd in 2020. Doing Business Team, "Historical Data Sets and Trends Data," The World Bank Group, <https://www.doingbusiness.org/en/custom-query> (Accessed 2 May 2021).
- 31 Cantika Adinda Putri and Herdaru P., "Tok! DPR Sahkan RUU Omnibus Law Cipta Kerja Jadi UU," *CNBC Indonesia*, <https://www.cnbcindonesia.com/news/20201005143138-4-191978/tok-dpr-sahkan-ruu-omnibus-law-cipta-kerja-jokowi-jadi-uu> (Accessed 2 May 2021).

activities outside the legal framework.³² Feige adds that informality includes industries that produce legal goods and services but are not compliant with labour, fiscal, and other administrative laws and regulations.³³

Rand and Torm believe that informal business is generally associated with low profits and productivity, limited credit access, absence of official employment contracts, and workers' little or no social security.³⁴ Contrary to being informal, McKenzie and Sakho suggest that operating formally has a lot of advantages.³⁵ It includes better access to credit, infrastructure, other productive public goods, and a broader customer base.³⁶

By being formal, the MSMEs will have more robust access to finance and higher profit. The benefit of formalization

to the government is in increasing state revenue. Boly finds a significant increase in the amount and likelihood of tax payments, both short and long term, after MSMEs getting formal status.³⁷ These results driven in a substantial rise in paying other taxes, such as license fees, import and export taxes, and property taxes.³⁸

International Labour Organization (ILO) has been campaigning for MSMEs formalization in ILO Recommendation No. 204 concerning the Transition from the Informal to the Formal Economy.³⁹ ILO believes that initiatives will create more and better jobs, reduce poverty and address the marginalization of those especially vulnerable to the most severe decent work deficits in the informal economy.⁴⁰ It will also help to provide them with better working conditions.⁴¹

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- 32 Norman V. Loayza, Luis Servén, and Naotaka Sugawara, "Informality in Latin America and the Caribbean," The World Bank Group. <https://openknowledge.worldbank.org/bitstream/handle/10986/4083/WPS4888.pdf?sequence=1&isAllowed=y> (Accessed 2 May 2021).
- 33 Edgar Feige, "Reflections on the meaning and measurement of Unobserved Economies: What do we really know about the "Shadow Economy"?" (Paper at the 4th Shadow Economy Conference, Tax Administration Research Center (TARC), University of Exeter, UK, 24 July 2015).
- 34 John Rand and Nina Torm, "The Benefits of Formalization: Evidence from Vietnamese Manufacturing SMEs," *World Development*, Vol. 40, No. 5, pp. 983-998, (2012), <https://doi.org/10.1016/j.worlddev.2011.09.004> (Accessed 3 May 2021).
- 35 David McKenzie and Yaye Seynabou Sakho, "Does It Pay Firms To Register For Taxes? The Impact Of Formality On Firm Profitability," *Journal Of Development Economics* 91 (1): 15-24. <http://doi:10.1016/j.jdevco.2009.02.003>. (Accessed 4 May 2021).
- 36 *Ibid.*
- 37 Amadou Boly, "The Effects of Formalization on Small and Medium-Sized Enterprise Tax Payments: Panel Evidence from Vietnam," *Asian Development Review*, 37(1), 140-158. doi:10.1162/adev_a_00144 (Accessed 4 May 2021).
- 38 *Ibid.*
- 39 "Enterprise Formalization," International Labor Organization, https://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/---ifp_seed/documents/publication/wcms_544828.pdf (Accessed 4 May 2021).
- 40 *Ibid.*
- 41 However, Diaz et al. do not necessarily believe that enterprise formalization will always go hand in hand

ASEAN also considers MSMEs formalization as a fundamental aspect to improve their quality.⁴² However, ASEAN goes too far by recommending informal MSMEs to be punished if they do not register their business formally.⁴³ This opinion is the notion I strongly disagree with, as to punish them is entirely against the idea of supporting MSMEs and people's wealth, especially in times of Covid-19 outbreak, when they need more help to maintain their business. Besides, prompting punishment to micro-enterprise will not enforce their discipline but potentially deter their willingness to do business.

MSMEs' size makes it more challenging for them to face costs for the prevention of a pandemic. They also have other problems, such as underutilized labor and capital. They need to adjust their business processes since there is a drastic decrease in demand and revenue caused by consumers' loss of income, fear of infection, and heightened uncertainty.⁴⁴ Without formality, the government will find it harder to assist informal MSMEs

struggling, including access to finance, legal protection, and social safety nets for the business and its workers.⁴⁵

To make MSMEs comply with the regulatory framework regarding formalization, the government must first understand why many MSMEs remain informal. Dabbla-Norris, et al. claim that informality is an involuntary condition brought by excessive regulation and the legal system's weaknesses.⁴⁶ Mukorera adds that the willingness or unwillingness to formalize MSMEs is massively related to institutional imperfections associated with the registration process, lack of access to technology, market, and financial constraints, and lack of entrepreneurial and management skills.⁴⁷

This understanding leads to almost every country, triggered mainly by EoDB ranking, reform its business procedure by reducing cost, strategies, and time to obtain permits, approval, and license to start their business. Law No. 11 of 2020 on Job Creation is the pinnacle of what the President's administration has

with labor formality, and vice versa. Juan Jose Diaz et al., "Pathways to Formalization: Going Beyond the Formality Dichotomy," The World Bank Group, <http://documents1.worldbank.org/curated/en/528901534251354144/pdf/WPS8551.pdf> (Accessed 4 May 2021).

42 ASEAN, "Formalisation of Micro Enterprises".

43 *Ibid.*

44 *Ibid.*

45 *Ibid.*

46 Era Dabla-Norris, Mark Gradstein, and Gabriela Inchauste, "What Causes Firms To Hide Output? The Determinants Of Informality". *Journal Of Development Economics* 2008).27-1 :(2-1) 85) https://econpapers.repec.org/article/eedeveco/v_3a85_3ay_3a2008_3ai_3a1-2_3ap_3a1-27.htm. (Accessed 4 May 2021).

47 S.Z.E. Mukorera, "Willingness To Formalize: A Case Study Of The Informal Micro And Small-Scale Enterprises In Zimbabwe," *Journal of Developmental Entrepreneurship*, 24(01), 1950001. (2019) doi:10.1142/s1084946719500018 (Accessed 4 May 2021).

done in the last five years.⁴⁸ However, it remains to see whether it will finally improve Indonesia's position in EoDB or have the desired outcomes.⁴⁹

Law No. 11 of 2020 on Job Creation may finally remove many obstacles for MSMEs to formalize their business. The government and legislators believe the extreme simplification of the business procedure will lead to increasing numbers of MSMEs, hence creating more jobs and escaping Indonesia from the middle-income trap.⁵⁰

This optimistic mindset is akin to De Soto's belief that these informal businesses operate outside these confusing laws that entail such high costs and complex regulations.⁵¹ Bruhn and McKenzie, however, find that global effort to push MSMEs to formalize their business by drastically removing the obstacles primarily only results in a

modest increase in the number of legal firms.⁵² According to them, most informal interactions do not sense the benefit of formalizing.⁵³ De Mel, McKenzie, and Woodruff suggest that remaining unofficial is often a conscious choice by MSMEs.⁵⁴

2. Behavioural Science as Legal Approach

Bolton states that behavioural science consists of 2 understandings: the behaviour of organisms regarding interhuman stimuli and the conduct of social systems.⁵⁵ Meanwhile, Kappes argues that behavioural science is a term that includes research and methods from several other disciplines from psychology, neuroscience, sociology, behavioural economics, and other fields mixed.⁵⁶ This paper discusses behavioural science as the social study of human behaviour

48 The Law on Job Creation extraordinarily affects 79 existing laws (Undang-Undang), with 52 laws on business license or permit matter being reformed. Also, approximately 1.203 articles from previous laws are amended or removed proportionally to ease MSMEs in running their business. PR Team The Coordinating Ministry of Economics Affairs, "Seputar RUU Cipta Kerja," The Coordinating Ministry of Economics Affairs, <https://ekon.go.id/info-sektoral/15/7/infografis-seputar-ruu-cipta-kerja> (Accessed 4 May 2021).

49 Susi Dwi Harijanti, "Efek Metode Omnibus Law Dalam Undang-Undang Cipta Kerja: Simplifikasi atau Hyper Regulasi?" (The Paper presented on Side Effect of The Omnibus Law Method on Law No. 11 of 2020 on Job Creation, Faculty of Law Universitas Indonesia, 27 March 2021)

50 Cantika Adinda Putri, "Sri Mulyani Buka-Bukaan Soal Manfaat Omnibus Law Bagi Ekonomi" CNBC Indonesia, <https://www.cnbcindonesia.com/news/20201013092856-4-193845/sri-mulyani-buka-bukaan-soal-manfaat-omnibus-law-bagi-ekonomi> (Accessed 4 May 2021).

51 Hernando De Soto, *The Other Path*. (New York: Harper and Row Publishers, 1986). Page 19.

52 Miriam Bruhn and David McKenzie, "Entry Regulation and Formalization of Microenterprises in Developing Countries," Policy Research Working Papers, The World Bank Group, No. 6507 (2013). <https://doi.org/10.1596/1813-9450-6507> (Accessed 5 May 2021).

53 *Ibid.*

54 William Maloney, "Informality revisited," *World Development*, 32(7) (2004): 1159-1178.

55 Charles D. Bolton, "Is Sociology a Behavioural Science?" *The Pacific Sociological Review*, vol. 6, no. 1, 1963, pp. 3-9. *JSTOR*, www.jstor.org/stable/1388293 (Accessed 9 April 2021)

56 Heather Kappes "What Is Behavioural Science at the LSE?" LSE Behavioural Science, 24 May 2016, blogs.lse.ac.uk/behaviouralscience/2016/05/24/what-is-behavioural-science-at-the-lse/. (Accessed 9 April 2021)

that impacts decisions, interactions, and actions.

The term 'behavioural science' gathered its first popularity in 1950.⁵⁷ In 2011, behavioural science got into the spotlight again by Kahneman with his 'Thinking, Fast, and Slow' book.⁵⁸ Behavioural science is a relatively new approach in Indonesian policy-making, let alone in regulation. However, it has been used worldwide, especially in developed countries.⁵⁹

When applied to law, it differs from the traditional regulatory approach and is considered an alternative.⁶⁰ Grundstein thinks that the primary utility of behavioural science if applied to law is its possibility to be applied to legal thinking.⁶¹ Rangone believes that the introduction of behavioural science in the regulatory

making is primarily to achieve the effectiveness of the regulation itself.⁶² It is essential since it targets evidence-based, plain, understandable, and accepted rules.⁶³ Benartzi adds that behavioural findings suggest the possibility of low-cost but has high-impact interventions.⁶⁴ However, Grundstein also alerts us that behavioural science cannot solve every legal problem.⁶⁵

Sunstein argues that behavioural findings have been used in regulatory making in the United States under Executive Order 13563 regarding Improving Regulation and Regulatory Review (2011).⁶⁶ In Section 4, it says:

"Where relevant, feasible, and consistent with regulatory objectives, and to the extent permitted by law, each agency shall identify and consider regulatory

57 Bolton, "Is Sociology a Behavioural Science?"

58 In his book, Kahneman tells that when human beings make a choice, it is riddled with behavioural fallacies, which often leads to an irrational choice. Kahneman highlights that the human brain consists of 2 systems when making decisions: System 1 where the brain works automatic, intuitive, and unconscious. It works spontaneously and requires little energy or attention, but it is often to be biased. Meanwhile, system 2 is slow, controlled, and analytical thinking. Unlike system 1, it requires energy and attention to think through all the choices. It reduces bias, yet it is often to be irrational. Daniel Kahneman, *Thinking, Fast And Slow* (New York: Macmillan, 2011). See also: Marek Kohn, "Thinking, Fast and Slow, By Daniel Kahneman," *The Independent*, <https://www.independent.co.uk/arts-entertainment/books/reviews/thinking-fast-and-slow-daniel-kahneman-6263560.html> (Accessed 9 April 2021)

59 The Mind, Behaviour, and Development Unit (eMBeD), "Behavioural Science Around The World: Profiles of 10 Countries," *The World Bank Group* <http://documents1.worldbank.org/curated/en/710771543609067500/pdf/132610-REVISED-00-COUNTRY-PROFILES-dig.pdf> (Accessed 9 April 2021)

60 Glen Hepburn, "Alternative To Traditional Regulation," *OECD* <https://www.oecd.org/gov/regulatory-policy/42245468.pdf> (Accessed 9 April 2021)

61 Nathan D. Grundstein, "The Relevance of Behavioural Science For Law," *Case Western Reserve Law Review*. 19 87 :(1967).

62 Rangone. "Making Law Effective:"

63 *Ibid.*

64 Shlomo Benartzi, et al., "Should governments invest more in nudging?," *Psychological science* 28, no. 8 1055-1041 :(2017).

65 Grundstein, "The Relevance of Behavioural"

66 Cass R. Sunstein, *Simpler* (New York: Simon and Schuster: 2013). Page 16.

approaches that reduce burdens and maintain flexibility and freedom of choice for the public. These approaches include warnings, appropriate default rules, and disclosure requirements as well as provision of information to the public in a form that is clear and intelligible.”⁶⁷

The phrase “...reduce burdens and maintain flexibility and freedom of choice for the public” is the key to implementing the law using behavioural science. Moreover, Executive Order 13707 regarding Using Behavioural Science Insights to Better Serve the American People (2015) is even more explicit, as you can see from its title.⁶⁸

One of the most known regulations constructed using behavioural science was the Affordable Care Act (2010), known as Obama Care.⁶⁹ This regulation was enacted even before those 2 Executive Orders, suggesting that behavioural science was already accepted as a method in the regulatory making and has had an essential role in constructing important laws ever since.⁷⁰

Those Executive Orders are an obvious example that Indonesian legislators can learn from the United States. Both instruments focused on giving a choice to the people rather than using force. The legislators can also implement behavioural science across many regulations in every aspect of governance in Indonesia. Not only rules concerning public service *per se*, but also for other issues as well, including but not limited to economic growth, healthcare, and criminal justice.⁷¹ Moreover, behavioural science is profoundly used in many sectors to combat the Covid-19 pandemic,⁷² as not everyone, especially the private sectors, has the authority and resources to enforce their rules.

a. Realigning People’s Choice with Nudge

One of the most potent tools in behavioural science is ‘nudge.’ This ‘Nudge’ or ‘nudge theory’ was presented by Thaler and Sunstein in 2008.⁷³ A nudge

67 Office of the Press Secretary, “ Executive Order 13563 - Improving Regulation and Regulatory Review,” The White House <https://obamawhitehouse.archives.gov/the-press-office/2011/01/18/executive-order-13563-improving-regulation-and-regulatory-review> (Accessed 10 April 2021)

68 Office of the Press Secretary, “ Executive Order 13707 - Using Behavioural Science Insights to Better Serve the American People,” The White House <https://obamawhitehouse.archives.gov/the-press-office/2015/09/15/executive-order-using-behavioural-science-insights-better-serve-american> (Accessed 10 April 2021)

69 Cass R. Sunstein, *Simpler*

70 Cass R. Sunstein, *Behavioural Science and Public Policy*. (Cambridge: Cambridge University Press, 2020). Page 13

71 *Ibid.*

72 *Ibid.* Page 22.

73 In his review, Leonard says Nudge is a manifesto for the new paternalism. He considers the book as well written, witty to the point of being charming, consistently interesting, disarmingly self-referential, and loaded with crisp summaries of the psychology literature on human fallibility. Thomas C. Leonard, “Richard H. Thaler, Cass R. Sunstein, Nudge: Improving Decisions About Health, Wealth, and Happiness.” *Constitutional*

is an intervention that affects people's behaviour while fully maintaining their freedom of choice.⁷⁴ Nudge is about how people make choices and how people can make better decisions on many things.⁷⁵

The idea of nudge is vital because people, whenever presented with options, often choose poorly.⁷⁶ Besides, no choice is ever neutrally presented, and people are susceptible to biases that can lead to poor decisions. By knowing how people think and behave, the government can use sensible "choice architecture"⁷⁷ to nudge people toward the best decisions for themselves, their families, and society without restricting our freedom of choice.⁷⁸

The critical element of nudge is that it does not coerce people to do certain things, and it is easy to choose other options (opt-out). For example, the distanced queue marker during the Covid-19 pandemic is a form of a

nudge, so people will follow physical distancing rules, even though they can stand everywhere beyond that marker.⁷⁹ There is no punishment if people decide to stand outside of it. This marker is the proper use of nudge because that marker aims to protect people from Covid-19 infection. The essence of nudge is to intervene with people to make better decisions objectively. Nudge is contrast with oppressive order, and it is a practical way to 'softly' tell people what to do without telling them what to do. In the end, the choice is theirs.⁸⁰

b. Shove as an Additional Tool

Another tool of behavioural science is a key to regulatory reform called 'shove.' As its name suggested, a shove is more complicated or more forceful than a nudge,⁸¹ but it shares the same basic principle of influencing people's choice

Political Economy 19.4 (2008): 356–360.

74 Richard H. Thaler and Cass R. Sunstein, *Nudge: Improving Decisions about Health, Wealth, and Happiness* (New Haven: Yale University Press, 2008)

75 *Ibid.*

76 *Ibid.*

77 Choice architecture is a method to of creating situations where people presented with options while maintaining their right to choose, but that options are presented in certain way to nudge people to make certain choices. *Ibid.*

78 *Ibid.*

79 Cass R. Sunstein, *Behavioural Science and Public Policy*.

80 Another example of nudge is the table manner rules where the utensils are placed accordingly. They put the knife and spoon on the right plate so people will use it with their right hand, and the fork on the left so people will use their left hand. But people actually can reject this idea easily and do the complete opposite, despite it seems inappropriate. This is a fine example of nudging even long before the publication of nudge theory, which has existed since the 18th century. Virginia Clark, "The ritual of table setting: its historical significance and cultural importance," House and Garden <https://www.houseandgarden.co.uk/gallery/table-setting> (Accessed 11 April 2021).

81 Adam Oliver, "Nudging, Shoving And Budging: Behavioural Economic-Informed Policy," *Public Administration*, 93 (3) (2015). pp. 700-714.

using the intervention.⁸² For example, if a nudge is about giving information and giving direction to do something, a shove is more blatant by giving the threatening message that you will get the consequences if you do not do this. Conly states that shoving sometimes can limit people's choices using coercive measures and bans for their excellence.⁸³ In this regard, the shove is different from nudging, which always campaigning for freedom of choice.

Conly states a shove is necessary because, in the end, people make bad choices, and a nudge is not enough.⁸⁴ Conly thinks that mandates are necessary and desirable because people make mistakes.⁸⁵ A shove shares similar values with traditional legal tools. As suggested by Sunstein, some issues such as violent crimes and tax compliance, for example, cannot be solved using nudges.⁸⁶

The UK Behavioural Insight Team (UK) also considers the effectiveness of shove. They believe that both nudge and shove can be effective.⁸⁷ However, they fully understand that they both often have

different cost-benefit profiles.⁸⁸ A nudge tends to be simple, cheap to implement, but has minor effects. In contrast, a shove tends to be complicated, expensive, and has more potential effects while also carrying more significant risks of failure.⁸⁹ Sunstein might agree with the statement that nudge is cheaper, but he will reject the notion that nudge can only have a negligible effect, as he believes nudge can have a higher benefit than a shove.⁹⁰

The BIT uses shove in their behaviourally-based policies, and Sunstein also agrees that shove is vital in certain aspects. However, Ubel states that a shove is not always the necessary answer when a nudge does not work.⁹¹ Besides, shove is a common practice in Indonesian regulations, which means that when a law that uses a deterrence approach fails to regulate as its wish, it shows the weakness of shove. The high number of traffic violations in Indonesia is an example of the failure of shove.

82 *Ibid.*

83 Sarah Conly, *Against Autonomy: Justifying Coercive Paternalism* (Cambridge: Cambridge University Press, 2013). Page 8.

84 *Ibid.*

85 *Ibid.*

86 Cass R. Sunstein, *Behavioural Science and Public Policy*.

87 Matt Barnard, "What's Better? A Nudge or A Shove?" UK Behavioural Insight Team <https://www.bi.team/blogs/whats-better-a-nudge-or-a-shove/> (Accessed 12 April 2021)

88 *Ibid.*

89 *Ibid.*

90 Cass R. Sunstein, *Behavioural Science and Public Policy*.

91 Peter Ubel, "Behavioural Economic Interventions - It's Not A Choice Between Nudges And Shoves," *Forbes* <https://www.forbes.com/sites/peterubel/2019/09/16/behavioural-economic-interventions-its-not-a-choice-between-nudges-and-shoves/?sh=47bbaef01abb> (Accessed 12 April 2021)

3. Key Strategies

Regarding MSMEs' decision to remain informal or choose to become formal, the government must understand the cognitive aspect in determining whether the MSMEs think they should be formalized or not. Their conscious decision to remain informal is resulted by their mental process, which influences the decision. As stated above, formal business is much better than informal, and the government must arrange regulation with strategies to convince them or 'intervene' their choice.⁹²

a. Removing Unimportant Procedures with Simplification

It is still necessary to reduce and remove unnecessary steps to formalization. The government must make it easy, quick, and affordable to get formal status, especially those who do not deliberately avoid formalization.⁹³ As suggested by De Soto, some MSMEs may

become reluctant to be formalized thanks to complex administrative procedures and associated costs.

Law No. 11 of 2020 on Job Creation, that removes many business licenses, is a form of simplification. However, simplifying is not limited to reducing procedure, because with the rise of online public service platforms across agencies, the system integration becomes critical in this aspect, especially with the privat sector. Many people become MSMEs simply by opening an online marketplace account (online shop) and selling their stuff⁹⁴. Especially with the Covid-19 protocol that limiting people to meet up and have transactions face to face, the rise of online sellers is increasing.⁹⁵ The reason is, starting a business using online platforms such as Tokopedia, Shopee, and other national or even international platforms is very simple and can be used within minutes without hassle.⁹⁶

The government must work together with these private sectors when people

92 WHO Technical Advisory Group On Behavioural Insights And Sciences For Health, "Behavioural considerations for acceptance and uptake of COVID-19 Vaccines," World Health Organization. <https://apps.who.int/iris/handle/10665/337335> (Accessed 13 April 2021)

93 *Ibid.*

94 *Ibid.*

95 Survei Angkatan Kerja Nasional (Sakernas) 2019, menunjukkan jumlah penjual barang melalui internet mencapai 15 juta orang atau 12 persen dari total pekerja Indonesia secara keseluruhan. See Islahuddin and Nanang Syaifudin, "Pedagang online panen di masa Korona" Lokadata.ID <https://lokadata.id/artikel/pedagang-online-panen-di-masa-korona> (Accessed 13 April 2021). See also Emir Yanwardhana, "Pandemi Bikin Banyak Orang Mendadak Jadi Pedagang Online," CNBC Indonesia <https://www.cnbcindonesia.com/news/20210305160333-4-228169/pandemi-bikin-banyak-orang-mendadak-jadi-pedagang-online> (Accessed 13 April 2021)

96 I checked and observed the procedures to start selling at Indonesia's most famous online marketplaces namely "Tokopedia" and "Shopee". From my observation, it is obvious that to start selling at both marketplaces are easy, quick, and very simple. See "Mulai Berjualan," Tokopedia <https://seller.tokopedia.com/edu/mulai-berjualan/> (Accessed 13 April 2021), see also "Seller Education Hub," Shopee <https://seller.shopee.co.id/edu/article/464> (Accessed 13 April 2021)

start opening their marketplace accounts. They are being formalized by default and registered as a business entity.⁹⁷ That way, these MSMEs will automatically become formal once they open their online account.

The government also still needs to accommodate the technology illiterate people. Therefore, it is also essential to consider other factors such as 'when' and 'where' to formalize. As millennials mostly dominate the internet,⁹⁸ the older generation, especially those who live in areas with poor internet signal strength, are having difficulties accessing the website. The use of internet is why the government must respond by physically providing formalization access, either using booth, or standing in readily accessible and convenient locations near MSMEs activity. This accessibility does not mean the formalization process is back to manual format, but there are officers employed there to assist those MSMEs in formalizing themselves or guiding them.

b. Delivering Effective Information

To maximize simplification, the government must give clear information, especially the advantages of formalization to MSMEs. The government needs to increase individual motivation through open and transparent dialogues, communication about the advantages of formality, and the risks of informality. They also need to highlight the security aspect of being formal and assure the government's potential assistance or support, especially during the pandemic.

Some MSMEs may be hesitant toward formality because they believe that the process is complicated, expensive, and even involved bribery.⁹⁹ They also believe that their current informal state is better, safer, and they do not need to burden themselves with corporate administrative tools such as a balance sheet.¹⁰⁰

The information published by the government must also picture several vital aspects: the data is timely given, easy to understand, the information is relevant to what they are supposed to do, how they are supposed to do it, and how

97 'Default' in this case is a powerful tool of nudge. For example, when people buy a new cellphone they tend not to change majority of its settings including wallpaper, ringtones, and other appearances. Thaler and Sunstein, *Nudge*.

98 See "Statistik Telekomunikasi Indonesia 2018" Biro Pusat Statistik Indonesia <https://www.bps.go.id/publication/2019/12/02/6799f23db22e9bdcf52c8e03/statistik-telekomunikasi-indonesia-2018.html> (Accessed 14 April 2021). See also "BPS Sebut Indeks Pembangunan Teknologi RI Rendah," CNN Indonesia <https://www.cnnindonesia.com/ekonomi/20181217131013-92-354254/bps-sebut-indeks-pembangunan-teknologi-ri-rendah> (Accessed 14 April 2021)

99 De Soto, *The Other Path*.

100 Rahul Kumawat, "Making Balance Sheet Needs Expertise And Takes Time," India Times <https://economictimes.indiatimes.com/small-biz/sme-sector/it-matters-why-the-balance-sheet-is-important-for-smes/articleshow/56351603.cms?from=mdr> (Accessed 14 April 2021)

they might benefit. The information must also address the right target and use the appropriate strategy.¹⁰¹ For example, if the government wants to inform older generations who are unfamiliar with technology, the online campaign is not the correct way to tell them. Also, the public campaign on expensive places like hotels, and restaurants, do not suit Micro-Entrepreneurs with low income who are not profoundly familiar with those places.

c. Social Influences to Imitate Behaviour

There is a high probability that people will follow other people's behaviour. This theory is known as Social Learning Theory, presented by Albert Bandura.¹⁰² According to Bandura, people perform their behaviour after observing, modelling, and imitating the behaviours, attitudes, and emotional reactions.¹⁰³ In short, people have a strong tendency to follow other people's behaviour. The government can put its influence on this.

The government must be fully aware of this social influence and use it properly and ethically. Many entrepreneurs will

follow if a trusted figure or community does the formalization. Prominent MSMEs figures or communities must set an example of formalizing their business. Hence, more MSMEs will follow this action. This influence is also effective in speeding up Covid-19 vaccination in Indonesia, and it is proven to be fruitful.¹⁰⁴

To successfully implementing those key strategies, the government must also consider the availability of resources in the first place. Indeed, nudging is affordable than shoving or other traditional law tools. However, still, it needs time, effort, and energy to work swiftly. The government must focus on informing benefits, advantages, and incentives of formalization, not using threatening or coercive messages.

This paper completely dismisses the idea of using force or punishment when it comes to MSMEs' formalization. Because basically, they are susceptible to financial loss and failure. Threatening them with criminal punishment would cause them more hesitant to conduct any kind of business because of the potential sanction. This would have a detrimental

101 S.F. Slater, G.T.M. Hult, and E.M. Olson, "On the importance of matching strategic behaviour and target market selection to business strategy in high-tech markets," *J. of the Acad. Mark. Sci.* **35**, 5–17 (2007). <https://doi.org/10.1007/s11747-006-0002-4> (Accessed 15 April 2021)

102 Albert Bandura "Social-learning theory of identificatory processes." *Handbook of socialization theory and research* 213 (1969): 262

103 *Ibid.*

104 To encourage people to use vaccine, the government need to harness social influences from trusted community figures. Showing that health professionals, politicians are being vaccinated can lead to greater acceptance and uptake by the general population. Amplifying endorsements from trusted community members can also help. See: WHO Technical Advisory Group On Behavioural Insights And Sciences For Health, "Behavioural Considerations".

effect on Indonesia's economy which heavily relies on MSMEs. In addition, with more than 90% informality, the resources to enforce mandatory formality will be massive. However, for other aspects of business such as tax avoidance, environmental issue, fraud, and other crimes (not a small one) committed by MSMEs can use shove as an alternative to nudge. As Rangone says, the behavioural approach in the regulatory making, or cognitive-based regulation, should mix traditional and new tools to make it more compliant with the law, provide better justice, and protect society.¹⁰⁵

D. Conclusion

Operating formally has a lot of advantages for MSMEs. It provides better access to credit, infrastructure, and other productive public goods and a broader market. Therefore, from the employment perspective, the formalization of MSMEs will have a lot of benefits as well. Meanwhile, MSMEs' informality is not only an involuntary situation where MSMEs are having difficulty formalizing due to excessive regulations, complex procedures, time-consuming, and expensive costs; remaining unofficial is often a cognitive-based and conscious choice. Most informal businesses do not sense the benefit of formality.

Law No. 11 of 2020 on Job Creation can use a behavioural approach to enforce

its implementation. It is still necessary to reduce and remove unimportant procedures of formalization. The process to become formal must be easy, quick, and affordable. It is also essential to create an integrated system between government agencies and private sectors to avoid repetitive processes. The government must inform MSMEs of the advantages of formality and the risks of informality since many MSMEs may be hesitant toward being formal because they believe the process is complicated and costly. The government must also engage with prominent MSMEs figures to perform the formalization of their business. Hence, more MSMEs will follow this action.

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Curriculum Vitae of the Author

Fahrurozi is a legislative drafter at Directorate General for Legal Administrative Affairs, the Ministry of Law and Human Rights Republic of Indonesia. He is actively involved in creating various regulations from economic, public, private, to international matters related to the task and function of his unit. Besides working as a civil servant, Fahrurozi also actively gives lectures in several universities, speaks in multiple events, and writes in various mass media. Graduated from the Faculty of Law Universitas Indonesia with bachelor and master's degrees, he is also a co-founder of Governance and Law Society (GoALS).