

Social Protection Reform in Indonesia – In Search of Universal Coverage

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The Reform Context

Indonesia has achieved remarkable progress in its transition to democracy and its economic recovery from the Asian financial crisis of the late 1990s. Indonesia is now characterized by a young and growing democracy with a decentralized government in a vast archipelago of different cultures and a population of 230 million people. Poverty levels that had increased by over one-third during the crisis are now back to pre-crisis levels. Indonesia has once again become one of the world's emergent middle-income countries. The Indonesian Ministry of Finance estimates the country's economic growth will be around 6.6% in 2008.

Despite this encouraging success and the ambitious development goals of the Government of Indonesia, the number of people living under US\$2 a day is at an alarming 49% of the total population. Around 40 million people, nearly 10 million households, are clustered around the lowest two of the three national poverty categories with an average income between Rp. 125,000 and 150,000 per month per person. These figures are exacerbated by the fact that many households are close to the national income poverty line and are defined as near-poor, indicating an even larger number of Indonesians who are vulnerable to poverty. Second, poor human development outcomes and lack of access to basic services for many Indonesians makes non-income poverty as serious, if not more serious than income poverty. Third, given the vast size and varying conditions in Indonesia, regional disparities are a primary challenge for the Indonesian Government. Poverty incidence is far higher in eastern Indonesia, but most of the population lives in the densely populated western regions. Recent poverty developments in Indonesia have been significantly affected by large increases in the price of rice and a rise in fuel prices in 2005. The latter has had a mixed

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effect, as the price of fuel increased because fuel subsidies were scrapped in part to mobilize the funding for Askeskin, the new government program to provide basic health services free of charge to the poor strata of the population.

Thus, persistent efforts are clearly required to ensure that economic growth benefits the majority of the population, the poor, and the near-poor. This is crucial for achievement of the ambitious goals laid down by the government for social development. For example, the mid-term plan (RPJM) for 2005-2009 and the national poverty reduction strategy (SNPK) aim to reduce the poverty rate from 18.2% in 2002 to 8.2% in 2009, in other words, to a rate below pre-crisis levels. The Government of Indonesia is also dedicated to achieving the Millennium Development Goals (MDGs) by 2015.

A social protection system that enables the population to cope with risks and vulnerabilities is especially important in Indonesia, due to the high movement in and out of poverty among households and the large number of households clustered around the poverty line. These specific characteristics of Indonesia justify the decision of policy makers to develop a well-designed social protection system to safeguard citizens from risks and vulnerabilities such as income loss, illness and out-of-pocket health expenditures, a poor harvest, or the rise in commodity prices. Thus, given the well-established links between human capital and economic wellbeing, the Government of Indonesia recognizes social protection as a core part of development policies to prevent people from falling into poverty, combat existing poverty, and increase equity.

The current form of publicly provided social protection in Indonesia is based on two kinds of public interventions, namely (a) contributory social insurance or mandatory savings for civil servants (covered by PT TASPEN and PT ASKES), the armed forces (covered by PT ASABRI), and formal-sector employees (covered by PT JAMSOSTEK) and (b) targeted efforts to provide economic or social support for poor or vulnerable groups of society. The Government of Indonesia has undertaken several steps to increase coverage specifically for the poor. In the aftermath of the Asian crisis of 1997/1998, previous downtrends in poverty levels dramatically reversed, especially in the considerable near-poor segment of the population. As an immediate response and following recommendations of the World Bank and the Asian Development Bank, several social safety net programs (JPS) to help especially poor people cope with their steeply declining purchasing power were hastily implemented by a wide array of government agencies providing health services (Kartu Sehat), subsidized rice (Raskin), fuel subsidies, and scholarships for poor children (Sumarto et al. 2005) as well as a multitude of small social assistance programs for specific target groups (abandoned children, disabled persons, poor elderly, etc.) operated by the Ministry of Social Affairs (Weber 2006, 107).

Early assessments of these ad hoc measures revealed low coverage, poor targeting, and, in general, little coordination.² The fuel subsidy, which disproportionately benefited the medium-income and rich households and at the same time was one of the centerpieces of the Indonesian social protection system until 2005, was reduced in 2005, although the move generated intense political controversy (World Bank 2006, 181). Further, the Government of Indonesia recently launched several pro-poor programs to buffer the increased cost of living for the poor, reallocating Rp. 17 trillion for health, education, and village infrastructure programs and cash transfers to 19.2 million poor and near-poor households from 2005-2006. The government has further declared that it will bring in rice imports if the harvest is not sufficient, thus stabilizing prices of this important commodity.³ It also recently began a pilot household and community conditional cash transfer scheme targeting the extreme poor in order to improve human development outcomes. In addition, the long existing Kecamatan Development Program (KDP) will be scaled up to a National Community Empowerment Program, or Program Nasional Pemberdayaan Masyarakat (PNPM), to provide block grants to some 2800 rural and urban sub-districts, with full national coverage of 5360 sub-districts by 2009 (World Bank 2007).

These efforts to provide increased support to the poor were complemented by the government's decision in October 2004 to implement Law No. 40 concerning the National Social Security System (*Undang-Undang Sistem Jaminan Sosial Nasional* or SJSN), which foresees reforming the existing social protection system towards universal coverage. A task force appointed through the Vice President's Office, first created by Presidential Decree (Kepres) No. 22/2002, drafted the law. The key feature of the new law is that it mandates the creation of several social security schemes for citizens: old-age pension, old-age savings, national health insurance, work injury insurance, and death benefits for survivors of deceased workers. Law No. 40/2004 is an important milestone, because it stipulates that the existing social security programs in Indonesia will be expanded so as to cover all Indonesian citizens, including those who are working in the informal sector, the unemployed, and the poor.

² Although the intended beneficiaries of these programmes are in the poorest quintile, they have access to only 31% of health cards, 39% of scholarships, and 29% of RASKIN benefits (Lindenthal 2004, 21). Tambunan and Purwoko (2002) present similar conclusions.

³ <http://news.tradingcharts.com/futures/4/8/91679784.html> (April 19, 2007).

The implementation of Law No. 40/2004 on the National Social Security System is currently bringing about a comprehensive reform of the existing system. Law No. 40/2004 provides the legal basis for the above-stated objective of social protection coverage for all. A task force, headed by the Coordinating Ministry of People's Welfare, is working on the introduction of new regulations as well as the mapping and harmonization of existing regulations relevant in the context of Law No. 40/2004. A great deal has been achieved since its enactment: the mapping and extensive review of existing laws has been finalized, and so has a comprehensive design of a harmonized legal and regulatory framework. Based on the latter, there is now a roadmap for implementation in place, and technical sub-groups are working on new laws – most importantly, the “carrier law” and government regulations. The whole process has been aligned with Law No.10/2004 that stipulates how laws are to be drafted. It has recently been formally endorsed by the president and now looks set to be completed by the legal deadline in October 2009.

Although some important initial reform steps have been taken, several major challenges lie ahead:⁴

- **Low coverage:** Coverage by the existing contributory social insurance system is still low: only about 16 million workers are covered by Taspen, Asabri, and Jamsostek schemes, out of a total labor force of about 101 million people, including job seekers (Angelini and Hirose 2004). This means that only 16% of workers are currently covered by formal social security schemes. Health insurance coverage by public schemes is slightly higher, with around 18 million insured. Extending coverage in terms of both organizational as well as sustainable financing options will be based on a comprehensive strategy that is currently being prepared by the ministries charged with building the new social security system (Jaminan Sosial Nasional, JAMSOSNAS). This requires detailed conceptual work and decisions on, for example, benefit package(s), contribution rates, and necessary institutional reforms. It also requires deciding on appropriate social protection instruments with regard to some specific risks such as old age and unemployment.
- **Fragmentation:** One objective of the reform is to build a coherent system of social protection and reduce the high degree of fragmentation that so much characterizes the current system. Benefits of streamlining include improved allocative efficiency of administrative resources. Coordination between the various programs that are targeting the poor needs to be enhanced. The cooperation and communication between different government ministries

⁴For a more detailed treatment, the interested reader is referred to Bender et al. 2008.

and service and insurance providers will be facilitated by a new statutory body, the National Social Security Council, soon to be installed by the president.

- **How to cover the informal sector?** The present system excludes the non-poor in the informal sector from any arrangement: they are not covered by the contributory social insurance and are not eligible for any form of social assistance. Considering the fact that the informal sector in Indonesia comprises a substantial part of the working population,⁵ with a high proportion of them being considered non-poor, developing an effective strategy on behalf of this population group is crucial for realizing the goal of universal coverage.

As already mentioned, a crucial reform issue is the streamlining of the numerous bodies that make up the current system and the defragmentation of their functions: at present, a relatively small part of the population is covered by public social security, namely employees of the military (through PT Asabri, PT Askas), civil servants (through PT Taspen, PT Askas), and those employed in private enterprises above a certain staff size and total payroll (through PT Jamsostek). The latter are insured against work accidents, illness, death, and funeral risks, but not against unemployment. In case of retirement, they receive a lump sum payment from a mandatory saving scheme (provident fund) related to their contributions plus interest. Members of the armed forces and civil servants are insured against illness (PT ASKES) as well as old age, in case of which they receive lump sum payments as well as annuity benefits for life after retirement (through PT ASABRI and PT TASPEN, respectively). Thus, the institutional setup of social security is mainly organized according to group affiliation. The responsibilities for programs of social assistance are vested within different ministries and different administrative structures. In addition, programs are operated at the central and local level.

From a technical point of view, there are two basic options for organizing the administration of social protection: (1) integration of all risk-related activities under one specific administrative body for each risk; (2) separation of all risk-related activities for certain groups of society and their specific administrative bodies. There is also a third, more pragmatic approach: (3) harmonization and rationalization of regulations between existing administrative bodies.

⁵According to the National Labor Force Survey (2007), the informal sector in Indonesia comprises a substantial and growing part of the working population, currently with 69% of the total labor force.

Focussing on the technical efficiency of a public social protection system with integration of carriers is an appropriate option for social insurance, whereas social assistance is best provided within a framework of (broad) separation: Insurance works by pooling risks across a large population. The larger the risk pool, the smaller the volatility of claims, thereby facilitating the management of the insurance. However, an insurance risk pool must not necessarily be as large as the entire population to effectively reduce volatility,⁶ and the positive returns to size diminish beyond a certain threshold. Yet for social insurance to work, a balanced composition of the risk pool is essential. This is achieved by integration, but not by separation.

In contrast, social assistance is, generally speaking, best provided within the framework of a (broad) separation: Firstly, by definition, it targets specific groups within a population, namely the poor and other specific needy groups. Secondly, again by definition, all social assistance benefits are targeted benefits. As targeting methods involve non-negligible transaction costs, subsuming social assistance under one administrative body provides the opportunity for exploiting economies of scope. In the third option of harmonization, institutional path dependencies are taken into account, and the existing institutional framework for social protection is gradually adapted where this is required by new or changing needs.

Harmonization is the option that Indonesia has chosen at present; it aims to harmonize all laws and regulations by 2009. Harmonization provides an important first step. However, given the limited technical benefits of harmonization in comparison to the other two options, the country may consider going further in the medium term. Options for later reforms are: (a) institutional integration of risk-related activities under one specific administrative body for each risk in standard social insurance and (b) institutional separation of activities for the poor and other vulnerable groups – in other words, social assistance – could offer an overall guiding framework. In this context, responsibility for social assistance should then be centered on a newly founded institution, perhaps under the umbrella of the Ministry of Social Affairs.⁷

Social health insurance is one of the major components of the social security system. This fact is also reflected by the priority this component is given within

⁶If this were the case, private insurances would not be able to operate.

⁷With regard to certain social insurances, the question arises if the poor or other specific needy groups should be included within the general insurance framework or covered separately. This is particularly relevant for social health insurance. In this case, the poor should be included within the specific social insurance, and the administrative body responsible for social assistance could remit the contributions on behalf of the poor to the respective social insurance administrative body, which would then be responsible for delivering the benefits/services to the poor.

the overall reform process in Indonesia. With regard to social health protection, the systemic question of which instruments to apply seems more or less settled with the plan to combine social insurance and tax-financed, means-tested social assistance for the poor. At present, PT Askes and PT Jamsostek provide social health insurance to civil servants and formal sector employees, respectively. In addition, the ASKESKIN scheme, managed by PT Askes, provides tax-financed healthcare to poor households. With ratification of Law No. 40/2004 on the National Social Security System, the basic principles of universal social security and a timeframe for the work necessary for the new system to be implemented throughout Indonesia were established. Within the boundaries already set by Law No. 40/2004 and the reform and implementation steps taken since then, however, many decisions still need to be made. For example, the choice about how to pool funds, namely, single or multiple funds, is currently under scrutiny.

Besides social health protection, the issue of old age protection is gaining increasing attention within the Indonesian context. Formal sector workers receive a lump sum payment from a mandatory savings scheme (provident fund) related to their contributions, plus interest. Thus, longevity risks are not covered. Members of the armed forces and civil servants receive a lump sum payment as well as an annuity benefit for life after retirement. In the absence of a comprehensive social insurance scheme providing life-long old-age benefits, the reform agenda for pensions in Indonesia is still open to innovative solutions.

To obtain prevention against demographic risks, one option would be to combine funding elements with pension insurance in a new national pension scheme. Subsequently, once the new national pension scheme is fully established, the share of pay-as-you-go financing could be reduced gradually in favour of the funding principle. Low-income earners could be supported to a certain extent by tax-financed instruments. A second option would be to introduce a tax-financed universal basic pension scheme with pensions based on a fixed percentage of local minimum wage.

However, in this option there are certain drawbacks to consider: first, like all universal schemes, it could be very costly to guarantee such a basic pension, considering the high percentage of the poor and near-poor population; second, a non-contributory pension scheme could create negative incentives for participation in contributory social insurance, so this solution could endanger moving from informal to formal employment. Another approach to solving the problem of old age poverty could be seen in the future role of social assistance, which would be subject to means testing and targeted to all persons with income below the national poverty line. However, this alternative is not a substitute for the previous options, but rather a complement to the first option.

Unlike social health protection, the issue of unemployment compensation and the instruments to employ is still strongly debated at present. Currently, only severance pay plays an important role in Indonesia. Alternative instruments such as unemployment insurance, unemployment assistance, individual saving accounts for unemployment benefits, and mandatory saving accounts for severance payments do not exist in Indonesia. Preliminary recommendations for unemployment compensation in Indonesia include a combined system of mandatory individual savings accounts and mandatory savings for severance pay, both of them complemented by solidarity funds.

One of the crucial questions remains how to extend social protection coverage to the non-poor in Indonesia's large informal sector. The non-poor among informal sector workers are the population segment currently suffering the highest degree of exclusion from social protection: they are not covered by contributory social insurance and are not eligible for any form of social assistance. The legal postulate of universal coverage will have to bring about fundamental changes in order to provide social security to this group. Whereas standard contributory social security is designed for formal sector employees and the poor are targeted by tax-financed and means-tested social assistance mechanisms, only few programs are directed towards the non-poor in the informal sector. Considering the enormous size of the informal sector in Indonesia, the overall integration of the informal into the formal economy should be the ultimate long-term objective. To include it in the social protection system in the medium term, specific social security programs will have to be designed and implemented, as standard social insurance with its defining characteristics of statutory membership and income-related contributions is not appropriate for reaching out to the informal sector. Due to the special characteristics of the heterogeneous and poorly defined group of people living in the informal economy and the resulting specificities of social security schemes for the informal sector, schemes for this group carry a variety of risks that endanger their effectiveness in terms of coverage and financial sustainability. Reliable data for planning, a careful design, and skilled administrative personnel for implementation are therefore necessary preconditions.

Linkages to the Concept of a Social Market Economy within the Indonesian Context

Social protection *per se* is an indispensable element within the concept of a social market economy. The structure of social protection within a social market economy is guided by the overarching principle of subsidiarity, which translates into a specific approach to social protection often referred to as the social state model. This

model combines statutory social insurance with means-tested and targeted social assistance for specific vulnerable groups as well as incentives for private measures. To what extent could this model be of relevance within the Indonesian context?

The outline above demonstrated that the current social protection system in Indonesia is based on two kinds of public interventions, namely contributory social insurance or mandatory savings for specific population groups, and confined targeted efforts to provide economic or social support for poor or vulnerable groups of society. Further, as mentioned, the Indonesian system displays a high degree of fragmentation and is currently undergoing a process of harmonization and consolidation. It is the stated objective of the government to achieve “universal coverage” and to take decisions on the policy issues relevant to this objective. At the present stage of the reform process, not all steps necessary for the operationalization of this objective have been fully developed yet.

In this context, the social state model has the potential to offer a unifying and guiding framework to provide orientation for extending, coordinating, and consolidating the current system, while matching existing structures. However, such a model should be used as a guiding model, not as a blueprint: Any model represents but a stylized and abstract representation of the real world. With regard to the social state model, this means for example that – at least to a certain extent – non-means-tested universal elements can easily be incorporated into the system.⁸

GTZ Activities

The Governments of Indonesia and Germany are currently collaborating on social protection in the following, complementary areas:

- 1) Policy advice and support, also on the implementation of a national social security system in the context of the implementation of Law No. 40/2004. Together with its implementing partner, the Ministry of Health, GTZ is working with the National Social Security Taskforce under the leadership of the Coordinating Ministry of People's Welfare. This taskforce is responsible for all aspects of the implementation process: formulation of new laws, presidential and government regulations, review of existing laws and their harmonization with the reformed social security system, and the government and public consultation processes required for the reform.
- 2) Furthermore, GTZ is providing advice to the Ministry of Health on specific questions arising from the introduction of universal social health insurance. The issue has far-reaching implications for the health system and

⁸Housing and family benefits are prominent examples in this context.

is therefore intertwined with most current priority health-policy questions. In its role as a member of the national taskforce, the Ministry of Health is responsible for drafting a presidential regulation on social health insurance. This will regulate all questions of membership, benefits, and service provision. It implies that a number of important health policy questions must be answered; furthermore, around 15 national laws will have to be harmonized so that the regulation can meet the regulatory requirements of Law No. 40/2004.

- 3) Policy advice to BAPPENAS, the Indonesian National Planning Authority, on strategic planning of the reform process: GTZ is providing BAPPENAS with international expertise for the development of strategies and policy recommendations for the Five-Year Plan 2010-2015 regarding the further development of the social protection system that will be launched at the end of the current legislative period in 2009. When asked by BAPPENAS to prepare a comprehensive report on options for social protection reform in Indonesia, GTZ assembled a team of academic and policy experts. A draft version was presented and discussed with various national and international stakeholders in a workshop held in August 2007; the final report will be published in early 2008 (Bender et al. 2008).

The Way Forward

As shown above, there has been remarkable progress in Indonesia's social protection system from the financial crisis of 1997/1998 to date. By passing Law No. 40 in 2004, the Government of Indonesia initiated a comprehensive process of reforming the existing system towards universal coverage, aiming to improve access as well as enhance quality of service delivery.

The reform process implies a multitude of policy decisions and legal and regulatory adjustments that are currently being addressed by the various stakeholders to the process. In this context, the incorporation of the non-poor in Indonesia's large informal sector, as well as the provision and financing of basic social assistance to the high number of poor or near-poor are two of the most crucial challenges on the way to universal coverage.

In addition, in many reform areas such as administration and institutionalization of the entire system of social protection, political decisions on options to be implemented have still to be made. The government is currently working on reaching a political consensus on these open policy questions as well as on securing the space crucially required to manoeuvre in face of the multifold and diverse interests of stakeholders involved.

BAPPENAS is involved in the ongoing reform process and is committed to accompanying the process and further developing strategies to optimize the process and work out and support the implementation of suitable options based on international experience. In this context, the joint BAPPENAS-GTZ report, *Options for Social Protection Reform in Indonesia*, is one contribution to the reform process. It analyzes visionary, but feasible options for the future of social protection within the Indonesian context.

The report also provides an important contribution to strategic planning of the overall reform process. In this process, BAPPENAS is charged with the task of preparing a draft version of a mid- and long-term roadmap for social protection reform. The roadmap will provide guidance on the timing and sequencing of reform steps and will be discussed among relevant political stakeholders. GTZ will continue its support and assist BAPPENAS in the elaboration of the roadmap.

Reviewing the current situation and analyzing the options for the various social protection schemes for citizens also reveals that the efficacy of ongoing and future reforms depends greatly on developments and progress in other sectors. Most prominently, it will depend on private sector development and the expansion of the formal sector and attendant reduction of the informal sector, tax system reforms, and sustained efforts in decentralization reforms. Further, reform options need to be carefully designed in order to prevent adverse impacts on the labor market. As economic growth clearly impacts on the feasibility and outreach of publicly provided social protection, continuing efforts to promote an enabling environment for economic growth are essential. This includes, among other things, the creation of a conducive and investment-friendly business environment.

Further, reform efforts should be realistic and consider prevailing constraints. For example, given the unfortunate relation between the number of poor and near-poor persons in Indonesia and given the limitations of tax resources, the potential outreach of social assistance is limited, and ad-hoc measures should be avoided. Basically, the decision is either to provide a relatively broad range of social assistance measures to a very limited group of persons, or to focus on a reduced number of measures (such as health services or modest forms of income support via cash transfers) provided to a wider share of the poor population.

Last but not least, it must be pointed out that achieving universal coverage, as intended by the Government of Indonesia, is a lengthy and incremental process – especially in a vast and heterogeneous population like that of Indonesia. With its long-term political commitment to achieving social security for all, the Government of Indonesia has met a pre-condition for success.

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