SUMMARY POVERTY REDUCTION AND SOCIAL STRATEGY

Country: Indonesia
Project Title: Competitiveness, Industrial Modernization, and Trade Acceleration Program, Subprogram 2
Lending/Financing Modality: Policy-Based Loan
Department/Division: Sectors Group

I. POVERTY AND SOCIAL ANALYSIS AND STRATEGY

Poverty targeting: General intervention. The program aims to reduce poverty by providing an enabling business environment to raise incomes. It will (i) reduce the costs of doing business, which will primarily benefit micro, small, and medium-sized enterprises (MSMEs); (ii) support formalization of informal firms, particularly in the tradeable sector; and (iii) increase private business investment.

A. Links to the National Poverty Reduction and Inclusive Growth Strategy and Country Partnership Strategy

To meet Indonesia’s development targets and continue the recovery from the coronavirus disease (COVID-19) pandemic, a structural transformation of the economy is essential. Manufacturing needs to be revitalized so it can provide quality jobs and higher wages, which can in turn support the expansion of the middle class. The Government of Indonesia’s National Medium-Term Development Plan, 2020–2024 (RPJMN) seeks to strengthen economic resilience in support of quality growth. It targets gross domestic product (GDP) growth of 5.4%–6.0% per year through 2024, and a reduction in poverty incidence from 9.2% in 2019 to 6.5%–7.0% in 2024. In addition, the RPJMN will promote development across regions of Indonesia to reduce disparities and provide equal opportunities for citizens, strengthen human capital development to promote employment and competitiveness, and improve disaster preparedness and climate change resilience. The government has also undertaken structural reforms to promote investments through the Job Creation Law, as well as through other legal and regulatory changes. Targeting more inclusive and environmentally sustainable growth, the Asian Development Bank (ADB) country partnership strategy (CPS) for Indonesia, 2020–2024 is closely aligned with the RPJMN’s goals. Under the CPS, ADB’s resources will focus on (i) improving well-being, including the development of workforce skills; (ii) accelerating economic recovery including support for economic policy and structural reforms; and (iii) strengthening resilience. The CPS emphasizes the structural transformation of the economy, productive capacity expansion, and human capital development to improve Indonesia’s global competitiveness. The Competitiveness, Industrial Modernization, and TradeAcceleration Program is a comprehensive intervention that is fully aligned with the RPJMN and intersects with the CPS through its first two pillars.

B. Results from the Poverty and Social Analysis during Project Preparatory TA or Due Diligence

1. Key poverty and social issues. Key economic and social indicators have regained their pre-pandemic levels. Gross domestic product (GDP) contracted by 2.1% in 2020 but grew by 3.7% in 2021 and 5.3% in 2022, bringing output to about 7% greater than in 2019. After losing the classification of upper middle income in 2021, Indonesia regained it in 2023. The unemployment rate increased from 5.3% in 2019 to 7.1% in 2020 but has since declined to 5.9% in 2022. At 9.5%, the poverty rate in 2022 is also close to its pre-pandemic level. Furthermore, there is ample policy space to respond to future shocks. The 2022 fiscal deficit was 2.4% of GDP, a year ahead of the scheduled return to the 3.0% deficit ceiling and is projected to remain well below the ceiling in 2023. Public debt was 39% of GDP in 2022, compared with 41% of GDP in 2021. Sovereign credit ratings are stable and external debt is deemed to be sustainable. However, inflation is expected to rise significantly, hurting the purchasing power of households. Facilitating new investments to expand job opportunities would support efforts to reduce poverty. In addition, formalizing informal MSMEs would allow the government to better target support to those enterprises.

2. Beneficiaries. Business owners and investors will benefit from a more welcoming investment environment, a streamlined and more efficient regulatory framework, lower costs and greater efficiencies, and an improved business climate. Indirect beneficiaries will include the labor force and Indonesian citizens, who will benefit from job creation, wage increases, infrastructure investment, and improved service delivery. Wages in tradeable sectors are likely to increase as manufacturing moves towards more sophisticated export products.

3. Impact channels. Improving Indonesia’s investment climate will help reduce poverty. Actions to make doing business easier are correlated with reductions in poverty incidence. Improving the investment climate for labor-intensive industries and MSMEs will help create jobs. An increase in exports and greater participation of MSMEs in global value chains will also support productivity growth and encourage wage growth. Higher value-added production will increase the demand for skilled labor. Finally, improving the investment climate will indirectly help expand and improve infrastructure, which will narrow income disparities. ADB has found that faster-growing middle-income countries have higher levels of infrastructure investment than those of their peers. These findings suggest that infrastructure development can reduce poverty and make growth more inclusive.
4. Other social and poverty issues. Public awareness of the reforms aimed at easing barriers to entry and facilitating growth will be essential for entrepreneurs and MSMEs to take advantage of the program’s reforms.
5. Design features. The program supports the creation of new firms, growth of old firms, and incentives for MSMEs. These reforms should attract entrepreneurs and new entrants to the labor market to start their own businesses. Such measures will also help with job creation and productive employment opportunities for youth in Indonesia, which has elevated youth unemployment and underemployment.

II. PARTICIPATION AND EMPOWERING THE POOR

1. Participatory approaches and project activities. As part of the program preparation, consultations were held with the government. The program used the government’s consultation and participation processes to engage with a wide range of stakeholders, such as private sector associations and industry representatives (automotive and electronics).

2. Civil society organizations. The program supports government processes to engage with various civil society stakeholders, including nongovernment organizations, and the Indonesian Chamber of Commerce and Industry.

3. Civil society organization participation during implementation: Information gathering and sharing (L), Consultation (L), Collaboration (L), Partnership (N)

5. Participation plan. Yes. No, the program supports government consultation and participation processes, and the Indonesian Chamber of Commerce and Industry, which will be involved in program monitoring

III. GENDER AND DEVELOPMENT

Gender mainstreaming category: effective gender mainstreaming

1. Key issues. Based on data from the Ministry of Cooperatives and SMEs, Indonesia had 64.2 million business units in 2018, of which 99.9% were MSMEs. Microenterprises make up 98.7% of the total number, while 1.2% are small enterprises, and 0.09% are medium-sized enterprises. Only a fraction of these SMEs—0.26%—have obtained a government contract. The figure is estimated to be much lower for MSMEs owned by women as they generally have less access to financial resources. Presidential Regulation Number 12 of 2021 has set a minimum of 40% of government procurement spending on MSMEs and cooperative domestic products. Data of cooperatives and MSMES, including women-owned businesses (WOBs), are still disorganized and have not been standardized. This has made empowerment programs for cooperatives and MSMEs ineffective. The Ministry of Cooperatives and SMEs, in collaboration with Statistics Indonesia (BPS) and supported by the Ministry of National Development Planning (BAPPENAS), is conducting the Complete Data Collection on Cooperatives, Micro, Small and Medium Enterprises (PL-KUMKM) in 2022–2024. The National Public Procurement Agency (NPPA) is also aligning with the regulatory commitment to spend 40% of public procurement to support local cooperatives and MSMEs, including WOBs. With data still being collected, NPPA must identify entry points for gender-responsive procurement that can be adopted and implemented in the public procurement process. In addition, NPPA also needs to build the awareness of stakeholders on WOBs in government procurement.

2. Key actions. The program includes (i) implementation of a program to support the participation of WOBs in government procurement, which includes gender-responsive procurement training and annual reporting on and identifying areas for strengthening of WOB participation in government procurement; (ii) establishment of an interministerial committee, chaired by the minister of cooperatives and SMEs and committee members including the minister of women empowerment and child protection; to improve the delivery of government services to enterprises; and (iii) development of an integrated MSME system, with sex-disaggregated data, for monitoring and reporting on the performance of WOBs. These will lead to the availability of sex-disaggregated supplier information and the incentivization of MSMEs (of which 30% are WOBs) to participate in global value chains in subprogram 3.

IV. ADDRESSING SOCIAL SAFEGUARD ISSUES

A. Involuntary Resettlement

Safeguard Category: A, B, C, FI

1. Key impacts. Based on an assessment of the proposed policy actions, the program will not entail involuntary land acquisition resulting in physical or economic displacement of people.

2. Strategy to address the impacts. Not applicable.

3. Plan or other Actions.

- Resettlement plan
- Resettlement framework
- Environmental and social management system arrangement
- No action

- Combined resettlement and indigenous peoples plan
- Combined resettlement framework and indigenous peoples planning framework
- Social impact matrix

B. Indigenous Peoples

Safeguard Category: A, B, C, FI

1. Key impacts. Assessment of policy actions indicate the program will not impact indigenous communities. Is broad community support triggered? Yes, No

2. Strategy to address the impacts. Not applicable.
3. Plan or other actions.

- Indigenous peoples plan
- Indigenous peoples planning framework
- Environmental and social management system arrangement
- Social impact matrix
- No action

Combined resettlement plan and indigenous peoples plan
Combined resettlement framework and indigenous peoples planning framework
Indigenous peoples plan elements integrated in project with a summary

V. ADDRESSING OTHER SOCIAL RISKS

A. Risks in the Labor Market

1. Relevance of the project for the country’s or region’s or sector’s labor market, indicated as high (H), medium (M), and low or not significant (L).

- unemployment (L)
- underemployment (L)
- retrenchment (L)
- core labor standards (L)

2. Labor market impact. A positive impact is expected for both informal and formal workers. Reskilling programs will also help unemployed workers reenter employment, while wages in the tradeable sector will increase.

B. Affordability

Not applicable.

C. Communicable Diseases and Other Social Risks

1. The impact of the following risks:

- Communicable diseases (M)
- Human trafficking (NA)
- Others (NA)

This program will strengthen the capacity of the government to tackle the impact of public health crises such as the COVID-19 pandemic. Reform area 1 enables the provision of quality and affordable health care, while reform area 3 focuses on providing income protection from job losses and strengthening of support in enterprise development.

2. Risks to people in project area. Not applicable.

VI. MONITORING AND EVALUATION

1. Targets and indicators. These include:

(i) foreign direct investment increased to $30 billion per year in 2026 from $25 billion in 2019,
(ii) manufacturing exports increased to $183.4 billion in 2026 from $115.7 billion in 2019, and
(iii) MSMEs’ output increased to 65% of GDP in 2026 from 57% in 2019.

2. Required human resources. A multisector team from the Public Sector Management and Governance Sector Office and Southeast Asia Department designed the program. Additional technical assistance has been mobilized to ensure the timely and effective implementation and monitoring of the program’s social- and gender-related design features and to assess related impacts. The government will also monitor implementation of its measures and provide data to the ADB team.

3. Information in the project administration manual. Not required for this program since no project is included.

4. Monitoring tools. National datasets from the Ministry of Finance, other line ministries, and BPS.

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*f* BPS. 2021. *Menuju Satu Data KUMKM yang Valid dan Reliabel (Towards One Valid and Reliable Data on Cooperatives and MSMEs).* Jakarta.