



Submission No 47

Inquiry into Australia's Relations with Indonesia

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**THE DEPARTMENT OF FAMILY AND COMMUNITY
SERVICES' ENGAGEMENT WITH
THE REPUBLIC OF INDONESIA**

**SUBMISSION TO THE FOREIGN AFFAIRS SUB-COMMITTEE,
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The Department's Engagement in the Asian Region

The Department of Family and Community Services' (FaCS') engagement with the Republic of Indonesia is part of its overall approach to building long term relationships with key countries in the Asian Region.

FaCS engages with the region because of its firm commitment to the **whole of government** approach to Australia's foreign policy. It seeks to establish long-term influential relationships at a portfolio level with other key countries in the Region across several areas of government within those countries. It does this with a view to furthering Australia's political and economic interests.

The nature of this engagement is such that it focuses on areas requiring expertise that only the FaCS portfolio can provide. This narrow focus is to provide **support for systemic change** within key countries in the Region. For example:

- In China FaCS works with the State Development Planning Commission, the premier body responsible for formulating social policy, exploring jointly approaches to community development (covering joint research, piloting of approaches and development of policy) to assist China to rebuild communities affected by recent economic reforms;
- In Vietnam FaCS works with the newly-constituted Committee for Population Family and Children's Affairs to develop a national strategy and policies for strengthening the role of the family in Vietnam's changing society, to enable the momentum of its economic reform to continue without grave social disruption;
- In Singapore FaCS has established a mutually beneficial relationship with the Ministry of Community Development and Sports, exchanging social policy approaches and facilitating dialogue (focussed at present on issues arising from low fertility rates and ageing populations). FaCS seeks to use this model of a social policy partnership to extend Australia's influence into the ASEAN group of countries; and
- In Indonesia FaCS is currently working with the Presidential Task Force for Social Security Reform to build a holistic system that will provide the Indonesian workforce with the basic elements of social protection, including provision for retirement, workers compensation, maternity leave and death benefits

Such engagement characteristically does not entail high cost to the department. FaCS is not constituted to provide aid and does not seek to do so. Rather, as noted above, the department limits itself to committing expertise to carefully targeted areas of identified countries undertaking major reform. Funding for the capacity building activities undertaken by the FaCS portfolio is provided through the normal budgetary allocation to FaCS' International Branch and supplemented, to some extent, from revenue raised by other international consultancy activities undertaken by FaCS on a fee-for-service basis.

Background to social security reform in Indonesia

The Indonesian Government is currently undertaking a major reform of its social insurance system, covering health insurance, retirement pensions, workers' compensation, maternity and death benefits. Under the present system, employers make contributions on behalf of employees to the following government owned insurance agencies:

- **JAMSOSTEK**, the largest of the insurance bodies (although it covers only a small percentage of the current workforce), serves private industry. It provides retirement pensions (based on the contribution made during an employee's working life), workers' compensation, maternity and death benefits;
- **ASABRI**, under the control of the Ministry of Defence, serves the armed forces and the police. It offers a system of retirement pensions, workers' compensation, maternity and death benefits similar to that paid by Jamsostek, with the notable exception that employees are paid a higher amount, a "defined benefit" (a set percentage of the employee's salary), on retirement;
- **TASPEN**, serves the public service. It offers a system of retirement pensions, workers' compensation, maternity and death benefits similar to that paid by Asabri; and
- **ASKES**, the health insurance system, receives a percentage of the amounts paid by employers in the above three systems and provides basic health cover to employees from the private sector, the armed forces and police and the public service.

Under the current system, contributions paid into the three retirement funds on behalf of employees are invested with the aim of obtaining a high annual return. However, any surplus obtained in this manner, is **not returned to the employees** to bolster their pensions on retirement. The financial operations of JAMSOSTEK and TASPEN are oversighted by the Ministry of State Owned Enterprises and any surplus they make is paid into the Ministry of Finance. ASABRI is oversighted by the Ministry of Defence and any surplus it makes is returned to that Ministry (the Ministry of Defence never receives more than 30% of its annual budget from the Government and must seek additional funding through a variety of means). Employees of the public service, armed forces and police, receive a defined benefit pension, a percentage of their salary on retirement, which is supplemented by the Ministry of Finance. However, employees in the private sector receive a lump sum payment that is no more than the amount paid on their behalf during their working life. Not unnaturally, this is seen as unfair and offers little incentive either to employers, who see JAMSOSTEK payments as little more than a tax that they will avoid wherever possible, or employees who, after a lifetime of work, get a negligible return that will be eliminated quickly by inflation.

Current reforms undertaken by the Republic of Indonesia

The first major reform envisaged by the Presidential Task Force is to unify the four social insurance bodies in **an integrated single system** offering a consistent system of payments. It is proposed that the four organizations will, initially, be grouped under a **single regulatory body answerable directly to the President**. This is a major structural reform that will come into operation in a number of stages and will take several years to accomplish.

The second reform is more far-reaching and promises to have a far greater impact on its clients and, indeed on the entire social fabric of Indonesia. The Task Force proposes that, in addition to grouping the retirement insurance funds into a single, unified system, **contributions paid by employers henceforth will be invested on behalf of the employee** and any return on the investment will be used to boost payments made to employees on retirement. In the defined contribution system proposed by the task force, **all clients of the system will get similar treatment**, receiving pension payments based on the amount contributed during their working life together with any additional amount that their contribution earned through investment.

This reform will introduce into Indonesia a system similar to other provident fund systems found elsewhere around the world. This initial, major reform is likely to be followed by a number of changes over time that will see coverage extended to the entire Indonesian workforce, including the self-employed, farmers and fishermen, who make up the bulk of the workforce. These staged reforms will in turn create major social changes:

- They will provide a substantial retirement safety net for all workers;
- They will contribute to social stability by alleviating areas of poverty in the long term
- They will contribute to economic stability because they will remove the current corrupt system and strengthen investment and financial structures;
- They will contribute to a more orderly workplace by putting in place structures that will assist industry and the workforce to adapt to change without major disruption;
- They will be the first step towards a more inter-connected system similar to that in other modern economies, with linkages to the sectors of education and training, health and community development and industrial relations.

In other words, the reforms are vital components in Indonesia's push to become a fully functioning modern society.

FaCS' role in the current reforms

FaCS' actions are aimed at assisting with systemic change in social policy and practice in those countries with which it engages. Given the complexity of the changes being contemplated in Indonesia, its focus is, necessarily, on a long-term relationship. FaCS therefore sought to establish a relationship with the Presidential Task Force within a brief period of time. A description of its engagement to date is at **Attachment A**.

The most significant step in that process occurred during the visit to Indonesia of Senator the Hon Amanda Vanstone, Minister for Family and Community Services in May 2002, accompanied by the Secretary of FaCS, Mr Mark Sullivan. During her visit they held discussions with the Indonesian Minister responsible for guiding the efforts of the Task Force, HE Mr Bambang Kesowo, Secretary of State. During those discussions, which covered the development of an integrated social security system in Indonesia, the following important considerations were identified:

- The need to integrate the existing social security schemes for public servants, military, police and civilian personnel and the private sector into the new scheme, with provision for appropriate transitional arrangements;
- The need to bring those working in the informal sector of the economy – especially in agriculture and fisheries – into a national scheme;
- The importance of the national scheme meeting the specific needs of low income and seasonal workers;
- The need to develop appropriate methods of collection of contribution and disbursement of collections in rural areas; and
- The operation of the new scheme within the context of the introduction of the new regional autonomy framework, with consideration being given to whether it should be centralised or whether substantive responsibility for its implementation be devolved to regional level.

During those discussions it was decided that FaCS would provide the following support to the Task Force:

- send a team to work with the Presidential Task Force to define the “core concept” behind the reforms, to be used as the basis for instructions for drafting the reform legislation;
- send a team to assist with drafting the reform legislation;
- host a follow-up visit to Australia by members of Task Force to study aspects of the Australian social security system necessary to finalise the design of the proposed integrated national social security system in Indonesia.

In August 2002 FaCS sent a team to consult with the Task Force and provide a report on essential elements of the “core concept” (a copy of the report is at **Attachment B**). It is understood the report was used subsequently by the Task Force in drafting the final reform proposals submitted to President Megawati Soekarnoputri. FaCS is currently holding discussions with the Task Force regarding the scope and nature of its involvement in the second cooperative task decided by Ministers Vanstone and Kesowo.

Future engagement by FaCS with Indonesia

During Minister Vanstone’s visit to Indonesia in May 2002, several important relationships with specific Ministries were initiated on behalf of the portfolio. In addition to meeting with HE Mr Bambang Kesowo, Minister Vanstone met and discussed social policy directions with:

- HE Dr Hamzah Haz, Vice President;
- HE Dr Yusuf Kalla, Coordinating Minister for People’s Welfare;
- HE Mr Jacob Nuwa Wea, Minister for Manpower and Transmigration;
- HE Mr Bachtiar Chamsyah, Minister for Social Affairs; and
- HE Sri Rejeki Soemarjoto, State Minister for the Empowerment of Women.

It is expected that these relationships will lead to the following engagement by the portfolio over the next few years

- Following her discussions with Minister Bambang Kesowo, Minister Vanstone sought and obtained support from the Minister for Foreign Affairs for a special Joint Working Group on Social Security to be established under the aegis of the **Australia-Indonesia Ministerial Forum**. The purpose of the Working Group will be to coordinate strategically cooperative activities between Australia and Indonesia in the area of social security. It is understood that the Indonesian Ministry of Foreign Affairs is favourably inclined to the establishment of the Working Group and is likely to support it at the next meeting of the Australia-Indonesia Ministerial Forum in early 2003.
- A Memorandum of Understanding has been negotiated between the FaCS portfolio and the Ministry of Manpower and Transmigration and is likely to be signed in November 2002 by Ministers Vanstone and Nuwa Wea. Cooperative activities under the Memorandum will aim at strengthening the operations of the JAMSOSTEK component of the reformed social security system through the provision of technical advice and expertise by Centrelink. In addition, it is expected that FaCS will act on behalf of the Ministry to facilitate linkages with other Australian departments that have been suspended in the recent past.
- FaCS is currently holding discussions with the Office of the Vice President (Office of Women Empowerment and Employment) about developing a program for strengthening leadership of non-government organisations through training and reskilling. The program will focus on enabling non-government organisations to respond in a coherent, coordinated way to policy driven initiatives in the evolving society. Approaches developed in current community development initiatives in Australia will be of particular value in the program eventually developed.
- It is expected that FaCS will develop a Memorandum of Understanding with the Ministry of Social Welfare in 2003. Cooperative activities are likely to focus on rebuilding the social safety net so that it can respond to developments in social security reform, meeting the needs of those members of the population who will not be included in the expending social security system.

FaCS recognises that the above changes taking place in Indonesia are complex and will take place over a long period of time. In selecting areas of engagement with Indonesia, FaCS has sought to employ its systemic approach to this work, similar to that adopted in other countries in the Region. However, FaCS recognises that, if its work is to have lasting value, there are unique aspects in its relationship with Indonesia that will require special attention:

- As part of its commitment to the whole-of-government approach, FaCS will concentrate on strengthening the relationship between the Indonesia and Australia in areas where none existed previously. Those relationships will of their nature be institutional bonds, largely Ministry to Ministry, aimed at strengthening their capacity to operate effectively.
- In targeting very carefully the government bodies with which it will engage, FaCS is prepared to commit to sustained periods of cautious engagement. In this it will remain consistent in its approach so that trust will develop on both sides.
- To maintain this commitment and impetus FaCS will continue to develop a stronger awareness of Indonesian needs and the different framework and timetable

within which Indonesia must operate, and will continue to remain cognisant of these factors.

ATTACHMENT A

FaCS' ENGAGEMENT WITH THE REPUBLIC OF INDONESIA

Date	Event/Activity
June 2000	<p>The Asian Social Policy Ministers' Forum is held in Brisbane by the Minister for Family and Community Services, Senator the Hon Jocelyn Newman. The Indonesian Minister responsible for coordination of social security is invited to participate and initially accepts. However, following the sudden death of President Hafez Al Assad of Syria, he is nominated to represent the Indonesian Government at the funeral. The Indonesian Government sends Dr Indra Hattari as an observer to the Forum. This is the first occasion that the department makes contact with an Indonesian policy maker and becomes acquainted with certain key reform issues facing the Government of Indonesia. Dr Hattari is a member of the Task Force for Social Security Reform recently set up by the then Vice President Megawati Soekarnoputri. Dr Hattari remains in contact with the department following the Forum and urges it to make a high-level visit to Indonesia to initiate contact with the Task Force.</p>
November 2000	<p>Dr David Rosalky, Secretary of the department, visits Jakarta and holds discussions with Prof Doc Yaumil Agoes Achir, adviser on social policy matters to Vice President Megawati Soekarnoputri and head of the Task Force for Social Security Reform. It is agreed that FaCS will sponsor a visit by members of the Task Force to assess areas in which FaCS can provide assistance in the forthcoming reforms</p>
February 2001	<p>The new Minister for Family and Community Services, Senator the Hon Amanda Vanstone, writes to Megawati Soekarnoputri newly installed as President of Indonesia. Minister Vanstone congratulates the President and formally invites her to send a delegation to visit FaCS. HE Mr Bambang Kesowo, Secretary of State, responds enthusiastically on behalf of the President, indicating GOI willingness to cooperate further with FaCS.</p>
June 2001	<p>A 3-person FaCS delegation led by the Assistant Secretary International Branch visits Jakarta to assess developments in the proposed program of social security reform. The delegation meets with Mr Bambang Kesowo and members of the Task Force, who inform delegation of proposed reform directions.</p>
February 2002	<p>A delegation comprising representatives of the Task Force, the Ministry of Manpower and Transmigration and from Jamsostek, under the sponsorship of the ILO visits FaCS and Centrelink. The visit focuses on:</p> <ul style="list-style-type: none"> • Obtaining technical advice from FaCS and Centrelink about

	<p>system and procedural changes necessary for the modernising of Jamsostek, the major Indonesian social insurance agency;</p> <ul style="list-style-type: none"> •• Identifying the necessary steps to be taken to formalise a Memorandum of Understanding between FaCS and the Ministry of Manpower and Transmigration; and •• Obtaining advice regarding administrative and legislative frameworks necessary for the reforms envisaged by the Presidential Task Force for Social Security Reform.
<p>May 2002</p>	<p>Minister Vanstone visits Jakarta and meets with:</p> <ul style="list-style-type: none"> • HE Dr Hamzah Haz, Vice President; •• HE Dr Yusuf Kalla, Coordinating Minister for People's Welfare; •• HE Mr Jacob Nuwa Wea, Minister for Manpower and Transmigration; •• HE Mr Bachtiar Chamsyah, Minister for Social Affairs; •• HE Sri Rejeki Soemarjoto, State Minister for the Empowerment of Women; and •• HE Mr Bambang Kesowo, Secretary of State. <p>A key outcome of the meetings with Ministers Jacob Nuwa Wea, Bachtiar Chamsyah and Sri Rejeki are decisions to proceed to development of Memoranda of Understanding covering respectively</p> <ul style="list-style-type: none"> •• technical assistance in restructuring social insurance systems (with the assistance of Centrelink), •• assistance in development of social assistance policies and the use of NGOs to deliver policy outcomes, and •• assistance in developing policies for the empowerment of women. <p>The meeting with Bambang Kesowo and key members of Presidential Task Force, given the strong relationship already in place, covers specific assistance to be provided immediately by FaCS to the Task Force. Actions identified include:</p> <ul style="list-style-type: none"> • Immediate assistance to Task Force to identify the "core concept" of social security reform; • Assistance to the Task Force in drafting reform legislation • A follow-up visit to Australia by members of Task Force to study aspects of the Australian social security system necessary to finalise the design of the proposed integrated national social security system in Indonesia. <p>It is also decided that action be taken to move towards the establishment of a Joint Working Group on Social Security under the aegis of the Australia-Indonesia Ministerial Forum.</p>

June 2002	FaCS sends a delegation to negotiate a Memorandum of Understanding with the Presidential Task Force and develop a Plan of Action to structure the cooperative activities.
August 2002	<p>FaCS sends a team of consultants to work with the Presidential Task Force in defining the “core concept” of the reforms.</p> <p>The team provides its report to the Presidential Task Force, of which it believed elements are incorporated in the Task Force’s final report to the President.</p> <p>The Memorandum of Understanding between FaCS and Presidential Task Force is signed.</p> <p>A Memorandum of Understanding is negotiated between FaCS and Ministry of Manpower and Transmigration.</p>
September2002	<p>Minister Vanstone obtains support from the Hon Alexander Downer, Minister for Foreign Affairs, for the establishment of a Joint Working Group on Social Security.</p> <p>FaCS liaises with Indonesian Embassy and obtains commitment from Indonesian Ministry of Foreign Affairs to support the proposal at the meeting of Australia-Indonesia Ministerial Forum to be held in early 2003.</p>
October2002	Minister Vanstone invites HE Mr Jacob Nuwa Wea, Minister for Manpower and Transmigration, to visit Australia in November 2002 to sign the Memorandum of Understanding between FaCS and his Ministry.

Social Security Reform

in

The Republic of Indonesia

The Core Concept

*Observations by
the
Australian Department of Family and Community Services Team*

August 2002

Background

On 2 May 2002, the Australian Minister for Family and Community Services, the Hon, Senator Amanda Vanstone, met with His Excellency, Mr Bambang Kesowo, Secretary of State for Republic of Indonesia, together with leaders of the Presidential Taskforce for Social Security Reform.

In discussions held at that meeting, Mr Bambang Kesowo outlined certain key stages in the reform process being undertaken by the Presidential Taskforce, of which the most immediately important were:

- refinement and finalisation of the key concepts underpinning the proposed reformed system (the timing of this stage is by no later than August 2002); and
- drafting of laws to put the proposed changes into effect, set for the end of 2002, after which they would be put to the Parliament.

His Excellency asked Minister Vanstone if her portfolio would play a role in the above process. Minister Vanstone had previously written to His Excellency offering to host a visit by members of the Presidential Taskforce to enable it to consider aspects of the Australian social security system in the course of its work. She readily acceded to this request, offering to:

- provide experts to conduct discussions with the Presidential Taskforce regarding core concepts;
- provide experts to play a role in drafting legislation; and
- host a visit to Australia by members of the Presidential Taskforce to assess additional elements of the Australian system that could be of use in the reform process.

A Memorandum of Understanding was subsequently drafted and a Plan of Action drawn up, embodying the above commitments. The Memorandum of Understanding was signed on 8 August 2002 in a ceremony held in Jakarta at the Office of the Deputy Secretary of State. The signatories were Professor Dr Yaumil Agoes Achir, Head of the Presidential Taskforce, and His Excellency, Mr Ric Smith, Australian Ambassador.

In anticipation of the Memorandum of Understanding coming into effect, the Department of Family and Community Services (FaCS) provided a team to participate in discussions with the Presidential Taskforce in Jakarta that same week. The Team comprised:

- Mr Leon Trainor, Director, Capacity Building, International Branch;
- Ms Leonie Corver, Director, Retirement Policy, Seniors and Means Test Branch; and
- Mr Kevin Casey, Consultant.

As previously agreed the team's primary focus was on retirement issues facing the Presidential Taskforce. From 6 to 9 August 2002, the team conducted the following activities:

- met with members of the Presidential Taskforce on 6 August and gave a brief outline of the Australian system of retirement funding;
- met with executives of JAMSOSTEK and TASPEN on 7 August, during which the key issues affecting those organisations were exposed in refreshing detail;
- on 8 and 9 August, the team formulated its considered views based on previous research and the information generously provided by Presidential Taskforce, JAMSOSTEK and TASPEN. Those views form the basis of this present paper; and

- on 9 August, the team presented this paper with its findings to the members of the Presidential Taskforce at the offices of the Vice President for the Republic of Indonesia.

Introduction: The Core Concept

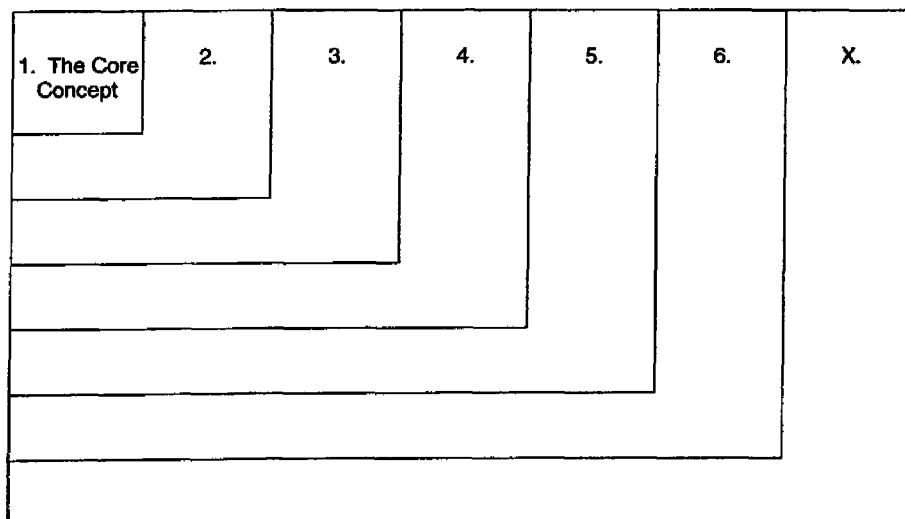
It is the view of the FaCS Team that reforms proposed to the social security system of Indonesia should best proceed by stages.

The first stage, the “core” of the reform process, represents changes that should be made to the existing system to ensure that its components:

- are legally established and supervised;
- interrelate harmoniously;
- achieve a measure of integration; and
- are able to respond with maximum effect to subsequent stages of the reform process, during which social security coverage is extended to ever increasing numbers of Indonesian people.

It is important to note that for various reasons, certain members of the population will never be a part of the social security system. Insofar as they are reached by the Government of Indonesia, they will do so by falling into whatever form of social safety net exists at a particular time.

The core of the reform process can be explained by the following diagram:



The overall diagram represents the totality of the Indonesian workforce and the stages by which coverage will be extended to it.

Part 1 of the diagram represents the core concept that is at the heart of reforms proposed to the system. In that concept the reformed, integrated system should achieve certain key goals before it proceeds to extend its coverage beyond the current members of the existing social security funds. Key issues for consideration in developing that core system, which the FaCS

team considers should be achieved as a primary goal, are outlined below. It is considered vital so that people can see the benefits of belonging to it.

Parts 2 – 6 of the diagram cover the different stages by which coverage is extended. Possible stages include (and there may well be additional stages not covered in this diagram) extension of coverage to:

- businesses employing one or more workers;
- self-employed workers;
- part-time or home based workers;
- fishermen; and
- farmers.

These groups of prospective members are only suggestions – there may well be other groupings and a different sequence for proceeding, however it is important that it proceed by careful stages. Policy and procedures should be developed for each group. The members of each group will have their own distinct characteristics (mode of collection, type of benefit paid, etc.) and will require separate strategies so that they may be drawn into the social security system.

Part X represents the fact that (as stated earlier) for various reasons, certain members of the population may never be covered by the social security system. Insofar as they are reached by the Government of Indonesia, they will do so by falling into whatever form of social safety net exists at a particular time. It should be noted that the numbers of people who rely on social assistance of one form or another should decrease progressively as coverage is extended. The forms of assistance that should make up a social safety net is not the subject of this paper, and has not been described by the FaCS team. Nevertheless, when attention is given in the future to designing and bringing into being the essential characteristics of the core concept and system, this should take place in consultation with the authorities responsible for the social safety net.

This paper describes:

- issues for consideration from a social policy perspective that need to be taken into account because each will have implications for the core concept;
- considerations about the legal structure that should apply to ensure the success of the core concept; and
- considerations about the investment of funds for the overall benefit of members.

Key Issues for Consideration

The social policy context

Consideration of reform to retirement income arrangements, and issues about the nature and scope of appropriate institutions, systems, and funds management arrangements, occurs within a broad social policy context. Social policy issues will both influence, and be affected by, reforms to retirement income arrangements, and social security reform more generally.

Integrated System

In our view it is important that the system be integrated, that is that it provide coverage for as wide a range of the population as possible, and that each of its components should complement each other.

It will therefore be important to have a consistent framework and approach for the system as a whole, and for each of its component parts. It will also be important that there is the capacity to share and transmit information between each of the parts of the system, to ensure consistency and minimise duplication.

The system should also be simple and transparent so that it is easily understood by the wider community. This will be important in ensuring community acceptance and support. It is appropriate to consider a campaign of information and education for the community to foster understanding and support.

Staged approach

Reform to the system would best proceed in a staged process of steps, with thorough planning and risk management, project and contingency planning so that change can be managed smoothly, in a way that maintains public support and confidence.

Sustainable Structure

The structure of the system should be sustainable. It will need both broad community support and understanding, and political support. It requires a solid legal and regulatory framework, and a stable management structure, together with robust information technology systems, and sound administrative processes.

Clear lines of responsibility and accountability

While clearly there is a case for different agencies to collect payments, manage contribution records and investment of funds, as well as deliver payments, it is suggested that overall responsibility for policy development and oversight could be vested in one authority. This should enable a structured and consistent approach to policy development and change, and legal or regulatory change in this area.

Centralisation / decentralisation

There is a good case for decentralisation of the service delivery responsibilities (collection of contributions, delivery of benefits etc) but we suggest that responsibility for policy development and oversight would best be centralised as suggested above.

Formal and informal sectors

As a first step, it will be important to extend proposed new arrangements for the formal sector and to achieve a high level of compliance. Once these changes are bedded down, and operating smoothly, as a next step, arrangements could progressively be extended to include the informal sector. This could initially happen through pilots for particular sectors, and may need to take account of differences for particular groups of the informal sector – eg:

- determining the level of income of individuals;
- determining levels of contributions (is the same level of contributions required);
- the most appropriate way of collecting contributions (given that incomes may be intermittent or irregular) – perhaps cooperatives have a role here;
- the level of benefits; and
- the form in which benefits are paid.

Government and other employees

Formal sector workers currently are covered by PT. JAMSOSTEK. Government employees are covered by PT. TASPEN and the Armed Forces are covered by PT. ASABRI. Some larger private companies have their own arrangements.

It would be useful to consider whether all employees should be covered under the one system, or whether there is a case for maintaining separate arrangements. In the case of Government Employees and the Armed Forces, it is noted that these systems are currently non-funded, and this may be increasingly costly in the longer term. Three options in this area include:

- to keep these arrangements operating separately;
- to close these schemes to new entrants, preserving arrangements for existing members. New entrants would be covered under the new scheme; or
- to close these schemes, and progressively transfer members to the new scheme.

Consideration would need to be given by Government to the advantages and disadvantages of each of these options in decisions about the preferred option.

One issue for consideration is the administrative and management overheads associated with accommodating several systems.

In the case of workers currently covered by the arrangements of larger private companies, it would be difficult to make a case for excluding them from the new arrangements. It is suggested that they should be included in the new arrangements, and any coverage provided under other schemes could be an add-on, or supplement, to compulsory coverage under the new scheme.

Adequacy

It will be important to consider both what is the desired minimum level of income required in retirement, and what is an adequate level of income in retirement. It will also be important to consider what goods and services the retirement income benefits should be expected to cover, and what period of time they could be expected to cover. This will be important in setting the level of contributions required to fund the system. This will need to be considered in the context of the overall sustainability and affordability of the system.

It will also be important to consider how the benefits paid will be adjusted to take account of price increases and rises in living standards, so that recipients are not disadvantaged over time, relative to the wider community.

People's expectations of their income and lifestyle in retirement need to be monitored in the context of how this matches up with what the reality will be. If the reality does not meet expectations, this will need careful management.

Source of contributions

A retirement income system based on a mix of employer and employee-contributions, coupled with some level of government contributions, would lead to better overall retirement incomes, and improved social outcomes in the longer term. Government contributions could take the form of tax concessions for contributions paid (by employers and employees). This would help to provide incentives for contributions.

Collection of contributions

Decisions will be required on the way in which contributions are to be collected and paid into the appropriate fund. It is suggested that contributions should be collected monthly (longer intervals leads to the possibility that the money will have been spent on other things and is no longer available). This is likely to be a major area of operational concern.

Lump sum or income stream (pension)

Consideration of the way in which payment will be made at retirement will be needed. It could be possible to take payments as a lump sum, a pension or income stream, or some combination of the two. If people take a lump sum payout, then it is possible that they may spend their lump sum very quickly, meaning that it is not available for income in retirement. If people are encouraged or allowed to take a lump sum, they will need information and education to enable them manage their lump sum.

Types of coverage to be included

We understand that additional contributions for unemployment insurance, disability, death and health cover may be included under the same “umbrella” social insurance arrangements. If this is the case, consideration will need to be given to the way in which these additional contributions fit within the system. They will need to be separately identified. The level of contributions required for each component, as well as the overall level of contributions, will need careful consideration. If the overall level of contributions is too high, it may have a severe impact on current living standards of members. If the overall level of contributions is too high at the starting point, consideration of transitional arrangements, to bring the level of contributions down to a manageable level over time, will be required.

At the same time, the benefits members are able to derive from the system will need consideration. The level of benefits paid, the means by which they are paid, and the duration for which they are paid will need to be considered in the context of the overall affordability and sustainability of the system.

It will also be important to consider what happens to a member’s contributions when they do not draw on unemployment, disability, death or health cover benefits. If they do not draw on these benefits, or draw on them only partially, what will happen to any unpaid part?

Non-funded / funded system

Moving gradually from the current non-funded, pay-as-you-go system to a funded system will be important, particularly in the face of an ageing population, and should help to minimise government liabilities in the longer term. At the same time, if managed effectively, it should increase overall savings and result in the creation of a pool of funds that can be used to assist further economic development.

Redistribution

Current coverage extends to government, military and police personnel, as well as to a small proportion of workers in the formal sector and to some in the private sector. However there is no coverage for most people. Even under new arrangements, many people may continue to fall outside the system, or to have only periodic periods of employment and contributions (for example, women with caring responsibilities, the unemployed or underemployed, and those with disabilities that prevent them from working).

In the longer term, consideration of a social safety net arrangement, to provide a basic level of coverage for these groups, may be needed. This could happen through the taxation system (for example providing social safety net benefits from tax receipts) and would have a more redistributive effect.

Record keeping

Sound record keeping systems and practices will be required to ensure a reliable and accurate record of contributions is kept. Ideally, records would be held in a central system, with the facility for online access from each of the local or area offices. This will be important, particularly for a mobile workforce. A unique identifier for each contributor would also be advisable. If such a number already exists in the form of a social security or tax number, then this could be used. If such a number does not exist at present, it may be advisable to consider such an approach. A unique identifier would mean that it is easier to transmit contributions electronically where appropriate, and should reduce duplication of records or multiple accounts. This would also facilitate data matching between systems where this may be needed.

Effective record keeping will facilitate provision of regular advice or statements of account balances to members.

Preservation of funds

It will be important that member's funds remain in their individual accounts until retirement age. This will then allow the full compounding effects of investment returns on their contributions, and mean an improved overall retirement income. However it may be necessary for provisions to allow access to a small proportion of member contributions for people who are in extreme hardship.

It may be worth considering increasing the retirement age (and therefore the age at which people can access their retirement benefits, initially to age 60). This will improve people's overall benefits, and mean that their average annual income in retirement will be higher.

Legal Structure

General

The legal structure that supports the retirement savings system should be robust but flexible enough to allow for specific conditions for different sectors of the community.

The retirement savings system to be implemented by Indonesia will be a funded system that requires contributions to be directly made by employers and employees. This will allow a pool of funds to accumulate that will be used to pay the benefits of the participants. Security of this pool of funds is paramount, as it is the only source of retirement income for the vast majority of the population.

Laws should be put into place to provide this security so that individuals, employers and the Government can have confidence in the system. This will also assist with the long-term acceptance of the new system by all parties.

The laws should be binding on the relevant parties and contain relevant and enforceable penalties for breaches of the requirements. This enables compliance to be monitored and for appropriate penalties to be applied.

It is recommended that the legal structure be given priority and that the laws supporting this structure be developed as the first step in the process.

Existing arrangements, such as JAMSOSTEK and TASPEN, should be reviewed to ensure that their constitution and operational structure allow them to operate under the new laws.

Regulatory Authority

The Government requires a supervisory regulatory authority to monitor the laws and to oversee the proper behaviour of the participants in the system including agencies, such as JAMSOSTEK and TASPEN, that provide services to the system.

The Regulatory Authority should be responsible to the President. It should have the responsibility of managing the retirement savings system and for co-ordinating the development and maintenance of the laws. It is vital that a single entity have the responsibility for this co-ordination to ensure that there is consistency of approach at all levels.

Types of Laws Required

There are a number of sets of laws which are required to provide effective support for a retirement savings system. These include:

a) Law Establishing the Regulatory Authority

The powers of the Regulatory Authority to effectively supervise and oversee the system and to impose the relevant penalties should be specified in law.

The Board of the Regulatory Authority should be nominated by the President and be representative of the community and Government.

The Regulatory Authority will need appropriate staff to carry out the monitoring and audit functions.

b) Prudential Laws

These establish the rules for the prudent management of the retirement savings system. They set out the operational rules for the managers of the system and ensure a consistency of approach. Provisions would generally include:

- registration and approval of entities such as JAMSOSTEK and TASPEN by the Regulatory Authority;
- reporting to the Regulatory Authority by the approved entities;
- governance requirements of the approved entities such as acting in the interest of the members of the system before any other interests;
- operational rules for managing the system such as preservation of benefits until regulated age;

- rules relating to the payment of benefits to members or beneficiaries; and
- penalties for breaches of the law.

a) Laws Governing Contributions

There should be a legal basis for determining the level of contribution payable by employers and employees. This level may vary depending on the status of the employee, such as Government employee, formal sector, agricultural/farming sector etc.

This law should also specify the frequency of payment of the contribution to the relevant manager.

It should also include a penalty regime for non-payment, or late payment, of contributions. Any such non-payment or late payment affects the value of the members retirement benefits and should be subject to penalties. Monitoring and enforcement of this should be effective to ensure long-term security of the system and be the responsibility of the Regulatory Authority.

b) Laws Relating to the Funds

There should be laws that establish the ownership of the moneys paid by employers and employees. Ideally, these funds should not form part of Government revenue funds but should be owned by a separate approved entity that is charged with the responsibility of owning and managing the pool of funds for the benefit of the members of the system.

In Australia and many other countries, the approved entity is a Trustee. The entity is normally a corporation with a board of directors. The company is appointed as Trustee of the fund and is bound by a set of specific rules. The rules may be specified in a legal document called the Trust Deed or they can be in legislative form.

It is feasible for Indonesia to establish the approved entities either as Trustees or as special companies subject to specific legislation.

It is the law which governs the approved entities that is important not the form. The approved entities need to be bound by law which imposes similar prudential requirements on the entity, such as applies to a trustee under Australian/British Trust Law. The Australian Superannuation Industry Supervision (SIS) legislation specifies these requirements (covenants) which bind the companies (acting as trustees). Indonesia could similarly specify the requirements in the legislation governing the approved entities.

Legislation should address the security of the funds to ensure their safety from fraud or embezzlement. The Government will need to give consideration to the form of that security because the system has been put into place by the Government and there is likely to be little or no safety net in the shorter term.

This law (or the prudential set of law) should specify any restrictions on the investment of the moneys. In an accumulation type fund, the members bear the investment risk and the approved entity should seek to optimise the rate of return on the investments.

Because members bear the investment risk, the Government would need to consider whether it will restrict investments or whether it will guarantee any investment failures. In countries where there is separate ownership of the funds and that there is freedom of investments by the approved entity, it is unusual for any guarantees to be provided by the Government.

c) Other Existing Laws

Laws that currently govern aspects of the social security and taxation systems may have to be revised to ensure that all laws are consistent and that there are no conflicts between the various sets of law.

Governance

The Regulator should supervise the activities of the approved entities to ensure that proper governance is applied in managing their functions. The approved entities should report regularly to the Regulator and be subject to regular audit by the Regulatory Authority.

Compliance and Penalties

The system will only work if there is a high rate of compliance with the provisions of the laws governing it.

Therefore a robust monitoring and audit function should be established under the control of the Regulatory Authority. Reporting and exchange of information between the approved entities and the Regulator is key to the success of this monitoring.

Internal audit requirements should be imposed on the approved entities to ensure that breaches, or potential breaches, are identified at the earliest possible time. This will enable corrective action to be initiated as soon as practicable.

The Regulator should have the power to initiate penalties for breaches of the law. For minor breaches penalties should be able to be imposed (or waived) by the Regulator. For more serious breaches, and certainly where wilful or criminal negligence is involved, the Regulator should be able to initiate legal proceedings.

Investment of Funds

General

The overriding function of the investment of the funds accumulating from the payment of the contributions is that the moneys should be invested for the benefit of the members of the system. Its function is not to maximise the income payable to the Government.

The members bear the investment risk and so the investment should provide for the security of funds as well as the return on the investment.

Long-term Strategy

The investment of this pool of funds has a long-term horizon, as the majority of benefits will not be paid until retirement. Thus the approved entity can develop a strategy that seeks to maximise the return on the investments over a running period of 3-5 years rather than

concentrate on the short-term performance of the investments. This enables the funds to be invested in equities and other long-term performing assets in preference to short-term investments with a potentially lesser yield.

Additionally, the volatility of equity returns is of lesser importance because of the smoothing effect of longer-term performance measurements. This allows growth assets to be used to back the members' benefits without unduly increasing the risk. The end result is higher benefits for members because the long-term return will be better.

Role of the Approved Entity

The approved entity should be responsible for establishing the investment strategy for the investment of the members' funds. The primary responsibility of the approved entity in investing the moneys is to maximise the net return to members within acceptable risk boundaries. The net return is after expenses of investment and any taxes have been paid.

Where the members' benefits are on an accumulation basis, the member bears the risk of the investment. Even where the benefits are on a defined benefit basis, the investment return is very a very important component of the funding of that benefit.

Therefore, there needs to be consideration as to whether there will be any Government backing/compensation for poor investment return. This needs careful consideration as short-term losses are not necessarily a proper reason for any Government compensation to apply.

It is important for the Government to provide compensation where there has been fraud or misappropriation within the approved entity to ensure members' interests are protected. This risk is minimised by regular audits of the approved entities by the Regulatory Authority.

The setting of the investment strategy by the approved entity involves determining the proportion of the funds (asset allocation) that will be invested in the various investment sectors:

- local shares;
- international shares;
- property;
- bonds; and
- cash/short term securities.

The approved entity can invest either directly or through one or many professional investment managers.

The approved entity can provide a range of investment strategies by varying the asset allocation.

Because the system will ultimately cover all or most people, the approved entity may determine that different investment strategies are applicable to different sectors of the community. Also, it may be appropriate to have a different strategy for those nearing retirement from those who have many years until benefits are payable.

A much longer-term aim of the system should be to allow members to select relevant investment strategies for themselves.

This requires members to have sufficient knowledge and information to enable them to make informed choices. Education of the population is required before this choice can be implemented. Even with education, a percentage of the population will never be able to make such a choice. In these circumstances, the approved entity should make the choice on behalf of the member (which is what initially happens anyway).

Increase in National Savings and Investment

By funding the system, significant pools of investable funds are made available. This will significantly increase national savings and assist in boosting investment in Indonesia.

Due to the long-term nature of the investments, funds can be encouraged to invest in infrastructure projects rather than the Government funding or borrowing for such projects.

Overseas investment can be controlled (if necessary) to ensure that the funds are used for the development of Indonesia rather than being invested offshore.