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**Indonesia Pension System:
Where to Go?**

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Introduction

A national social security system is being prepared in Indonesia by a presidential team. The team comprises of officials of several government ministries and eminent persons previously served in state owned enterprises implementing government health insurance or provident fund programs. It has been working for few years to prepare a blue print of national social security system. The blue print is carved in a draft law, which was submitted to the parliament by the end of January 2004. Articles and commentaries on the proposed system, however, have been published by press since last year and pose various reactions.

A critical review on the proposed mandatory pension program and provident fund, parts of the national social security system, will be presented by the end of this paper. Several sections will be devoted beforehand to explain briefly the history of old-age income protection in Indonesia, key features of existing pension and provident fund schemes, and current financial condition of the schemes.

Effects of the proposed mandatory pension program and provident fund on existing civil service pension and provident fund for private employees as well as voluntary pension will be examined. Although a more comprehensive study on the proposed national social security system is still required, the review will provide a critical assessment on the future of pension provision in Indonesia.

This paper was prepared based on an unofficial version of the draft law on national social security system dated 8 January 2004 and discussions with several members of the presidential team mentioned above. It might contain errors in the details as they were not finalized yet in the above mentioned version. But, best effort has been dedicated to capture and reproduce the general framework of the draft law, as of the version date, as accurate as possible.

Historical Background

There is no a unified program providing pensions for Indonesian although several schemes promising lump sum benefits or pensions for various segment of workers exist. Civil servants receive lump sum benefits and monthly pensions after retirement. The same benefits are also granted to members of the armed forces. A provident fund is established for private workers providing lump sum benefits upon the attainment of age 55. Monthly pensions are still luxury for most private workers as only few employers adopt and implement pension programs voluntarily. Informal workers are at the pits as no formal program has ever been established for them to make old age income available.

Civil servants are perhaps the most fortunate group. Even during the Dutch occupation period retirement income for this group of workers was guaranteed. Pension promises for them and their survivors were re-affirmed in 1956 when the President enacted a law on pension spending. The law stated that pension benefits would be paid directly from state budget and funds previously established by the Dutch government to provide pensions were liquidated. Pension rules for civil servants were once again revised in 1969 with the sanction of another law, i.e. the Law number 11/1969. This Law is still in effect now.

The Law number 11/1969 authorizes the government to establish a separate fund for the implementation of the Law. The President then stipulated a decree requiring 4% of salary to be collected from civil servants for pension contributions. The rate was increased to 4.75% in April 1977. Accumulated funds were deposited only in state banks until their administration was transferred to PT Taspen, a state company, in 1985. Monthly pensions continued to be paid directly from the state budget until December 1993, despite the transfer.

Starting January 1994 the funds administered by PT Taspen are used to pay a portion of monthly pensions. The state budget continues to bear the greater part of payment burden, except in January, February and March 1994 when the entire benefits were paid from the funds. The share of the funds ranged from 21 to 25% of benefit payments.

Besides pensions, civil servants also receive lump sum benefits at retirement. The benefits are insured by PT Taspen as endowment insurance. The provision of this type of benefits was started in 1963 based on a government regulation on savings and insurance plans for civil servants. The amount of benefits is calculated based on formula determined

by the Minister of Finance. The formula has been modified several times to adjust it to most current condition, especially new salary schemes for civil servants. The most recent modification has been made effective since 1 January 2001.

Members of the armed forces have been treated very similarly to civil servants. They received monthly pensions and lump sum benefits at retirement. PT Asabri, another state company, was established in 1971 to insure lump sum benefits.¹ It has been administering monthly pension payments since 1981.

Formal private 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 type in 1992 when a law on social security program for workers (Jamsostek program) was stipulated. The Jamsostek program was limited to formal workers at the start, but extension to informal workers is clearly anticipated in the law. The extension has never been realized, however, and the coverage is still limited to tenured workers. PT Astek was changed to PT Jamsostek which then manages the provident fund.

In 1992, another important regulatory change took place. A new law was introduced to regulate voluntary private pension funds. The Law number 11/1992 emphasizes the importance of voluntary private pension funds in providing old-age income. It also defines clearly “a pension fund”, as already mentioned in various tax legislations since 1970s.

The existence of private pension funds could actually be tracked back to early 1970s, when several employers registered their pension funds with the Minister of Finance. Income tax legislation started to give privilege to registered pension funds. Contributions to such funds were income deductibles, while income of the funds from several types of investment, as determined by the Minister of Finance, is non-taxable. This privilege continues until now although types of non-taxable investment have been modified.

The Law number 11/1992 on pension funds also introduced pension program for self-employed. The program, of defined contribution type, is managed by financial institution pension funds. Only banks and life insurance companies may establish financial institution pension funds, separated from their own employer pension funds.

¹ Based on the Government Regulations number 45/1971.

Although this paper will focus on formal pension provisions, it must be understood that family and community supports remain the most important component of old-age income protection in Indonesia. The number of people who are either receiving monthly pensions or actively contributing to pension and provident fund programs are less than 10%. Another small group may have invested lump sum benefits that they received at retirement prudently and used proceeds of the investment for income. But, the majority started to depend on relatives very soon after retirement.

Detailed Explanation of the Current Schemes

Programs for Civil Servants and Members of the Armed Forces

Pension programs for civil servants and members of the armed forces are very much the same although they are based on different laws. Pension program for civil servants is prescribed in the Law number 11/1969, while one for members of the armed forces is set in the Law number 6/1966. The following explanation is made with reference to the Law number 11/1969 and its implementing regulations. It, however, is also applicable to members of the armed forces with very minor variation.

Pension benefits are rewards for loyalty to the government. As such, they are provided only to participants who terminate employment with honor after quite long service. Civil servants and members of the armed forces who are dismissed or leave the service before pension benefits are vested will lose them.

Pension benefits are paid to civil servants who retire at age 56, or at age 50 but with minimum of 20 years of service. If, due to an official organization restructuring plan a group of civil servants have to be laid off, one in the group is entitled to pensions if s/he has at least 10 years of service. Voluntary termination prior to having 20 years of service will make benefits forfeited.

Pension benefits are 2.5% of basic salary plus family allowance for each year of service, with maximum of 75% of basic salary and family allowance. Prior to January 2001, this formula generally gave very low replacement ratio. This was caused by poor arrangement of civil servants remuneration system. For most civil servants, basic salary and family allowance represented one third of total take home pay.

In January 2001, basic salary of civil servants was adjusted to include an allowance previously categorized as “additional allowance”. Since then, any

improvement in civil servants remuneration has been made by increasing basic salary. As a result, pension replacement ratio is significantly improved and automatically adjusted every time the government increases the basic salary.

Survivors of active or retired civil servants receive 36% of basic salary. Survivor pensions will continue until widow/widower dies or re-marries, or until all children attain 21 years of age or 25 if they are still in school. A lump sum death benefit may be paid to parents of the deceased civil servants if the deceased do not have wife/husband nor children.

The Law number 11/1969 does not require any contributions from civil servants. In fact, benefits would, according to the Law, be paid directly from the government budget. A presidential decree issued in 1974 made contributions from civil servants mandatory. They are deducted from monthly salary at the level of 4.75% of basic salary. It is not very clear on what base this presidential decree was issued, but an article of the Law number 11/1969 implies a mandate for the government to establish a separate pension fund for civil servants. Unfortunately, the presidential decree² which mandates civil servant contributions does not provide return of contributions upon termination of employment. This forfeiture of contributions has been publicly criticized.

Accumulation of pension contributions is administered by PT Taspen separately from its own assets. It is now used to pay a portion of monthly pensions. Due to changes in the level of basic salary, the accumulation has been decreasing. A study conducted in 2001 projects the accumulation to run out by the end of 2008 and the government budget will have to bear the entire pension payments afterwards.

No assets are accumulated for members of the armed forces. Member contributions are immediately used to satisfy a portion of monthly pension expenditures, although major part of these expenditures has yet to be met by the government budget.

Civil servants and members of the armed forces also participate in endowment plans providing lump sum benefits upon their death or the attainment of age 56. The plans are prescribed in the Government Regulations number 25/1981 (civil servants) and the Government Regulations number 67/1997 (members of the armed forces).

² Presidential Decree number 56/1974 and its revision, Presidential Decree number 8/1977.

Benefits for civil servants currently are calculated based on the following formula.

0.6 times basic salary and family allowance based on the Government Regulations number 6/1997 times total years of service, plus

0.6 times the increase in basic salary and family allowance (from one determined in accordance with the Government Regulations number 6/1997 to one based on the Government Regulations number 26/2001) times years of service from 1 January 2001.

Unfortunately, benefit formula for members of the armed forces is not available at time of writing of this paper.

The plan is financed by participants' contributions of 3.25% of basic salary. Contributions are paid to PT Taspen (civil servants) and PT Asabri (members of the armed forces³) which act as insurers of the plan. The accumulation of contributions will be returned to participants who terminate employment prior to retirement.

PT Taspen is not really an insurer of the plan, as it does not have authority to set the benefits. Benefit formula is set by the Minister of Finance based on the level of contributions and the level of PT Taspen's assets. The formula has been modified several times to respond to changes in the level of basic salary and family allowance. As a consequence, the endowment plan is nothing more than a defined contribution plan with some sense of intra-generational redistribution.⁴

Special income tax treatment applies to pension programs for civil servants and members of the armed forces. Contributions to the programs can be deducted from workers' taxable income. Income of the programs from certain types of investment is not taxable. Monthly pensions, however, are taxed in accordance with general rules on personal income tax.

PT Taspen and PT Asabri, as limited liability companies, have to pay income tax and produce dividends. These obligations, combined with lack of authority to determine benefit formula, weaken the companies' ability to guarantee the set level of endowment benefits. In fact, they have used this situation many times as an argument to propose modification to benefit formula to government.

³ PT Asabri also insures civil servants working at the Ministry of Defense. This group of civil servants does not belong to PT Taspen endowment plan.

⁴ Similar observation applies to the endowment plan for members of the armed forces.

Pension program and endowment plan for civil servants are under supervision of the Minister of Finance. In areas related to the administration of civil servants PT Taspen has to consult with the State Agency of Personnel. Pension program and endowment plan for members of the armed forces are under direct supervision of the Minister of Defense.

Pension and endowment programs for civil servants, and, more quietly, ones for members of the armed forces, have been criticized for long time. Many active participants and retirees comment on the value of benefits which have been incessantly decreasing. They specially are not satisfied with frequent changes made on the lump sum endowment benefit formula and request for an explicit guarantee from the government. Long vesting period and forfeiture of contributions also caused complaints.

Some economists and pension experts are concerned with future financial impact of both programs to government budget. The government was forced to modify endowment formula several times in the past, but it is very unlikely that the government can do it repeatedly in coming years. Civil servants and members of the armed forces will ask for more concrete government's role in maintaining the programs and, more importantly, the value of benefits. This, in turn, will create difficulties for the government to solve and disclose financial deficiencies of the programs.

Several studies were carried out in the past but none was followed up in a serious fashion. Myopic view on pension and endowment programs for civil servants and members of the armed forces is likely to continue in near future. But, it will not keep on going for more than four or five years as accumulated funds for both pension and endowment will run out by that time. The government will have had to start reforming both programs before this happens.

Provident Fund under Jamsostek Program

The Law number 3/1992 describes social security programs for workers (Jamsostek programs). Programs covered by the Law are life insurance, work accident protection, provident fund, and health maintenance plan. All programs are mandatory for workplaces with at least 10 workers or a monthly payroll of Rp 1 million, although the fourth one can be opted out from PT Jamsostek. In this section, we will specifically focus on the provident fund.

The provident fund provides lump sum payment of the accumulation of contributions for

- Participants who retire at age 55 or more;
- Participants who terminate employment due to total disability;
- Participants who terminate employment with minimum of five years of participation and have been waiting for at least six months before applying for the payment;
- Survivors of deceased participants.

If the final accumulation of contributions exceeds Rp 3 million, the participant may select five-year term annuity, instead of lump sum payment.

Contributions are paid by employers and workers. Employers contribute 3.7% of workers' total salaries/wages, while workers have to set aside 2% of their salaries/wages. The rates of contributions are set in the Law.

The Minister of Labor and Transmigration determines the rate of interest to be applied to accumulated contributions in a certain year. The determination of the rates of interest should have been in consultation with the Minister of Finance, but no record for such a consultation was found.

PT Jamsostek manages the provident fund. It invests assets of the fund mainly in time deposits, certificates of Bank Indonesia (SBI), stocks and bonds listed in Indonesian capital market. The government determines prudential rules on Jamsostek's investments in the Government Regulation number 28/1996. Some sources testify that the provident fund's assets are reported separately from assets of other programs. Likewise, liabilities of the provident fund are also segregated from other programs' liabilities.

Similar to pension programs, the provident fund operates under favorable income tax rules. Contributions to the fund are income deductibles. Income of the fund from certain types of investment is not taxable and final tax calculation is applied to benefits paid by the fund. PT Jamsostek, however, has to pay income tax and generate dividends for its single shareholder, the government. This, more or less, also affects the growth of the accumulation of contributions.

Supervision of Jamsostek programs are mainly performed by the Minister of Labor and Transmigration. In such specific areas as investment and finance, the Minister of Finance is consulted and provides guidelines.

The Jamsostek provident fund has been under public observation for years. Criticisms on its fundamental ideas, design and operation have come from domestic

society as well as international organizations. Some have been resolved by relevant authorities, individually or jointly, but few others need higher level political decisions.

Designed to provide lump sum benefits, the provident fund fails to offer reasonable protection of old-age income maintenance. Naturally, no one can guarantee that participants would wisely invest lump sum benefits that they receive from the fund and derive monthly income from such an investment. In practice, most of them would have used up the money within short period.

Possibility to withdraw the accumulation of contributions before retirement further impairs the purpose of the provident fund to provide retirement income. Most, if not all, participants who terminate employment before age 55 but have contributed for five years, redeem their accumulation of contributions after waiting for six months. Very few of them re-invest the money and could reasonably expect higher accumulation of funds.

The management of the provident fund is very frequently scrutinized by employer associations and labor unions. They criticize PT Jamsostek's investment practices as being heavily influenced by some officials for their own advantage. Recent legal proceedings, in fact, have put several former directors of the company and government officials before the court. Although new government has stated its intention to put good governance into practice, investment practices of PT Jamsostek still need thorough observation.

Disclosure was poorly managed by PT Jamsostek until recently. Although it now publishes annual financial statements in nation-wide newspaper, it has not satisfactorily informed the public on the management of its assets and liabilities. Some participants may have received an individual benefit statement but the majority never knows the amount of his/her accumulation of contributions.

Other problems are worth mentioning. First, the status of PT Jamsostek as a state company, has made the government frequently blamed as benefiting from the programs improperly by taking dividends. Second, contribution evasion is a permanent issue which can not be properly solved by PT Jamsostek as it does not have authority to enforce regulations. Third, the proposal to invite PT Jamsostek to cater management of new welfare initiatives promoted by some parties including officials of the Ministry of Labor and Transmigration, may endanger the practice of clear segregation of assets and liabilities and create potential burden to the provident fund. Fourth, as a system of single

social security number does not exist, many participants, especially those who have moved from one workplace to another, are registered twice or more, and face difficulties to aggregate their entitlements when they fall due.

Voluntary Private Pension Programs

The Law number 11/1992 on pension funds makes “a pension fund” a specific term. It refers to a legal entity which has distinct rights and obligations. 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 founder’s and co-founders’.

The Law stipulates two types of pension funds, namely employer pension funds and financial institution pension funds. An employer pension fund is to be founded by a natural person or a legal entity for its workers and, if any, workers of other employers who will act as co-founders of the pension fund. A financial institution pension fund is to be established by a bank or a life insurance company for persons who want to save for their old age, whether they are tenured workers or self-employed.

Participation in a pension program must not be made mandatory, especially when the program is a contributory one. If it is non-contributory, participation may be made automatic although workers shall retain a right not to join the program for personal reasons.

Founders have to specify categories of workers that may participate in their pension program. The specification must of course not discriminate certain workers from the others. Once the specification is prescribed in pension regulations, workers belong to eligible categories shall not be prohibited to join the program if they are 18 years of age and have at least one year of service.

A participant must not terminate her/his participation in a pension program if s/he still belongs to an eligible group of workers. If s/he is no longer in such a group, s/he could not withdraw benefits or related funds until s/he attains 10 years before normal retirement age. Participants are entitled to pension benefits after 3 years of participation and may transfer the rights and related funds to another pension fund upon termination of employment prior to retirement.

An employer pension fund may implement a defined benefit pension program or a defined contribution one. A financial institution pension fund, on the other hand, may only implement a defined contribution pension program.

For a defined benefit pension program, benefit formula is to be prescribed by the founder in its pension regulations. Monthly pensions may not exceed maximum limits determined by the Minister of Finance. Currently, the limits are 2.5% of pension base salary/wage per year of service and an overall maximum of 80%. Benefit reduction is allowed for early retirement but may not exceed actuarial reduction.

Contributions to a defined benefit program shall be actuarially calculated at least once every three years. If the program is contributory, the rate of worker contributions has to be prescribed in pension regulations and shall not exceed three times of benefit credited in the related year. Triennial actuarial calculation will also determine financial soundness of the program.

Rate of contributions to an employer pension fund which implements a defined contribution program is to be prescribed by the founder in pension regulations. Workers shall not be required to contribute more than 60% of employer's contributions. The total contributions in a year shall not exceed 20% of pension base earnings. The maximum limit for annual contributions also applies to contributions to financial institution pension funds.

Accumulated funds in a defined contribution program shall be used to purchase an annuity from a life insurance company. Participants have right to select a life insurance company and a specific form of annuity.

The same tax treatment as one applies to pension programs for civil servants and Jamsostek provident fund also works for private pension programs. Contributions to registered pension funds are income deductibles, income of the funds from certain types of investment is not taxable, and monthly benefits from the funds are taxed in accordance to general rules on personal income tax.

Unlike PT Taspen, PT Asabri and PT Jamsostek, private pension funds have to adhere to strict regulations on transparency and prudential supervision. Pension funds shall provide annual reports to participants. The reports shall describe latest condition of the funds and changes that are made in pension regulations. Financial institution pension funds, in addition, have to publish audited financial statements in nation-wide newspaper and to provide fund accumulation statements to individual participant at least once a year.

Pension funds have to file financial and investment reports with the Minister of Finance every semester. They also have to submit yearly audited financial and investment reports and, for those implementing a defined benefit program, triennial actuarial reports.

The Minister of Finance is authorized to conduct off and on-site examinations on pension funds. Off-site examinations are carried out based on filed reports and other information related to pension funds. On-site examination to pension funds is performed to ascertain compliance to pension legislations and efficiency of pension funds operation.

Voluntary nature of private pension programs has been blamed for their slow growth. Despite internationally recognized legislations, based on which private pension funds will operate prudently and safely deliver pension promises, employers tend to abandon ideas of establishing voluntary pension programs in favor of the fulfillment of obligation to contribute to the mandatory provident fund only. A new labor law, sanctioned in 2003, puts more pressure to the development of voluntary pension programs as it contains more stringent rules on termination of employment and severance benefits.

Current tax incentives are not considered sufficiently attractive for employers and workers to make voluntary pension savings. For self-employed workers, in fact, there is no explicit incentive at all to make contributions to a registered financial institution pension fund.

Financial Performance of the Current Programs

Financial performance measurement varies from one program to another due to the difference in characteristics. For the Jamsostek provident fund, annual rates of investment return are very important as they affect the determination of annual rates of return by the Minister of Labor and Transmigration to be applied to initial balance of individual accounts. Similar view applies to pension funds with a defined contribution pension program. For defined benefit pension programs, the capability of available assets to back up liabilities is normally the most significant aspect to measure. Below is an overview of financial performance of existing programs.

Pension and Endowment for Civil Servants and Members of the Armed Forces

As described earlier, funds for civil service pension program and endowment plan are managed separately. Funds for the pension program are collected from civil servant contributions and administered by PT Taspen segregated from its own assets. Contributions for endowment plan, on the other hand, are received by PT Taspen as premium income and become its assets.

There is no regular actuarial valuation to determine the sufficiency of funds to satisfy accrued liabilities of both programs. For some parties, regular valuation is not very important as the government gives ultimate guarantee for the fulfillment of liabilities. For several others, however, the valuation is crucial to project financial burdens of the government due to pension program and endowment plan for civil servants as well as members of the armed forces.

Accumulation of civil servant contributions for pension program increased from 1998 to 2000, but has been decreasing since 2001. The decrease is due to an increase in pension benefit payments following the restructuring of salary scheme made by the government in January 2001. An internal study by PT Taspen later in 2001 showed that if current funding practices persist, the funds will last no longer than 2008.

The endowment plan faces a similar problem. A modification of benefit formula was made in 2002 to solve the problem. The modification is expected to sustain the assets of PT Taspen to meet its future liabilities. But, another increase in basic salary was made in 2003 and no further adjustment has been made in the formula.

For members of the armed forces, there is no accumulation of contributions for pension program. Contributions collected from members are used to pay pension benefits, in addition to budget allocation from the government. For the endowment plan, contributions are remitted to PT Asabri. No government support is recorded for paying endowment benefits.

Financial condition of pension program and endowment plan for civil servants and members of the armed forces as per 31 December 2002 is presented in Table 1. The growth of assets is depicted in Picture 1.

Provident Fund under Jamsostek Program

As mentioned earlier, assets and liabilities of the provident fund are claimed to be recorded separately from other programs'. Unfortunately, the available source of information when this paper was written, i.e. *Indonesian Insurance in 2002*, does not segregate assets and liabilities of the programs. Data presented in Table 2 is for PT Jamsostek as a whole, not specific for the provident fund. Some sources claim that from past experience, the liabilities of the provident fund are estimated about 90% of the total liabilities of PT Jamsostek to participants.

The growth of assets of PT Jamsostek from 1998 to 2002 is depicted in Picture 2.

Table 1 (In million rupiahs, except rows with %)

	Programs for Civil Servants		Endowment Insurance for Armed Forces
	Pension	Endowment Insurance ¹	
Assets	10,410,249	9,851,358	1,863,745
As % of GDP ²	0.64	0.61	0.12
Liabilities to Participants	Not available	9,363,338	1,611,043
Members contributions	1,958,050	1,391,363	219,738
Benefits paid	14,831,869	929,340	91,579
Govt. Share	11,437,118	0	0
Investment returns	1,518,063	1,451,943	274,086
% ROI	15.13	16.15	16.77 ³

¹ Including endowment plans for several state owned enterprises.

² Gross domestic products for 2002 is Rp1,610,016 billion.

³ A rough approximation based on the audited financial statement for 2002.

Picture 1

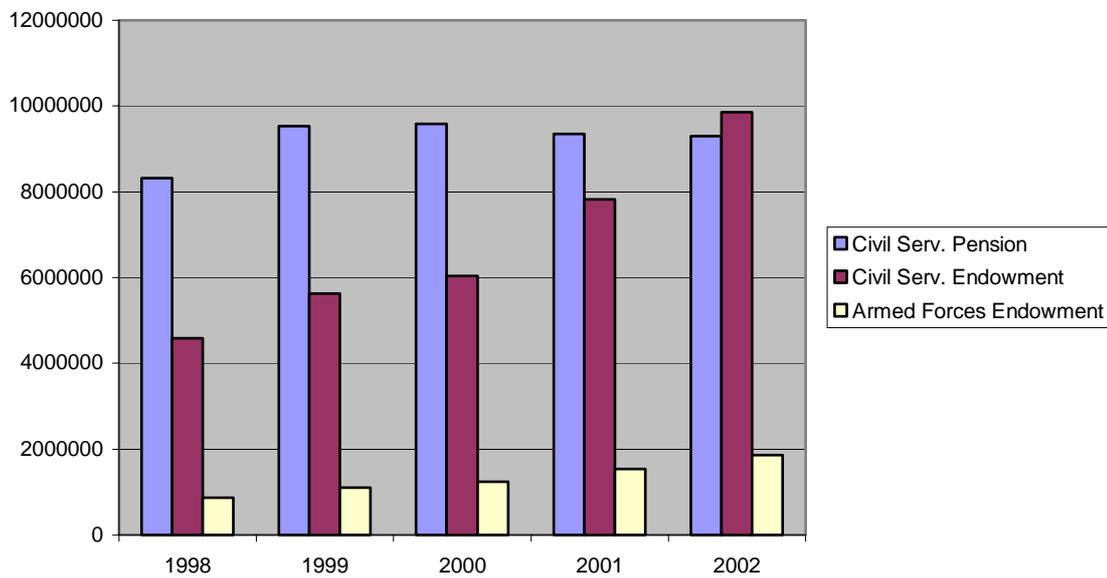


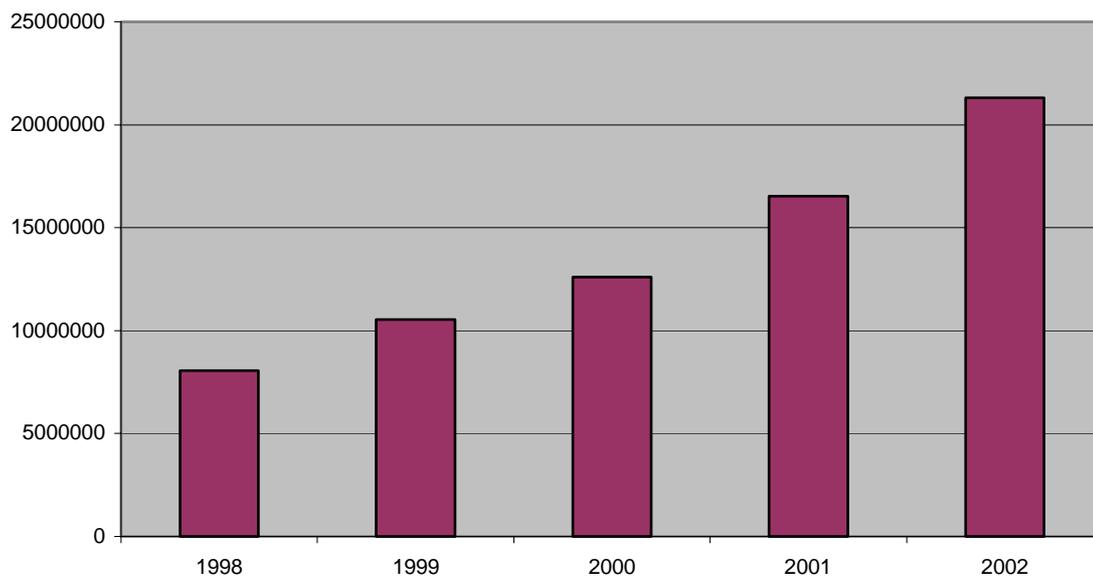
Table 2 (In million rupiahs, except rows with %)

	Jamsostek Programs
Assets	21,317,262
As % of GDP ¹	1.32
Liabilities to Participants	19,605,687
Contributions	945,770
Benefits paid	403,343
Investment returns	1,092,950
% ROI ²	5.96

¹ Gross domestic products for 2002 is Rp1,610,016 billion.

² Estimated roughly from the total investments of PT Jamaostek as reported in *Indonesian Insurance in 2002*.

Picture 2



Voluntary Private Pension Programs

Private pension programs have been growing steadily, despite economic crisis in 1997 – 2002. Several employers had to stop their pension programs due to financial problems that they had to solve, but total assets of pension programs in Indonesia always increase. This happens because pension legislations require liquidated pension assets and

liabilities are transferred to other pension funds and can not be distributed directly to participants prior to their retirement.

Financial performance of private pension funds in 2002 is presented in Table 3. Data for employer pension funds with defined a benefit pension program, data for employer pension funds with defined contribution pension program, and data for financial institution pension funds is presented separately. The data is totaled for all pension funds so, for example, deficit figure shown in the table is for all pension funds and does not mean there is no pension fund with surplus. Performance of individual pension fund varies from one to another.

The assets of all pension funds from 1998 to 2002 are depicted in Picture 3.

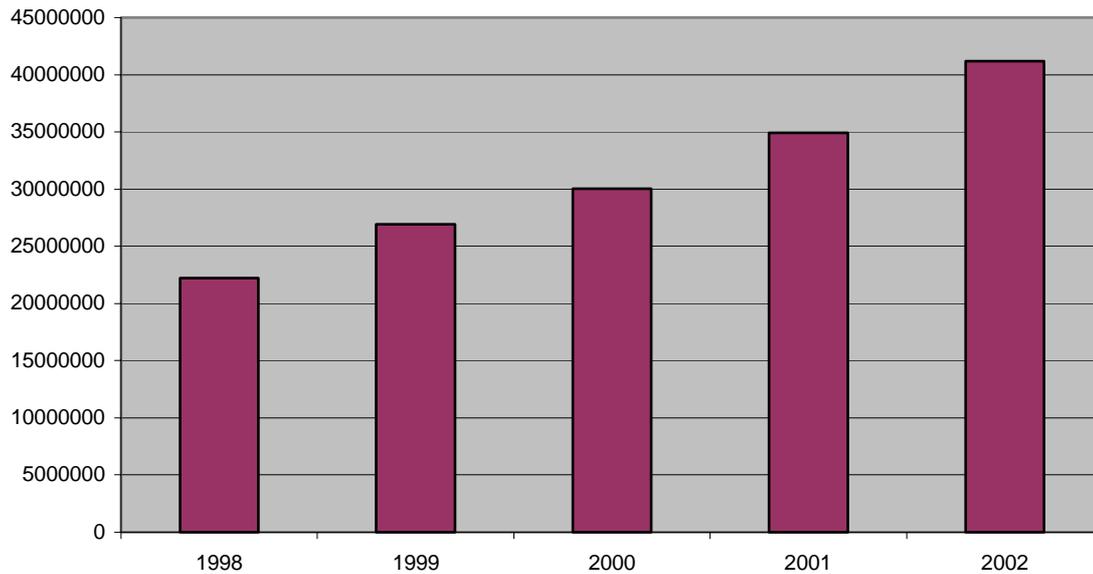
Table 3

	Employer Pension Funds		Financial Institution Pension Funds
	Defined Benefit	Defined Contribution	
Assets	36,835,568	1,884,234	2,486,672
As % of GDP ¹	2.29	0.12	0.09
Liabilities to Participants	39,384,007	1,909,704	2,483,126
Contributions	2,667,252	313,165	818,169
Benefits paid	2,453,723	32,784	69,926
Investment returns	4,757,687	256,034	241,026
% ROI ²	14.38	15.98	12.40

¹ Gross domestic products for 2002 is Rp1,610,016 billion.

² Estimated roughly from the average of total investments of all pension funds.

Picture 3



Proposed National Social Security System: An Optimal Policy for the Future?

Description of the Proposed System

As mentioned at the beginning of this paper, a draft law on national social security system is being prepared by a presidential team. Several versions of the draft law have been in public circulation, but none was acknowledged by the team as an official one. Several differences were found in these various versions of draft law, but the general framework is very much the same. The proposed framework consists of the followings:

1. five mandatory programs, namely work-accident protection program, life insurance, provident fund, pension program, and health maintenance program;
2. all-worker coverage, including informal workers, with gradual inclusion;
3. pre-funding for all programs;
4. a tripartite board to assist the president to formulate policies on national social security system;
5. several state companies to run the programs.

Programs

Among five proposed programs, provident fund and pension program are the most relevant to discuss.

Both employers and workers have to pay contributions to the provident fund. The rate of contributions will be determined in a set of government regulations. Benefits are the accumulation of contributions with interest. They will be paid in lump sum as early as five years before normal retirement age.

Participants may borrow from the provident fund by pledging their benefits. This borrowing, however, can only be done after certain years of participation.

The proposed pension program is of defined benefit type. A participant will be entitled to monthly pensions if s/he has at least 15 contributing years. Benefit formula will be prescribed in government regulations. It is indicated that minimum benefits will also be set. If one contributes for less than 15 years, however, s/he will only get accumulated contributions.

Pension program will require contributions of equal proportion from employers and workers. The rate of contributions will be determined in government regulations. It is not clear how the rate will be adjusted to respond to the emergence of surplus/deficit.

Management of the system

Several state companies will be established by the government to implement the proposed social security system. These companies will collect contributions, manage accumulated assets and pay benefits. It is not clear yet in the draft law whether each company will specialize in a certain program or may manage several program altogether, and whether it may have nation-wide coverage or will operate in a certain demographic area.

The state companies will have two boards, i.e. a supervisory board and a board of directors. Members of both boards will be appointed by the president. A supervisory board will be responsible to formulate operational policies of the company and to supervise its operation. A board of directors will be responsible for the operation of the company.

A presidential board will be formed to assist the president to formulate general policies on national social security system. It will comprise of 18 members: five from the government, five from employers, five from workers, and three relevant experts.

Asset and liability management

Funding will be arranged separately for each program. Cross-subsidy between programs is not allowed. A sufficient level of assets will have to be maintained for each program, but no indication is mentioned in the draft law about the level of sufficiency, how it will be measured and how often such measurement will take place.

In the case of pension program, it is still unclear how contribution rate will be adjusted when the level of sufficiency is not attained. It is not described how deficits, that naturally might occur, will be dealt with. An article of the draft law indicates that the government may step in if the deficits are just too big to be shared by employers and workers.

Investment will be the responsibility of companies running the programs. No specific investment guidelines have been written in the draft law. An article is prescribed to make sure that investment will be carried out with efficient, effective and prudent manner.

Transparency

Program managing companies will have to provide a regular report on the accumulation of contributions to participants. The form of the report will be determined in government regulations. The companies will also have to publish their audited financial statements in national newspaper.

Transitional issues

The draft law does not specifically clarify how existing programs will be merged into the proposed social security programs. Although the proposed programs are very similar to provident fund under Jamsostek program as well as civil service pension program and endowment plan, required adjustments will not be known until key features of the proposed programs are described in more detail in government regulations.

Critical Review on the Proposed System

A compilation of critical comments on the proposed system is laid down below.

1. The proposed provident fund is designed very similarly to existing provident fund under Jamsostek program. As benefits are paid in lump sum and may even be withdrawn prior to retirement, the program is very unlikely to maintain income after retirement. The possibility to pledge the benefits for cash borrowing will even hamper intention to provide protection of income during old age. Experience

shows that many people tend to cash in their financial rights as soon as possible if they are allowed to do so, and soon use up the money unwisely.

2. It can be argued that the purpose of providing lump sum benefits upon retirement under the provident fund program competes with the purpose of severance payment as required by the labor law. If so, both employers and workers have to set aside funds for the same purpose. Unless substitution of benefits is allowed, having two similar programs prescribed in two different laws demands further cost and benefit analysis.
3. Fifteen-year vesting under the proposed pension program is of course better than 20-year vesting under the current civil service pension program. But, it is very long vesting period if compared to one prescribed in the Law number 11/1992 on pension funds. This long vesting period may demote the pension program in wider framework of old age income protection. A mandatory pension program should be able to offer income floor for as many persons as possible (of course, with the risk of higher level of funding)
4. Opting-out from the provident fund and pension programs will not be allowed. It will discourage employers who already have a voluntary pension program to sustain the program. The total costs for pension promises will become too high for employers to bear. As pension benefit formula and level of contributions to provident fund are not prescribed in the draft law, early reassessment of total costs would not be possible. If pension benefits and provident 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.
5. Charging and collecting pension contributions with variable rate will be very difficult. Socialization of rates of pension contributions will have to be carried out regularly. Employers and workers will query frequent adjustments which have to be made on the rate of contributions due to surplus/deficits of the programs. They may even become very sensitive to financial condition of the program.
6. Policy and strategy to maintain financial health of the pension program are vaguely described in the draft law. As mentioned earlier, no description has been made on who will be responsible to take care of deficits. In bad situation, the government will likely be held responsible to deal with emerging deficits. The

likelihood is more obvious if the program to cover informal and poorly remunerated workers.

7. Confusion shall be anticipated in transforming the existing endowment insurance scheme for civil servants and members of armed forces to either provident fund or pension program. Transformation to provident fund will involve actuarial calculation of individual rights and replenishment of any deficits. Government, again, will have to anticipate obligation to cover the deficits. On the other hand, transformation to pension program will need good socialization regarding a change in the method of benefit payment. The majority of civil servants and members of armed forces will want to preserve lump sum payment of endowment insurance benefits, instead of having monthly pensions only.
8. The lack of clear transitional plan from various existing programs to the proposed system will create uncertainty among the management and employees of PT Taspen, PT Asabri and PT Jamsostek. Private employers and workers will also be encouraged to evade paying contributions for Jamsostek program.
9. Commercial interest of banks and life insurance companies on pension provision will be affected. They may argue against the proposed social security system, and in particular the provident fund and pension program, on the basis of market intervention by the government. While making pension program compulsory and publicly managed may have reasonable grounds from the point of view of adverse selection avoidance, centralizing the management of provident funds may destroy pension business of banks and life insurance companies through financial institution pension funds. Poor image of PT Jamsostek in managing provident fund may become promotional material against mandatory centralized provident fund.
10. Taxation of contributions and benefits is not described. The companies managing the programs may not be taxed at all. Although it is understood that taxation is more appropriately taken care of within tax legislations, proper description of general framework of taxation may avoid ad-hoc treatment which frequently happened in the implementation of Jamsostek program, pension program and endowment insurance scheme for civil servants and members of armed forces as well as voluntary private pension programs. Ad-hoc treatments may have contributed to the lack of motivation to run or participate in pension programs.

Closing Remarks

Current pension system in Indonesia undoubtedly needs evaluation and improvement. Uneven legislations produce unequal treatment among various types of workers. Some groups of workers may enjoy lump sum benefits at retirement and monthly pensions afterwards, while the others have to be comfortable receiving small amount lump sum benefits. Informal workers, in the worst case, do not even have any income protection at old age.

A unified pension system is desirable to replace currently fragmented system. The new system is expected to guarantee subsistence pensions to all workers, including informal workers. Such a system needs to be carefully crafted as it may create potential burden for the state. It has to be sustainable by design and easily implemented. Furthermore, it should not discourage both employers and workers to make additional savings for retirement voluntarily.

A new law on national social security system should become an umbrella for all social security programs in Indonesia, including basic pension program. It should be able to describe role of each program in the system and correlation among programs.

Current draft law on national social security system does not give clear picture of the proposed social security system. It does provide information on the types of proposed programs, but details of each program are to be described in implementing regulations. The costs and benefits of the system for employers, workers and society as a whole remain unclear as financial simulation and projections related to the system are never published. Transition rules are not thoroughly defined. This may pose uncertainty to existing workers as well as PT Taspen, PT Asabri, and PT Jamsostek.

Intention to have a unified social security system has been in place. The realization, however, still needs more serious thoughts and works by all parties to ascertain the most suitable system for workers, employers and the entire society.

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