

Employee Welfare in Indonesia: System, Cost, and Funding

It has been 3½ years since the Law Number 13 Year 2003, namely the Labor Law, (“UUK-13/2003”) was issued on March 25, 2003. A lot of controversies have emerged since then, the most recent one being an amendment plan by the Government which received support from employer associations but invited refusal from labor unions. The amendment plan was finally cancelled on the back of academic study results. (Source: *Liputan 6 SCTV, September 13, 2006*).

A proper and efficient implementation of UUK-13/2003 needs comprehensive understanding from employees, employers, and other related parties and a funding system to support the long-term fund accumulation for old-age welfare.

The purpose of this writing is to provide comprehensive information on employee welfare system in Indonesia, estimation of its cost to company, related funding efforts, and benefit amounts at retirement age.

Law and Regulations on Employee Welfare

Employee welfare system in Indonesia, particularly for private and state-owned companies, consists of mandatory plans and voluntary plans. The system itself, UUK-13/2003 being only a part of which, covers the following plan types:

- old-age, death, work accident, and health care benefits;
- severance and service pay;
- pension and insurance.

Mandatory plans are regulated by the Law Number 3 Year 1992 on Worker Social Security (“Jamsostek”) and UUK-13/2003, while voluntary plans are regulated by the Law Number 2 Year 1992, namely Insurance Law, and the Law Number 11 Year 1992 on Pension Fund (“Pension Law”).

Jamsostek: In general, Jamsostek is compulsory for companies having at least 10 employees or paying a total monthly payroll of at least Rp 1,000,000. Jamsostek manages 4 plans, which provide Old-age Benefit (“JHT”), Death Benefit (“JK”), Work Accident Benefit (“JKK”), and Health Care Benefit (“JPK”).

Jamsostek has the following characteristics:

- JHT is a defined contribution plan;
- On attainment of retirement age, benefit is paid as lump sum; however, if JHT balance exceeds Rp 3,000,000 the benefit can be paid monthly for maximum 5 years on participant choice;
- On completion of minimum 5 years of participation, JHT balance can be paid on employment termination preceding a 6-month waiting time;
- Each plan is funded through payment of contributions;
- It is not compulsory for companies to join JPK if they already have a similar or better plan.

Only 25% of total workforce in private sector are registered with and actively paying contributions to Jamsostek.

UUK-13/2003: In general, employment termination is regulated in chapter XII articles 150-172. Post-employment benefits, in particular, are regulated in article 162 (voluntary resignation), article 166 (death), article 167 (retirement age), and article 172 (disability or prolonged ill-health).

Benefit amount depends on rendered service years, while benefit types consist of Severance Pay ("UP"), Service Pay ("UPMK"), and Compensation Pay ("UPH") that amounts to 15% of UP and UPMK. UPH is to compensate for medical, housing, annual leave balance, and repatriation.

UUK-13/2003 has the following characteristics:

- a defined benefit plan;
- commonly perceived as paying lump sum benefit;
- funding is not compulsory

Benefit amount on death or at retirement age is $(2 \times UP + 1 \times UPMK)$ plus $15\% \times (2 \times UP + 1 \times UPMK)$; the maximum amount is $32.2 \times$ final monthly wage for 24 years of service or more. Benefit amount on disability or prolonged ill health is $(2 \times UP + 2 \times UPMK)$ plus $15\% \times (2 \times UP + 2 \times UPMK)$; the maximum amount can reach $43.7 \times$ final monthly wage for 24 years of service or more. In case of voluntary resignation, there is no UPH to compensate for housing, medical, and health care (Letter of Minister of Workforce and Transmigration to workforce institution heads in provinces and regencies / cities in Indonesia dated August 31, 2005), unless the company provides Separation Pay. Details of UP and UPMK's benefit scale (in multiple of final monthly wage) are shown in Table 1.

Pension Fund: Pension Fund has 5 main characteristics, which are: separation of assets through establishment of a separate legal entity, compulsory regular and systematic funding, government monitoring and training, deferred payment of benefit, and voluntary – it is Company option whether to establish a pension fund or not.

Pension Fund has the following characteristics:

- Retirement benefit is basically paid monthly, unless benefit amount is lower than government requirement it can be paid lump sum;
- Plan can be defined benefit or defined contribution.

Pension Fund institutions consist of:

- Employer Pension Fund ("DPPK"), a pension fund which is established by a company for its employees – this pension fund can manage a defined benefit plan or a defined contribution plan;
- Financial Institution Pension Fund ("DPLK"), a pension fund which can only be established by a bank or a life insurance company – and can only manage a defined contribution plan;
- Profit-based Pension Fund ("DPBK"), a defined contribution DPPK in which contribution level is determined based on company profit but should amount to minimum 1% of a year's total payroll.

Currently Indonesia has 321 DPPKs and 21 DPLKs, 5 of which are founded by bank. A total of around 500 to 700 employers and less than 2 million employees have joined the DPPKs, while the numbers are less than 3,000 employers and $\frac{1}{2}$ million employees for the DPLKs.

Combined with Jamsostek participants, the figures are diminutive compared to Indonesia's total workforce.

Employee Welfare Cost

Jamsostek: Employee welfare cost to Company for Jamsostek plans is fixed as regulated by the government. Details of contribution to Jamsostek for each type of benefit are described in [Table 2](#).

UUK-13/2003: Cost of UUK-13/2003's post-employment benefits is not certain due to the characteristic of defined benefit plan; however, it can and should be actuarially calculated. Company liability can be estimated using certain actuarial calculation method, economic assumptions (discount rate and salary increase rate), and actuarial decrement assumptions (mortality, disability, and voluntary resignation). Assuming normal retirement age is 55 and based on economic, actuarial decrement, and population distribution assumptions, and past service liability is nil, the cost of UUK-13/2003's post employment benefits (death, retirement age of 55, disability, and resignation) is on average equivalent to 7.92% of monthly wage. Details of calculation results are presented in [Table 3](#).

Mandatory Plans – Jamsostek plus UUK-13/2003: It is shown in [Table 2](#) and [Table 3](#), Company cost for Jamsostek ranges from 8.74% to 10.24% of monthly wage, while the cost of UUK-13/2003 is on average 7.92% of monthly wage. Therefore, total cost to company for these mandatory plans ranges from 16.66% to 18.16% of monthly wage. This amount already includes cost for JPK, which is average 4.5% of monthly wage and limited to maximum monthly wage of Rp 1,000,000.

Voluntary Plan – Pension Fund: Most defined benefit pension funds promise a lump sum benefit level of 1.5 x monthly earning for each service year, or a monthly benefit level of 2% x monthly earning for each service year. The cost of such benefit formula highly depends on the level of actuarial assumptions, but on average it can be assumed to be 12.5% of monthly wage for the lump sum benefit and 20.0% of monthly wage for the monthly benefit. Supported by average employee contributions of around 4.5%-6%, cost to company becomes 8%-14% of monthly wage. For defined contribution pension funds, the average cost distribution between employee and company is 2.69% and 7.48% of monthly wage consecutively; in other words, 30% cost is borne by employee and 70% by company.

On average, company cost for a minimum pension fund would range between 7.48%-8.00% of monthly wage. If there is a comprehensive integration between UUK-13/2003 and Pension Fund, then total company cost for employee welfare would stay in the range of 16.22% to 18.24% of monthly wage. Company cost for old-age welfare excluding JK, JKK and JPK plans of Jamsostek (the cost of which is 5.69% for industry type III) would range from 10.53% to 12.55% of monthly wage.

Cost and Benefit

Having known the cost as explained above, now we will see the level of retirement benefits produced by such employee welfare cost.

Old-age welfare can be measured using replacement rate, which is the percentage of retirement earnings to final earnings just prior to retiring. How much is required to maintain the same lifestyle before and after retirement? Experts estimate a proper replacement rate of 70% to 80% of final earnings; this rate should be reached during active employment (about 35-40 years). How much of this amount should be borne by the country through social security and mandatory plans, by employer through voluntary plans, and by employee through his own savings?

Replacement rate is closely related to service years and retirement age. In Indonesia, where retirement age is 55 (quite low compared to other countries), an employee only has 30 years of work if he starts working at age 25. Consequently, the replacement rate in Indonesia needs to be adjusted to a maximum of 60% of final earnings. For comparison purpose, [Table 4](#) shows replacement rate and retirement age in some Asian and European countries.

Mandatory plans' (Jamsostek and UUK-13/2003) total cost is 13.62% of monthly wage (2% of which is paid by employee to JHT Jamsostek), while 30 years of service are estimated to render a total benefit of 55.38 times final wage. This amount is equivalent to a replacement rate of only 38% of final wage – around 85% of the benefit is paid by company through mandatory plans. If the target replacement rate is 60%, then there is a shortage of 22% or equivalent to 7.88% monthly wage. Details of calculation results can be seen in [Table 5](#).

The table also points to a conclusion that mandatory plans (Jamsostek and UUK-13/2003) are not sufficient to provide proper old-age welfare. This situation can provide an opportunity for voluntary plans, such as pension fund and or insurance plan, to grow.

Severance Insurance

Kompas newspaper November 4, 2006 and various recent seminars and mass media discuss the idea of providing severance insurance to cover employees in the case of lay off by making it compulsory for all companies to collectively pay contributions to an appointed institution.

This could indicate lack of balance between caring for terminated employees and those staying with company up to retirement age. Providing more benefit to those not serving the company anymore may reduce productivity, slow down the expansion of employment opportunity, and reduce long-term funding for old-age welfare. Besides carrying the solvency risk of defined benefit funding, such plan is not economically beneficial, because:

- In case there is no lay off, company contributions are not returnable due to collective funding nature;
- Service pay and Jamsostek's JHT for old-age would result in smaller amount of benefit unless company implements voluntary pension fund.

Basically, a continuous 30-year-accumulation of 8.94% of monthly wage for an employee starting employment at age 25 (without investment return, salary increase, and actuarial decrement assumptions) would result in a fund amounted to 32.20 x final monthly wage. If an employee receives 1 x UP at

resignation, then the accumulation of the 8.94% of monthly wage will always exceed potential payment of $1 \times UP$, at the same time funding for retirement benefit payment of $32.2 \times$ final monthly wage if the employee continues working to retirement age (see [Table 6](#)).

If the idea of mandatory severance insurance managed by a certain institution is realized, the cost will add burden to companies and in turn the additional cost will also de-motivate companies from planning for employee's old-age welfare. On the other side, current mandatory plans are not sufficient to maintain the same quality of life after retiring (only 38% of final wage, or even 0% if paid as lump sum). In contrast, the increase of life expectancy and reduction of birth rate in almost all countries, including Indonesia, will in time make old-age welfare more and more important.

Requiring companies to pay contribution or premium for severance insurance will add economic burden, moreover if the fund accumulation is managed by only one institution. This does not mean systematic and regular funding is not necessary – accounting records of the liability have been made in financial statement.

The Importance of Funding

It is important and urgent to conduct public education on the importance of early funding. It may not be necessary to make funding compulsory, because companies need the flexibility to plan not only the amount but also the timing. It is worth being considered to give tax incentive on the accumulated fund, including investment returns on certain instruments. To avoid overlapping of funding, it is also very important to openly emphasize the permission to offset the accumulated fund – particularly through pension funds – and the benefits under UUK-13/2003 for all cases of employment termination, not just retirement.

Systematic and regular funding with tax incentive will benefit not only employees due to the security of making the fund available, but also company in managing its cash flow.

To ensure funding quality and healthy market competition, funding should not be done through one particular institution. Companies should be given flexibility to choose the fund management institution. A healthy competition will lead to a more efficient market, lower management fee, and higher quality of service.

Lump sum or monthly payment: In reality, the benefits of Jamsostek and UUK-13/2003 are paid as lump sum. This lump sum payment does not support continuous old-age income, the main principle of employee welfare, which is not only important for employee welfare, but also for the employee's family and public welfare, and increase of productivity and economic development. The availability of long-term fund investment through capital market can be used to support economic development. It is not easy to change the culture that values lump sum payment more than monthly; therefore, public education efforts aiming at shaping public perception on the importance of continuous income for old age welfare.

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It will be wonderful if there is a mutually-supportive integration between Pension Fund and UUK-13/2003. Pension Fund can serve as a better implementation for UUK-13/2003, and the Law can encourage pension funds in Indonesia to grow.

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TABLE 1
Severance and Service Pay's Benefit Scale

Service Years (MK)	Severance Pay ¹⁾	Service Pay ¹⁾
MK < 1	1	0
1 <= MK < 2	2	0
2 <= MK < 3	3	0
3 <= MK < 4	4	2
4 <= MK < 5	5	2
5 <= MK < 6	6	2
6 <= MK < 7	7	3
7 <= MK < 8	8	3
8 <= MK < 9	9	3
9 <= MK < 12	9	4
12 <= MK < 15	9	5
15 <= MK < 18	9	6
18 <= MK < 21	9	7
21 <= MK < 24	9	8
MK >= 24	9	10

1) In multiple of final salary

TABLE 2
Contribution for Each Type of Jamsostek Benefit

Jamsostek Plan	Contribution Level (% of Wage)– Industry Type ²⁾				
	I	II	III	IV	V
Work Accident Benefit (JKK)	0.24%	0.54%	0.89%	1.27%	1.74%
Death Benefit (JK)	0.30%	0.30%	0.30%	0.30%	0.30%
Old Age Benefit (JHT)	5.70%	5.70%	5.70%	5.70%	5.70%
Health Care Benefit (JPK) ³⁾	4.50%	4.50%	4.50%	4.50%	4.50%
Total Contributions⁴⁾ – Employer and Employee	10.74%	11.04%	11.39%	11.77%	12.24%
Employee Contribution for JHT	2.00%	2.00%	2.00%	2.00%	2.00%
Employer Contribution	8.74%	9.04%	9.39%	9.77%	10.24%
Employer Contribution excluding JPK	4.24%	4.54%	4.89%	5.27%	5.74%

2) Example of Industry Type: I (banking), II (cigarettes), III (hospitality), IV (shipping), V (mining).

3) Contribution for married employee 5%, single 3% – assume average contribution for 50% married/50% single

4) Contributions are based on monthly wages; only for JPK monthly wage is limited to maximum Rp 1,000,000.

TABLE 3

Estimation of Liability for Each Type of Benefit under UUK-13/2003

Age (years)	Future Service (years)	Contribution ⁵⁾ – Benefit Type				Total Contribution	Age Distribution ⁶⁾	Average Contribution
		Retirement	Death	Disability	Resignation ⁷⁾			
25	30	5.30%	0.43%	0.06%	0.43%	6.22%	28%	1.74%
30	25	7.27%	0.52%	0.07%	0.24%	8.10%	24%	1.94%
35	20	8.01%	0.49%	0.07%	0.09%	8.66%	21%	1.82%
40	15	8.42%	0.42%	0.06%	0.02%	8.92%	11%	0.98%
45	10	8.61%	0.31%	0.04%	0.00%	8.96%	10%	0.90%
50	5	8.77%	0.16%	0.02%	0.00%	8.95%	6%	0.54%
Average Contribution⁸⁾							100%	7.92%

5) Based on certain economic and actuarial decrement assumptions, and actuarial valuation method.

6) Age distribution in 50 different companies with total workforce around 70,000 orang.

7) Voluntary resignation benefit is assumed to be 15% x (UP + UPMK).

8) Contributions are based on monthly wages.

TABLE 4

Replacement Rate and Retirement Age: Other Countries

Country	Pension in % of Final Wage	Retirement Age (Male/Female) in years
Germany	82%	65/65
French	79%	65/65
Italia	80%	65/60
Netherland	78%	65/65
Switzerland	81%	65/62
England	69%	65/60
USA	67%	65/65
Japan	75%	60/60
China	N/A	60/60
Vietnam	N/A	60/55

TABLE 5
Replacement Rate: Mandatory Plans

Plan	Contribution (% of Wage) – Liability			Benefit Estimation (x Wage) ⁹⁾			Pension ¹⁰⁾ % Final Wage
	Company	Employee	Total	Company	Employee	Total	
Old Age Plans							
Jamsostek – Old Age	3.70%	2.00%	5.70%	15.05	8.13	23.18	16%
UUK-13/2003 – Pension	7.92%	0.00%	7.92%	32.20	0.00	32.20	22%
Subtotal	11.62%	2.00%	13.62%	47.25	8.13	55.38	38%
Other Plans ¹¹⁾							
JKK	0.89%	0.00%	0.89%				
JK	0.30%	0.00%	0.30%				
JPK	4.50%	0.00%	4.50%				
Subtotal	5.69%	0.00%	5.69%				
Total	17.31%	2.00%	19.31%	47.25	8.13	55.38	38%

9) The difference between net investment return and salary increase is 0% per annum for 30 years.

10) Monthly Pension is obtained by dividing Benefit amount after 30 years by an annuity factor of 144.

11) Assume contribution level for Industry Type III.

TABLE 6
Contribution Level (8.94%) and Severance Pay

Year	Contribution (% of Wage)	Fund Accumulation (x Wage)	Severance Pay (x Wage)
1	8.94%	1.07	1
2	8.94%	2.15	2
3	8.94%	3.22	3
4	8.94%	4.29	4
5	8.94%	5.37	5
6	8.94%	6.44	6
7	8.94%	7.51	7
8	8.94%	8.59	8
9	8.94%	9.66	9
10	8.94%	10.73	9
15	8.94%	16.10	9
20	8.94%	21.47	9
25	8.94%	26.83	9
30	8.94%	32.20	9