PENSION REFORM EXPERIENCE IN INDONESIA

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List of Abbreviations and Acronyms

Asabri	PT. ASABRI (Persero)
Askes	PT. Asuransi Kesehatan Indonesia (Persero) / Asuransi Kesehatan (Health Insurance Program)
Bapepam-LK	Capital Market and Financial Institution Supervisory Agency, Ministry of Finance
BAPPENAS	Ministry of National Development Planning / National Development Planning Agency
BI	Bank of Indonesia
BKN	National Civil Service Agency
BPJS	Social Security Administrative Bodies
BPJS Kesehatan	Social Security Administrative Body for SJSN Health Program
BPJS Ketenagakerjaan	Social Security Administrative Body for SJSN Employment Programs
BPK	State Financial Audit Board
BUMN	State Owned Enterprise
CS	Civil Service
CSP	Civil Service Pension
DB	Defined Benefit
DC	Defined Contributions (also IA: Individual accounts)
DJSN	National Social Security Council
DR	Dependency Ratio
DPPK / EPF	Employer Pension Funds
DPLK / FIPF	Financial Institution Pension Fund
GDP	Gross Domestic Product
GOI	Government of Indonesia
ILO	International Labor Organizations
Jamsostek	PT. Jaminan Sosial Tenaga Kerja (Persero)
JKK	Work-accident program
JKm	Death benefit program
JK	Health program
JP	Pension program
JHT	Old Age Savings program
Kemenakertrans / MOMT	Ministry of Manpower and Transmigration
Kemenkeu / MOF	Ministry of Finance
Kemenko Kesra	Coordinating Ministry for People's Welfare
Kemenpan-BR	State Ministry for State Apparatus and Bureaucracy Reform
KMK	Decree from Minister of Finance
LAN	State Administrative Agency
LPCM	Level Percentage Contribution Method
NDC	Notional Defined Contributions
PAYG/Paygo	Pay-as-you-go
Pejabat Negara	State official
Persero	Profit oriented SOE with share capital from GOI

Rp	Rupiah (In January 7th, 2013 Rp 9650 per US$)
RR	Replacement Ratio
RUPS	Shareholders meeting
SJSN	National Social Security System
Taspen	PT. Tabungan Asuransi Pensiun (Persero)
SOE	State Owned Enterprise
THT	Endowment Savings Program
WB	World Bank
Yayasan	A form of nonprofit foundation under the civil code

I. Introduction

The Government of Indonesia ("government" or "GOI") will implement a new National Social Security System (referred as *Sistem Jaminan Sosial Nasional* or SJSN) over the course of the next three years that, when fully implemented, will radically transform the structure of social security system in Indonesia. The legal bases for these changes are Law No. 40/2004 on National Social Security System (referred as SJSN law) and Law No. 24/2011 on Social Security Administrative Bodies (referred as *Badan Penyelenggara Jaminan Sosial* or BPJS law).

The SJSN law was enacted in 2004 and creates five national social security programs – a health program and four employment programs (work accident, old-age savings, pension, death benefits) that will eventually cover all Indonesians, including formal and informal sector workers, and provide the same benefits for all. The BPJS will be responsible for collecting contributions from workers, employers and the government in order to finance promised benefits and contributions will be placed in separate social insurance funds for each program. Formal sector workers and their employers will make contributions as a percent of wages, informal sector workers will contribute a flat amount in rupiah and the government will make contributions for the poor that will also be a flat amount in rupiah.

The enactment of BPJS law on November 25, 2011 marked the end of a long debate regarding the administration of the SJSN programs and clears the way for the design and implementation of SJSN programs. The BPJS Law mandates the establishment of BPJS Kesehatan (BPJS Health) for administering the SJSN health program and BPJS Ketenagakerjaan (BPJS Employment) for administering the SJSN employment programs. It transforms the current administrators, PT Askes and PT Jamsostek, from state owned enterprises to BPJS Kesehatan and BPJS Ketenagakerjaan respectively, and changes their legal form to public legal entities. By law, the BPJS should start their operations on January 1, 2014. BPJS Kesehatan should start offering the SJSN health program on January 1, 2014 while BPJS Ketenagakerjaan should start offering the SJSN employment programs on July 1, 2015.

While the enactment of the BPJS law is a significant step in the implementation of SJSN, much work remains to be done. Since the enactment of BPJS law, the government has been working on a roadmap that will provide guidance for the implementation of BPJS and SJSN programs. The roadmap for the implementation of BPJS Kesehatan and the SJSN health program was launched in December 2012, while the roadmap for the implementation of BPJS Ketenagakerjaan and the SJSN employment programs is expected to be launched and finalized in 2013.

This paper will discuss the effects of the implementation of the SJSN and BPJS laws on the Indonesian pension system. To understand the purpose and effect of the SJSN implementation, this paper will also give a brief overview of the current programs as well as their challenges, a brief overview of the SJSN law and the BPJS law, key features of future SJSN programs, potential issues for its implementation and key required actions for reform.

This paper is prepared based on the SJSN law, BPJS law and discussions with the roadmap team and several members of the government who are currently responsible for the implementation of the SJSN system. Although this paper discuss critical issues and possible implementation actions, the implementation remains at an early stage and much more work remains.

This report will primarily focus on the two retirement programs only (pension and old age savings programs). Other programs covered by the existing system and the SJSN system, such as health, work-accident and death benefits may be briefly mentioned but will not be included in the discussion in later sections of this report.

II. Analysis of Current Pension Systems in Indonesia

2.1 HISTORICAL CONTEXT

Pension programs were offered to civil servants during the Dutch occupation period and were re-affirmed in 1956 when the President enacted a law on pension spending. Civil service pension rules were once again revised in 1969 with the issuance of Law No. 11/1969 which is still in effect. Civil servants and the armed forces participate in defined benefit schemes only and receive pre and post-retirement life insurance, lump sum benefits and monthly pensions after retirement. Pension programs for civil servants and members of the armed forces are very much the same although they are based on different laws. Pension programs for civil servants are prescribed in the Law No. 11/1969, while pensions for members of the armed forces is set in Law No. 6/1966.

The issuance of the civil service pension law in 1969 and the introduction of tax incentive for pensions through Law no 7/1983 created interest among social organizations and state owned enterprises to provide pensions to their employees and resulted in the establishment of *Yayasan Dana Pensiun* (a form of nonprofit foundation under the civil code that managed pension programs) and supported the growth of pension funds in Indonesia.

Formal private sector workers have been participating in a scheme providing lump sum benefits at retirement since 1977. The scheme was initially established as endowment insurance bundled in a social insurance program for formal workers. It was run by PT Astek, a state owned company. The scheme was modified to a provident fund in 1992 when Law No. 3/1992 on social security programs for workers was enacted. At that time, PT Astek was changed to PT Jamsostek which then assumed responsibility for managing the provident fund. There are four programs – old-age savings, death benefits, work accident and health insurance. Employers can opt-out of the Jamsostek health program if they provide a separate health program with the same or better benefits. Jamsostek programs are mandatory for companies with over 10 employees or with a monthly payroll of at least (IDR) 1 million Indonesian rupiah (approximately USD 100 p.m.).

The existence of private pension funds could be tracked back to early 1970s, when several employers registered their pension funds with the Minister of Finance. Law No. 11/1992 (referred as Pension Fund law) was introduced to regulate voluntary occupational private pension programs offered by private sector employers to their workers, to provide voluntary pension funds for individuals and to emphasize the importance of voluntary private pension funds in providing old-age income. A pension fund is a separate legal entity from its founder and co-founder(s). This specification is made to ensure the separation of pension assets from the assets of the founders and co-founders. The Law also stipulates two types of pension funds which are further defined by following government regulations:

- Government Regulation No. 76/ 1992 concerning Employer Pension Funds (EPF or DPPK), which can offer either DB or DC programs to employees of the sponsoring employer or employees of a co-sponsor.
- Government Regulation No. 77/ 1992 concerning Financial Institutions Pension Funds (FIPF or DPLK) that are DC programs opened to employees and the self-employed who wish to accumulate retirement savings through supervised and regulated tax-sheltered group vehicles offered by approved banks and insurance companies

To set up an EPF or a FIPF, the company has to apply for a legal license from the Ministry of Finance.

The issuance of Law No. 13/2003 on Labor (referred to as the Labor Law 13) required employers to provide a mandatory termination indemnity defined benefit plan to all permanent private sector employees, about one third of the total workforce. Upon termination of employment, regardless of the reason, the employer is obliged to provide severance pay and long-service pay in a lump sum. The payment of severance pay benefits under Labor Law 13/2003 is the responsibility of the employer only and is regulated under manpower rules.

In 2004 the Government of Indonesia issued Law No. 40/2004 on the National Social Security System (*Sistem Jaminan Sosial Nasional* or referred to as the SJSN law) and planned to fully implement the system in 2009. However, the implementation process was delayed due to the lack of a law on social insurance administrators. Consequently, the SJSN implementation only started when Law No. 24/2011 on Social Security Administrative Bodies (*Badan Penyelenggara Jaminan Sosial* or referred to as the BPJS law) was enacted in November 2011.

2.2 ISSUES WITH THE CURRENT ARRANGEMENTS

Indonesia's experience during the 1997-8 financial crisis showed that the country's social protection system was not sufficiently robust to protect citizens against the severe ramification of the financial crisis, which included a sharp drop in real GDP, large increases in unemployment, currency devaluation and declining real wages and income. As a result, the Indonesian Constitution was amended to require the establishment of a national system of social protection. The SJSN and BPJS laws were enacted to implement the system required by the Indonesian Constitution and to solve several key shortcomings of the current system.

2.2.1 Fragmented programs

The current pension system is fragmented and varies by labor market groups - civil servants, the military and formal sector workers. Each segment has different benefits and a different administrator, and the system of supervision and enforcement is a challenge. The government also sponsors a variety of targeted social assistance programs for the poor and vulnerable. However, this report will not discuss these social assistance programs.

Table 1 shows the legal structure and types of benefits under current law and the SJSN law, while Table 2 shows details of the benefits and contributions for the current programs.

Table 1: The structure and benefits of the current and SJSN programs

<table>
<tr><th rowspan="2">Type of Programs</th><th rowspan="2">Type of Workers</th><th colspan="4">Current System</th><th colspan="5">Future System (SJSN)</th></tr>
<tr><th>Legal Basis</th><th>Programs</th><th>Status</th><th>Administrator</th><th>Legal Basis</th><th>Programs</th><th>Status</th><th>Administrator</th><th>Remark</th></tr>
<tr><td rowspan="7">Civil Service Pension</td><td rowspan="3">Civil Servants</td><td>Law No.11 of 1969</td><td>Pension – DB</td><td>Mandatory</td><td rowspan="3">Taspen</td><td rowspan="7">• SJSN Law
• BPJS Law</td><td rowspan="7">• Health
• Work-Accident
• Old-Age Savings
• Pension
• Death benefits</td><td rowspan="7">Mandatory</td><td rowspan="7">• BPJS Kesehatan for health program
• BPJS Ketenagakerjaan for employment programs</td><td rowspan="7">Voluntary supplemental program may be provided to civil servants and armed forces under other systems outside SJSN to maintain current level benefits enjoyed by these groups</td></tr>
<tr><td>Government Regulation No. 25 of 1981</td><td>THT</td><td>Mandatory</td></tr>
<tr><td>Presidential Decree No.56 of 1974</td><td></td><td></td></tr>
<tr><td rowspan="4">Military and Police</td><td>Law No. 6 of 1966</td><td>Pension – DB</td><td>Mandatory</td><td rowspan="4">Asabri</td></tr>
<tr><td>Government Regulation No.36 of 1968</td><td></td><td></td></tr>
<tr><td>Government Regulation No. 67 of 1991</td><td>THT</td><td>Mandatory</td></tr>
<tr><td>Presidential Decree No. 56 of 1974</td><td></td><td></td></tr>
<tr><td rowspan="2">Jamsostek's Old Age Savings</td><td>Private sector workers</td><td>• Law No. 3/1992
• Government regulation No. 14/1993</td><td>DC:
• Work-accident
• Old-age savings
• Death benefits
• Health</td><td>Mandatory, except for health (opt-out is possible)</td><td>Jamsostek, But Optional Jamsostek for health</td><td rowspan="2">• SJSN Law
• BPJS Law</td><td>• Health
• Work-Accident
• Old-Age Savings
• Pension
• Death benefits</td><td rowspan="2">Mandatory</td><td rowspan="2">• BPJS Kesehatan for health program
• BPJS Ketenagakerjaan for employment programs</td><td></td></tr>
<tr><td>Informal sector workers</td><td>• Law No. 3/1992 on Workers' Social Security
• MOMT Minister regulation No. 24/2006 on the Implementation Guidance of Social Security Program for workers outside working relationship</td><td>DC:
• Work-accident
• Old-age savings
• Death benefits
• Health</td><td>Voluntary</td><td>Jamsostek</td><td>• Health
• Work-Accident
• Old-Age Savings
• Death benefits</td><td>SJSN pension program is currently not offered to informal sector workers.</td></tr>
</table>

Type of Programs	Type of Workers	Current System				Future System (SJSN)				
		Legal Basis	Programs	Status	Administrator	Legal Basis	Programs	Status	Administrator	Remark
Voluntary Occupational Private Pension	**Private sector workers**	Law No. 11/1992		Voluntary						Voluntary supplemental program may still be provided to private sector workers to maintain current level benefits enjoyed by these groups, however it is purely the employers' decision
		Government Regulation No. 76 of 1992	DB or DC		EPF / DPPK					
		Government Regulation No. 77 of 1992	DC		FIPF / DPLK					
Mandatory Termination Allowance	**Private sector workers**	Law No. 13/2003	DB	Mandatory	None					This program may need to revisit upon the implementation of SJSN programs

Source: Author's compilation

Table 2: Benefits and Contribution Rates for Current Programs

Program	Civil Service Pension	Jamsostek's Old Age Savings	Private Pensions	Mandatory Termination Allowance
NORMAL RETIREMENT AGE	56 or age 50 with 20 years of service	55 or 5 years of contributions for termination	Commonly: 55. Maximum 60	As per prevailing law
PROGRAM FORMULA (% of pensionable wages)				
Pensionable wages	Basic salary plus family allowance			
Accrual rate	2.50% for each year of service	5.70%	Maximum: DB: 2.50%/year; DC: 20%/year	
Maximum	75% of basic salary	N.A	DB: 80%; DC: 20% /year	
Benefit payment mode	Annuity benefit for life	Lump sum payment of Accumulated contributions plus the declared rate of return on account balances and contributions	20% lump sum, 80% monthly pension for life	Lump sum – benefit varies by years of services
CONTRIBUTION (as % of pensionable wages)				
Employee	4.75%	Formal sector worker: 2.00% Informal sector worker: 2 percent of income ("income" set up at	Maximum: 60% of employer's contributions The total contributions in a year shall not exceed 20% of pension base earnings	None

Program	Civil Service Pension	Jamsostek's Old Age Savings	Private Pensions	Mandatory Termination Allowance
		minimum wage level of IDR 1 million / month)		
Employer	Paygo, varies on actual expenditure	Formal sector worker: 3.70% Informal sector worker: None	DB: pay monthly/annually, depend on actuarial valuation DC: as set out in the EPF/FIPF regulation	Paygo, paid full by employer
COVERAGE				
Number of participants	1,860,713 beneficiaries receiving pension (June 2012) 4,522,211 active civil servants i.e. contributors (June 2012)	Formal sector worker: 9,337,423 active contributors (2010) Informal sector worker: Approximately 400,000 members for at least one of the four programs	2,817,997 active contributors (2010)	
ASSETS				
Total asset in Rp Trillion	99.99 (including non-investment assets) Based on Taspen annual report 2011	98.73 – based on Jamsostek annual report 2011	130.34 (2.03% of GDP) Based on Bapepam LK Pension Fund Report 2010	None

Source: Author's compilation

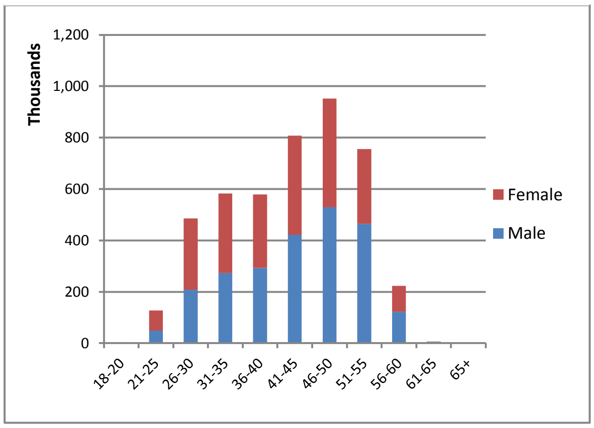
2.2.2 Low coverage

A large portion of the population is still not covered by the current pension arrangements. The current pension system coverage is limited to civil servants, the military and about 25 percent of formal sector workers. Only about 12% of the total labor force is covered; much of the formal sector and the entire informal sector are not covered.

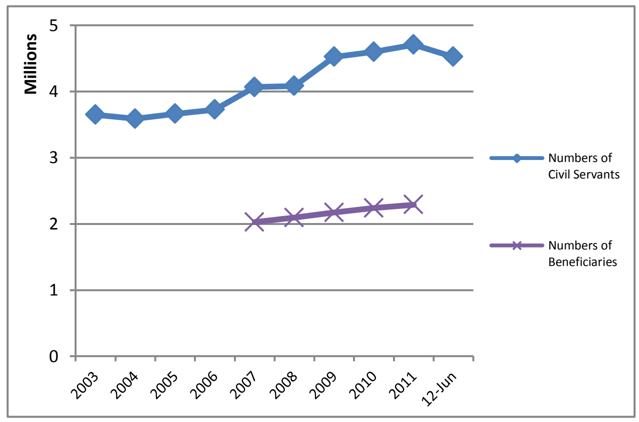
Participation in Civil Service Pension

The BKN (National Civil Service Agency) website shows there were 4,522,211 active civil servants and 1,860,713 beneficiaries as of June 2012. Graph 1 shows the current active distribution peaks for the 46-50 age group due to past hiring patterns, and approximately 1 million civil servants are age 50 or above

Graph 1: CSP Membership as of June 2012



Graph 2: CSP Membership, 2003- June 2012



and approaching the standard retirement age of 56. The civil service pension program also permits retirement at age 50 with 20 or more years of service, so most of the group is already eligible for immediate retirement without actuarial reduction. Graph 1 also shows there will be a surge in retirement over the next 20 years. Graph 2 shows the growth in the number of civil servants and beneficiaries is sporadic and concentrated in certain years. In 2012, the workforce reduction is due to a temporary moratorium on civil servant recruitment. The average growth rate of active civil servants is less than the growth rate of civil service pension beneficiaries. This trend is likely to continue for another 10-15 years since the large number of civil servants hired in the mid-1970's and early 1980's are now reaching retirement age. Data on military and police personnel are not as readily available as for civil servants.

Participation in Jamsostek's Old-Age Savings Program

Almost all formal sector employers and their workers are required to participate in the social insurance programs offered by PT Jamsostek. However, only about 25 percent of eligible workers are actively contributing to Jamsostek's old age savings program, indicating high levels of evasion from the mandatory contribution requirement for this program. Table 3 shows the history of membership in Jamsostek's old-age savings program. Total membership in Jamsostek's old-age savings program for both active and inactive accounts has grown over the past five years. Active accounts are for those workers who are still making regular contributions to the Jamsostek's old age savings program. Inactive accounts are for those workers who are no longer making regular contributions but who have not yet withdrawn their account balances. However, the number of inactive accounts has grown more rapidly than active accounts. It is likely the number of inactive accounts will reduce sharply over the next two years as these amounts are paid out in anticipation of the start of the SJSN old age savings program and the transformation of PT Jamsostek to BPJS Ketenagakerjaan.

The number of employers participating in the Jamsostek's old age savings program has also increased and at a more rapid rate than the number of participating workers. Consequently, the average number of workers per employer has dropped from 93.7 in 2006 to 73.4 in 2010. Inactive employers are those who have become bankrupt or merged with another company. Note that inactive workers are not just employees of inactive employers. They can also be workers who have left employment with active employers and not received a distribution of their account balances.

Table 3: Jamsostek's Old-Age Savings Program Membership

Employee	2006	2007	2008	2009	2010
Active	7,719,695	7,941,017	8,219,154	8,495,732	9,337,423
Inactive	15,361,672	15,778,933	18,407,661	20,534,941	22,408,877
Total	23,081,367	23,719,950	26,626,815	29,030,673	31,746,300
Employer					
Active	82,352	90,697	100,684	115,683	133,580
Inactive	60,872	68,516	75,121	84,531	91,312
Total	143,224	159,213	175,805	200,214	224,892

Source: Jamsostek's Annual Report

Participation in Voluntary Private Pension Programs

Table 4 shows the numbers of employer sponsored defined benefit plans has been declining, but the number of such plans is still much larger than the number of employer sponsored and individual defined contribution programs combined. It also shows that many defined benefit pension funds have been shut down over the past four years. The primary reasons are employer bankruptcy, financial problems, and mergers and acquisitions. Aside from that, as mentioned in the previous section, the introduction of mandatory severance pay under Labor Law 13 has also affected the growth of private pension fund in Indonesia. Table 5 shows information on private pension fund membership in both employer-sponsored and individual private pension programs under DPLK. It shows that the number of participants in employer-sponsored pension programs (DB and DC combined) is about equal to the number of participants in individual DC programs.

Table 4: Number of Private Pension Programs in Indonesia

Year	2006	2007	2008	2009	2010
Number of Active Private Pension Funds					
Employer Pension Fund – Defined Benefit plan (DB-DPPK)	235	226	216	210	208
Employer Pension Fund – Defined Contribution plan (DC-DPPK)	37	36	39	41	40
Financial Institution Pension Fund (DPLK)	25	26	26	25	24
Total	297	288	281	276	272
Number of Terminated Private Pension Funds					
Employer Pension Fund – Defined Benefit plan (DB-DPPK)	68	77	88	96	98
Employer Pension Fund – Defined Contribution plan (DC-DPPK)	23	26	26	28	29
Financial Institution Pension Fund (DPLK)	10	11	11	12	13
Total	101	114	125	136	140

Source: Report of Pension Fund 2010 by Pension Bureau – BAPEPAM-LK

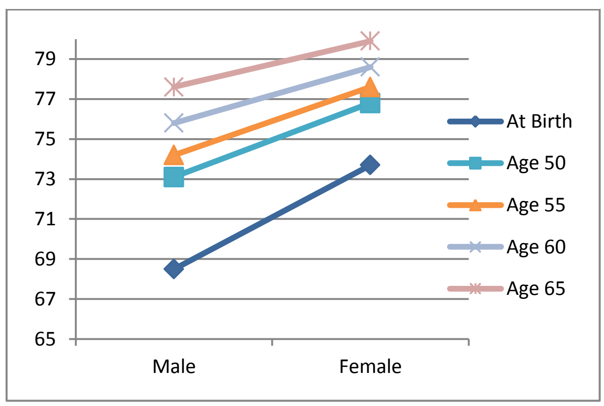
Table 5 - Numbers of Participants and Beneficiaries of Employer Pension Fund (DPPK) and Financial Institution Pension Fund (DPLK)				
Description	Year		Increase/Decrease	
	2009	2010	Person	%
(1) Active participants of Employer Pension Fund (DPPK)	923,023	903,981	-19,042	-2.06%
(2) Inactive participants of Employer Pension Fund (DPPK)	455,965	478,760	22,795	5.00%
a. Pensioners	289,488	305,515	16,027	5.54%
b. Widows/Widowers	96,271	101,594	5,323	5.53%
c. Children	2,850	2,898	48	1.68%
d. Deferred vested employees	67,356	68,753	1,397	2.07%
(3) Participants of Employer Pension Fund (DPPK): (1) + (2)	1,378,988	1,382,741	3,753	0.27%
(4) Active participants of Financial Institution Pension Fund (DPLK)	1,197,065	1,322,684	125,619	10.49%
a. Individual participants	461,359	546,270	84,911	18.40%
b. Group participants	735,706	776,414	40,708	5.53%
(5) Inactive participants Financial Institution Pension Fund (DPLK) (deferred vested)	105,180	112,572	7,392	7.03%
(6) Numbers of Financial Institution Pension Fund (DPLK) participants: (4) + (5)	1,302,245	1,435,256	133,011	10.21%
Total numbers of Pension Fund participants: (3) + (6)	2,681,233	2,817,997	136,764	5.10%
Source: Report of Pension Fund 2010 by Pension Bureau – BAPEPAM-LK				

2.2.3 Failure to meet the objectives of the programs

Low Normal Retirement Ages affect benefit levels and future fiscal sustainability

Indonesia's life expectancy has improved significantly. The World Bank data shows that in 2010, Indonesians' life expectance at birth was 71. Graph 3 shows Indonesians' life expectance at age 55, 60, 65 are above 70. However, current retirement ages in Indonesia are quite low relative to life expectancy.

Graph 3: Life expectancy by age and gender



Currently retirement ages vary significantly by program and type of group. The standard retirement age for civil servants is 56, but can be extended for certain positions to 60, 62, 65 or 70 based on the government's needs. Civil servants can retire as early as age 50 with a minimum of 20 years of service. Most private sector employees retire at age 55 but some are eligible for early retirement as early as age 45. Low retirement ages result in short contribution periods and longer periods for receiving benefits, putting significant pressure on the system. Therefore, retirement age needs to be increased now and to be further increased in the future as life expectancy improves in order to pay adequate benefits and maintain program fiscal sustainability.

Civil Service Pension –Benefits are inadequate for higher paid civil servants

The pension is calculated using final base pay, which is only a small percent of the total take-home pay received by civil servants, especially for mid-level to senior officials. Consequently the pension benefits received by mid to high level officials can be highly inadequate compared to the total compensation they were receiving prior to retirement. For high-paid civil servants, pensions can be less than 20% of total pay at retirement. Thus, the current pension program doesn't guarantee adequate income following retirement, forces civil servants to look for other sources of retirement income and may provide an incentive for corruption. Reform of the design is necessary to generate benefits that are equitable across all pay levels, align it with the government's bureaucracy reform and pay reform initiatives, and ensure program sustainable.

Jamsostek – Early withdrawal, no future income security

The benefit under the Jamsostek old age savings program is paid as a lump sum instead of as a monthly annuity. There is no guarantee that employees will invest their old age savings plan distributions wisely for future income security after retirement. Therefore the program will likely not provide lifetime income after retirement. Furthermore, the Jamsostek account balance can be withdrawn if a worker becomes unemployed, has contributed to the program for 5 or more years and has been unemployed for 6 months or more. This further reduces the size of the account balance available at retirement.

Graph 4: Number of claims, total amount paid out in benefits, 2007-2011

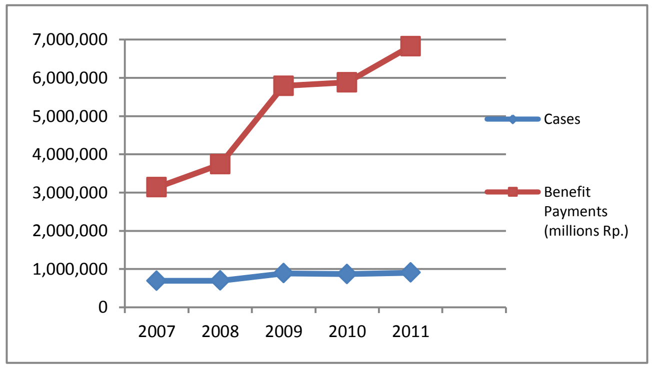


Table 6 shows the reasons for payouts in 2010 and 2011. The vast majority of all distributions are for early withdrawal.

Table 6: Reasons for payouts in 2010 and 2011					
Type of Jamsostek's Old Age Savings Claim	2010	%	2011	%	Growth
Age of 55 years	61,816	7.12%	66,332	7.33%	7.31
Leaving Indonesian Territory	633	0.07%	636	0.07%	0.47
Permanent Disability	45	0.01%	43	0.00%	-4.44
Becoming State Official/TNI/Polri	12,333	1.42%	7,897	0.87%	-35.97
5 Years Membership (early withdrawal)	773,311	89.12%	808,150	89.31%	4.51
Passed Away	19,585	2.26%	21,869	2.42%	11.66
Total	867,723	100.00%	904,927	100.00%	4.29
Source: Jamsostek's annual report 2011					

Table 6 clearly shows that the program is not serving its primary purpose of accumulated savings for retirement. It may also indicate system abuse, as there is anecdotal evidence that workers leave to receive their accumulations and are quickly rehired, or they move from one covered employer to another and improperly receive their accumulated contributions.

Labor Law 13 – Lump sum payment for now

Labor Law No. 13/2003 requires employers to pay defined benefit (DB) termination indemnities to permanent employees upon termination. Labor Law 13 benefit varies by years of service. The Labor Law does not require pre-funding of the severance pay benefit, but its accrued liability and accounting expense must be recognized in the company's financial statements. This can have a significant effect on the company's net worth and profitability, particularly for publicly listed companies. For those companies that were providing employer-sponsored private pension plans prior to enactment of Labor Law 13, it meant additional labor cost to the company. Therefore, some companies simply terminated their private pension programs or postponed their initial plan to provide private pension programs for their employees, eroding the growth of private pension programs. Since the Labor Law 13 benefit is not funded, workers cannot be sure they will receive benefits on employment termination.

Other than that, since the severance pay benefit is paid as a lump sum, it is unlikely employees will save it for retirement, but rather will spend it immediately. Therefore the purpose of securing income following retirement is also not met.

2.2.4 Governance issue – Lack of oversight and transparency

Current reporting procedures for the civil service pension program don't give an accurate and transparent view of the financial status of the program. Cash accounting is currently used for pension expense in the government's financial statements. While pay-as-you-go (PAYG) funding is acceptable, PAYG accounting is not consistent with international accounting principles and does not allow accounting costs to be easily and equitably allocated to sub-national government units. Proper disclosure of the program's unfunded liability, expense for accruing pension benefits and interest expense is necessary.

The Jamsostek provident fund has also been under public observation for years and employer associations, labor unions and international organizations have criticized its design and operation. Disclosure was poorly managed by PT Jamsostek until recently. Although it now publishes annual financial statements in nation-wide newspapers, it has not satisfactorily informed the public about the management of its assets and liabilities. Moreover, disclosure of benefit information to participants is also lacking. Some participants may have received an individual benefit statement but the majority doesn't know the amount of his/her contributions and accumulated account balance.

Indonesia's ratio of pension assets to GDP is lower than in neighboring countries. However, a higher ratio of pension assets to GDP does not guarantee the adequacy of pension system or a higher rate of economic growth. Rather, it will depend on the pension system structure itself, the development of local capital markets and other factors. Nonetheless, the lack of pension asset management supervision, control and transparency under the mandatory pension plans is a major impediment to pension asset growth, especially for the civil service pension program and Jamsostek's old age savings program. Only private pension programs are strictly regulated by the Ministry of Finance. Good governance and also investment policy requirements for private pension programs are set out clearly by the Ministry of Finance and annual reporting by independent professional auditors and actuaries is required at least once every three years.

Table 7: REPORT OF ASSETS AND INVESTMENTS OF PT.TASPEN (in billion rupiahs)

	2007	2008	2009	2010	2011
Investment Asset	30,063	34,868	48,190	62,559	81,314
Non-Investment Asset	6,937	9,317	12,472	14,608	18,683
Total Asset	37,001	44,186	60,661	77,167	99,997

Source: PT Taspen's Annual Report year 2011

Table 8: Total Private Pension Funds Asset as % of GDP		
Year	Total Private Pension Funds Assets	As % of GDP
2006	77,770,000,000,000	2,33%
2007	91,170,000,000,000	2,30%
2008	90,350,000,000,000	1,82%
2009	112,510,000,000,000	2,00%
2010	130,340,000,000,000	2,03%
Source: Report of Pension Fund 2010 by Pension Bureau – BAPEPAM-LK		

III. Drivers for Pension Reform

As noted in the previous sections, the 1997-8 financial crisis together with the shortcoming in the current pension systems have led to recognition of the need to reform the pension system and to the enactment of the SJSN and BPJS laws. Changes are needed to extend coverage, ensure programs meet their objectives, assure program fiscal sustainability and to improve the overall governance and transparency of the pension system.

However, changes in demographics and culture, a move toward greater democracy and decentralization, and Indonesia's emergence as a middle income country with a growing middle class have also been key contributors to the need for reform. Indonesia needs to change its systems and institutions to support its needs as a democratic and rapidly growing middle income country. Key changes driving the need for reform include:

- **Changing demographics**. Declining mortality and fertility rates have led to major demographic changes in Indonesia and elsewhere in the world. Life expectancy is increasing at the same time that the number of children is declining, leading to rapidly aging societies. This will lead to a large increase in the number of elderly and the need for an adequate pension system to meet their income needs. At the same time, it will also increase the pressures on the country's pension systems as fewer and fewer workers must support an ever increasing number of elderly.

- **Change in social culture**. Urbanization and the decline in the number of children have changed the family and social structure in Indonesia. There are now fewer children to help support their elderly parents than in the past. Children are also leaving their villages and moving to cities in search of more lucrative employment opportunities. Consequently, the family support system is not as robust as it was in the past and there is a greater need for the State to assist with the establishment of programs and institutions to care for the elderly.

- **Economic growth and emergence of democracy**. Indonesia has enjoyed robust economic growth since its recovery from the 1997-8 financial crisis, the fall of the Suharto regime and the emergence of more inclusive political institutions. Indonesia's entry to the G20 created another economic advantage for the country. Indonesia's more robust economy also minimized the impact of the 2008 financial crisis and rapid growth continued. Indonesia needs a pension system that will support and help it sustain its economic growth. A well-designed national pension system can allow a more flexible and mobile labor force by allowing workers to change jobs without fear of losing their health and pension benefits.

- **Sustained and inclusive economic growth**. Indonesia has successfully moved from a low income country to a middle income country. To help avoid the middle income trap, avoid increases in income inequality and sustain inclusive economic growth, Indonesia has developed and integrated economic growth and poverty reduction master plans to support Indonesia's MDG objectives and also ensure income protection and opportunity for all. National social protection programs that extend social insurance coverage to the entire labor force and social assistance program targeted to the poor and vulnerable are a major component of any strategy for and an investment in inclusive and sustained economic growth.

- **Improved government capacity**. As a middle income country, Indonesia's civil service will be expected to provide greater and more professional services for the population. This will require a significant increase in the government's capacity to design, implement and administer programs to sustain economic growth and social development. As the country transition from low to middle income, the role of the government in social protection will change from social income provider to a combination of social income provider for the poor and vulnerable and a regulator of public and private social protection systems to meet the needs of Indonesia's emerging middle and upper class citizens. This will require the development of much stronger and more sophisticated risk management capacity within the government of Indonesia.

- **Expanded financial literacy.** As a result of economic growth, Indonesia has developed a significant middle class who are more educated, have different needs and have more money to set aside for retirement. The government cannot meet all of the income protection needs of the country through public programs. Citizens will need to supplement government programs with private savings. This will require the development of a culture of financial planning and asset management. This step is also necessary to ensure the financial independence and the growth of the private sector industry. By Constitution, the country is obliged to provide basic protection for its people so they can live with dignity. However, the private sector will need to provide supplemental services and benefits to relieve fiscal pressure on the government, but at the same time ensuring strict supervision of the industry to educate and protect the public.

IV. Current Reform

While increasing coverage, improving benefits and assuring fiscal sustainability are key goals of the pension reform, it is equally important to establish the administrative systems and governance structures needed to protect program assets and assure system efficiency and accuracy. Key administrative issues include the use of unique identification numbers by both BPJS and by the organizations working with the social security administrators and an improved process for governance of the assets in the social security system. There is a need for more clarity on how the governance structure under the new laws will work in practice. The SJSN and BPJS laws establish a very different governance structure, moving away from a structure based on for-profit administrators reporting to the

Ministry of State-Owned Enterprises to a model based on not-for-profit public entities reporting to the President and managing social security trust funds on behalf of participants.

4.1 KEY FEATURES OF REFORM

The BPJS law sets out the governance and administration of the national social security programs. The key provisions of the law are outlined below.

- **Transformation of the current administrators into BPJS**

Under the Law, the BPJS will be a public legal entity that is responsible to the President. Unlike the current social security administrators, the BPJS will not be perseros, i.e. for-profit state-owned enterprises, and the Ministry of State-Owned Enterprises will no longer be responsible for supervising their activities. This brings Indonesia into compliance with established international practice. Social insurance programs should not be a profit center for the government. Rather they should be established to protect citizens against financial and macroeconomic risk. PT Taspen and PT Asabri (the administrators of the social insurance programs for civil servants and the military) will be transformed much later, prior to 2029. In many countries, civil servants and the military have separate programs from the rest of the population and Indonesia will need more time to integrate these groups into the national social security system.

In establishing the BPJS, the assets, liabilities, employees, rights and obligations of the current administrators will be transferred to the BPJS. The government will also pay in initial capital of not more than IDR 2 trillion for each of the BPJS.

- **Governance structures of the BPJS**

The BPJS Law sets out a governance structure with a typical Indonesian two Board set-up. The Board of Commissioners will consist of seven members including two government representatives, two employee representatives, two employer representatives and one public figure. The Board of Directors will consist of at least five members selected on the basis of professional qualifications.

A selection Committee will recommend candidates for both Boards to the President. The President must submit two candidates for each position for the non-government members of the Board of Commissioners to the Parliament and the Parliament selects the members. For candidates for the government members of the Board of Commissioners and for all members of the Board of Directors, the President makes the final selection. Members of both Boards serve 5-year terms and can be nominated for a second 5-year term. For the first two years, the Boards of the BPJS will be the same as the Boards of Askes and Jamsostek.

- **Distinction between the assets of social security funds and the assets of the BPJS**

The BPJS law improves the legal and financial structure of the social insurance system by legally separating the assets of BPJS from the assets in the social security funds. The government must first decide on the benefits to be provided under each of the five programs and the required contribution rates. These contributions should be sufficient to fully pay for all benefits and administrative costs for that program. No cross-subsidies among social security funds are permitted.

Contributions from employers, workers and the government and investment income on those contributions will be placed in the appropriate social security fund. These assets can only be used to pay benefits to participants and pay for administrative expenses. The assets in these funds are managed by the BPJS but do not belong to the BPJS. Social security fund assets will be held at the State-owned custody bank.

The BPJS assets come from several sources – paid-in capital from the government, assets transferred from PT Askes and PT Jamsostek, and fees charged by BPJS to the social security funds for its administrative services. The BPJS can charge fees as a percent of contributions and/or as a percent of investment income to cover its administrative costs for each of the five programs. This is similar to the structure of Indonesia's mutual funds and private pension funds.

The separation of administrator and fund assets in different legal entities and the use of a custodian to hold fund assets are important safeguards for fund members and are consistent with international best practice. In theory, this assures that BPJS creditors cannot seize fund assets, keeps the BPJS from having direct control of the assets that belong to members, and allows the custodian bank to review the financial transactions requested by the BPJS to assure they comply with the law. Additional regulations will be needed to assure the system operates as intended.

- **Risk management**

It is important for the Government of Indonesia to assure that the financial risks of the social insurance programs are properly managed. If the contribution rates are set too low relative to promised benefits, or if the contributions and/or benefits are not periodically adjusted, or if program funds are mismanaged, the social security funds could become insolvent. This creates a potentially large contingent liability for the State budget, which is the ultimate guarantor of fund solvency. Consequently, the Government has a strong incentive to assure the programs are properly managed. This will require the creation of risk management capability within the government and strong supervision and control of BPJS operations to prevent fraud and corruption, assure proper financial management and control operational expenses.

- **Supervision of BPJS**

There will be internal and external supervision of BPJS activities. The BPJS will be supervised internally by the Board of Commissioners and an internal audit department. In addition, they will be supervised externally by the National Social Security Council (DJSN), the new Financial Services Authority (OJK) and the State Financial Audit Board (BPK).

- **Administrative system**

The BPJS responsibilities will include registration of employers and workers (in both the formal and informal sectors), assigning identification numbers to all members, collection of contributions in cooperation with other government agencies, local government and state-owned enterprises (with only public organizations allowed to be involved in the collection of contributions), application of sanctions to non-payers, processing of claims, verification, monitoring and reporting. The reporting procedures for BPJS include a requirement to submit to the President both semi-annual reports, and also an annual report by June 30 of the following year (whose executive summary must also be published by the BPJS in the media). The BPJS must also inform participants about their rights and, at least once per year, the benefits they have earned in the pension and old-age savings programs.

The BPJS is also required to manage the investment of social security fund assets and establish technical reserves based on standard actuarial practice. Finally, at all times, the BPJS must operate the social insurance programs in the best interest of the participants.

4.2 ISSUES WITH CURRENT REFORM

The SJSN and BPJS laws offers general guidance but leaves much of the specifics to regulations, and significant information is contained in the elucidation of the law rather than in the text of the law itself. The BPJS law requires the issuance of 18 separate regulations and/or decrees. All regulations for the health program must be issued within one year of enactment and those for the employment programs within two years.

It is too early to make further analysis of the fiscal impacts of the new system as no program design and contribution rates have been set. The implementation is still in the infancy stage. However, there are areas of concern regarding implementation of the Law as follows:

- **Governance structures**

While the BPJS report to the President, it is not clear who in the President's office will actually be responsible for supervision and control of BPJS operations. The National Social Security Council, (*Dewan Jaminan Sosial Nasional* or DJSN), is responsible for synchronizing the administration of the SJSN system, but it is not clear what their specific functions are.

The law also states that the new Financial Services Authority, (*Otoritas Jasa Keuangan* or OJK), is responsible for external supervision, but doesn't clarify its functions. Given the huge amounts of money that will flow into the two BPJS and the critical role they play in the social protection system for the country, it is important to have very strong supervision and control to protect the rights of participants and prevent fraud and corruption. The roles, functions, accountability and responsibility for each of the supervisory bodies must be clearly stated in writing and agreed to by all parties.

- **Collection of contributions**

Another set of concerns relate to the collection of contributions. The first issue is the unnecessary duplication -- both BPJS are charged with collecting contributions from the same employers and individuals. A second issue is the difficulty of making sure that the required contributions are paid on time and in the correct amount. It is good that the BPJS have been given the right to impose administrative sanctions in cases of non-compliance. Jamsostek does not have that authority and it has made their enforcement difficult and led to wide-spread evasion. Despite the availability of administrative sanctions, collecting from millions of informal sector workers individually and from micro-enterprises will prove very challenging.

- **Organizational transformation - Changes in organizational structure and business processes**

Significant changes in the legal, governance, organizational structure, job descriptions, business processes and IT systems will be needed for PT Jamsostek as it transforms from a persero managing programs for a particular labor market segment to BPJS Ketenagakerjaan managing nationwide programs covering thousands of employers and millions of informal sector workers. BPJS Employment will need to implement a new pension program and manage an old-age savings program that will eventually be significantly larger than the existing old-age savings (*Jaminan Hari Tua* or JHT) program that it manages today.

- **Issuance of identification numbers**

In order to properly administer the social security programs, it is important to ensure that everyone receives an identification number and that there is no duplication. The Ministry of Home Affairs is working on an electronic identification program, but the time frame for its roll-out is unclear. It is likely that it will not be ready in time for the start of the SJSN health program. This means the BPJS will likely need to develop a separate ID number solely for the SJSN system. Once again, it doesn't make sense for the two BPJS to separately issue ID numbers. Instead, they must work together to assure that the ID numbers are issued and are unique – everyone has one and only one number.

- **Heavy political influence**

The program design and contribution rates have not yet decided. Union are reluctant to contribute to the SJSN programs and they insist that employers pay the entire contribution on their behalf. At the same time, the labor unions oppose reforming Labor Law 13 or reducing severance pay benefits. There has also been no discussion yet on the role of private pension funds in the reformed pension system. These decisions will also have to be made in a highly political atmosphere. Indonesia will have a presidential election in 2014 and the current President cannot seek re-election since he is already in his second term, so politicians may try to seek short gain by offering high benefits with lower than necessary contribution rates and leave financial problems to future generations.

- **Informal sector**

Unlike other SJSN programs, the pension program is mandatory for the formal sector only. Consequently, informal sector workers will not be eligible to participate and receive a monthly lifetime pension benefit. Consequently, the government may wish to consider offering separate non-SJSN income protection benefit programs on a targeted or universal basis to informal sector workers. In the long term, the government may want to consider requiring informal sector participation in the SJSN pension system.

- **Program design and contributions required and their impact on labor market**

The nationwide BPJS Ketenagakerjaan programs will differ in both design and coverage from the existing programs. However, the SJSN law offers general guidance only and does not specify the benefit formula and contribution rates of the SJSN programs. The complexity of defining new benefit designs and setting contribution rates for SJSN employment programs will need to take into account different characteristics, needs, and ability and willingness to pay contributions between formal and informal sector workers.

It should also be noted that payroll contributions will have a significant impact on the labor market. It is important to understand that social insurance programs – programs that are financed by payroll taxes on employers and workers – raise serious labor market, labor relations and macroeconomic issues. Employers and workers will both be required to pay contributions to the health, pension and old age savings programs, while the work accident and death benefit programs will be fully financed by employers. These contributions will be a percent of covered payroll. If benefit programs are too rich, then the contribution rates could be high enough to create hiring disincentives. The payroll taxes, in combination with the recent large increase in minimum wages in some parts of the country and new restrictions on outsourcing and contract employment could combine to have a serious negative impact on employment.

Indonesian policymakers need to be realistic about the true cost of its social security programs and the affordable level of benefits. If programs are properly priced, employers and workers will be forced to make a choice between paying higher contributions or receiving smaller benefits.

- **Impact on the growth of private pension program**

Opting-out from the SJSN social insurance programs will not be allowed. This may discourage employers who already have voluntary pension program from continuing their programs. The total costs for pension promises may become too high for employers to bear. As the pension benefit formula and level of contributions to the old age savings fund are not prescribed in the draft law, early assessment of total costs is not yet possible. If pension benefits and old age savings fund contributions are set high in government regulations, the existence of voluntary pension program will definitely be adversely affected. Employers will tend to satisfy their obligation to the mandatory program before thinking of funding a voluntary one.

The commercial interest of banks and life insurance companies may also be affected by the implementation of the SJSN system. While making pension programs compulsory and publicly managed may help avoid adverse selection, centralizing the management of fund assets with the government may destroy the pension business of banks and life insurance companies. Therefore the government should carefully consider the role of the government, the private sectors and individuals in securing future income protection.

- **Tax**

Taxation of contributions and benefits is not described. The BPJS managing the programs will be not-for-profit entities and will not be taxed at all. Although it is understood that taxation is more appropriately taken care of within tax legislations, a proper description of the general framework of taxation may avoid ad-hoc treatment, which has frequently plagued all of the existing pension programs and is one of the contributing factors in the low rate of participation in the voluntary pension schemes.

V. Conclusion and Next Steps

The enactment of the BPJS law is a significant step in the implementation of a social protection system for all Indonesians. However, much work remains to be done to design the individual programs, calculate appropriate contribution rates and properly manage the governance and financial risks associated with these programs.

The roadmap for the implementation of BPJS Ketenagakerjaan and SJSN employment program is expected to be developed and finalized in 2013. This is a very short turn-around since BPJS

Ketenagakerjaan should be ready to begin operations by January 1, 2014 and the SJSN employment programs should be ready to begin on July 1, 2015.

The government of Indonesia should learn from other countries' experience, especially from those countries whose systems have already been around for more than 15 years. It is also necessary to conduct regular socialization on program design and proposed rates of contributions so employers and workers are aware of the program benefits and requirements. This is particularly important to avoid any misperception about the system which can be exploited for political purposes.

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