

► Policy Brief

July 2021

Actuarial analysis of a proposed unemployment insurance scheme in Indonesia

Key points

- Consistent with the social insurance principles on which the scheme is established and in line with good practice, the UI scheme should be financed through employee and employer contributions.
- Employer and employee contributions are set at a fixed percentage rate of salary and at a level to target a reserve fund amount of two times the estimated annual benefit payment commitments in 2030.
- The benefit is set at 50 per cent of their average insurable earnings in the previous six months paid for a maximum duration of six months.
- This benefit is paid to all those who become involuntarily unemployed and had contributed for a minimum of 12 months in the 24-month period preceding the termination of employment.
- The recommended contribution rate for the proposed design option is therefore 1.35 per cent of insurable earnings.

Overview

This brief contains a summary of the report "[Actuarial analysis of a proposed unemployment insurance scheme in Indonesia](#)" written by Landry and Brimblecombe (2021) and published by the International Labour Organization (ILO) on June.

The report has been prepared within the framework of the project between the Government of Indonesia, represented by the Minister of Manpower (MoM), and the International Labour Organization (ILO). The main objective of the report is to assess the cost of implementing an unemployment insurance (UI) scheme in Indonesia and to identify which factors influence the cost of such a scheme. The report considers a specific design option for the UI scheme, as well as alternative design options and scenarios. It is based on data received as of 1 January 2020.

The role of UI has changed over time. Schemes initially sought to provide cash payments to eligible unemployed persons during periods of involuntary unemployment at a level to maintain to the greatest extent possible their standard of living. The scope of UI has since been expanded, and modern UI schemes also seek to promote return to work through the support and promotion of employment retention and reinsertion measures in the labour market. Consequently, social protection and employment policies are coordinated, and Active Labour Market Policies (ALMPs) become a key component of UI schemes.

According to international labour standards, a worker whose employment has been terminated should be entitled to UI benefits if they meet certain conditions, unless a severance allowance or other separation benefits are systematically paid. Even when this is the case, it is

important that the combination of such allowances and UI benefits meet certain minimum conditions.

Consistent with the social insurance principles on which the scheme is established and in line with good practice, the UI scheme should be financed through employee and employer contributions. Contributions should be set in such a way as to support a countercyclical stabilization of the economy, namely that its revenue requirements should remain as stable as possible over time. We therefore recommend that the financing approach is as follows: *Employer and employee contributions are set at a fixed percentage rate of salary and at a level to target a reserve fund amount of two times the estimated annual benefit payment commitments in 2030.*

The proposed design option includes a benefit to claimants of 50 per cent of their average insurable earnings in the previous six months paid for a maximum duration of six months. This benefit is paid to all those who become involuntarily unemployed and had contributed for a minimum of 12 months in the 24-month period preceding the termination of employment. In other words, upon involuntary termination, a person who has accrued a minimum of 12 months of contributions in the 24 months immediately preceding the termination will become eligible to receive up to six months of UI benefit payments. Table 1 presents the key parameters of the UI scheme assessed. We believe that such a benefit structure is appropriate for the context in Indonesia and provides adequate benefits; is in line with ILO Conventions and international practice; takes into account the tripartite discussions undertaken; and reflects the aims of the UI law and policy.

► **Table 1: Main parameters of the proposed design option**

Parameter	Proposed design option
Coverage	Mandatory coverage for all employees in private sector enterprises (including construction workers as soon as possible)
Contribution Record required for benefit eligibility	A total of 12 months in the preceding 24-month period leading up to the date of claim
Eligible Reason for Termination of Employment	Involuntary loss of job or forced termination ¹
Insurable Earnings	Basic salary and fixed allowance, except for non-wage allowance (ceiling of IDR8,939,700 per month in 2020 ²)

Average Monthly Earnings (AME)	Average earnings over the 6 months prior to claim (ceiling of IDR8,939,700 per month in 2020 ²)
Benefit Rate	50% of AME
Maximum benefit duration	6 months
Waiting period	7 days

IDR = Indonesian rupiah.

¹ If considered relevant to the stakeholders, voluntary terminations could also be accepted in circumstances where terminating was the only reasonable alternative (for example, harassment, discrimination, major changes in work duties, terms and conditions of the job, discrimination because of membership in an association, organization or union of workers, pressure from employer or fellow workers to quit your job, etc.). Accepting additional types of terminations, however, tends to make a UI scheme more expensive.

² The ceiling is indexed annually in line with the GDP growth rate (in line with historic practice).

Actuarial valuation results are based on the data as of 1 January 2020 received from BPJS-TK and the assumptions adopted. The results, therefore, depend on the assumptions that represent the best estimates of the actuaries based on data received and our judgment, as well as being internally consistent. Although the future is uncertain and there are specific challenges related to the first actuarial valuation of a new scheme, we believe that the assumptions are appropriate and therefore the suggested contribution rates below are appropriate.

Table 2 presents the suggested contribution rate for the proposed design option as well as the minimum contribution rate that would be required to ensure the scheme's sustainability under a base (or best estimate) scenario, pessimistic scenario and an optimistic scenario. Presenting a range of possible outcomes allows for prudence in the context of the limited available data on which this study is based. Assessing the cost of a UI scheme does indeed require very specific data and a historical perspective of the context and labour market, which are sometimes very difficult to obtain before the programme is introduced.

► **Table 2: Recommended contribution rate under base, pessimistic and optimistic scenarios, considering both benefit and administrative expenditures (in per cent)**

	Pessimistic	Base	Optimistic
Suggested contribution rate (in per cent) ¹	4.89	1.35	0.66
Minimum contribution rate to ensure the scheme's sustainability (in %) ²	3.91	1.08	0.54
Projected year of reserve exhaustion with a 1% contribution rate ³	2022	2024	n.a.

n.a. = not applicable.

¹ The suggested contribution rate is the contribution rate that would be required to allow the scheme to accumulate a stabilization reserve of two times its total expenses (benefits and administrative costs) over the projection period of ten years.

² Refers to the contribution rate that would be just sufficient to remain sustainable over the projection period (no accumulation of a stabilization reserve at the end of the projection period).

³ The year when contributions received would be less than projected benefit and expenses if a 1% contribution rate was applied, and therefore, when additional financing would be needed.

The recommended contribution rate for the proposed design option is therefore 1.35 per cent of insurable earnings. This contribution rate should be shared between employers and employees.

Alternative scenarios

In this report, alternative design options have been assessed. While we recommend the approach to provide the base benefit design described above, such analysis can assist policymakers in understanding the impact of changes in benefit levels.

The scenarios assessed in this report are as follows:

- If the benefit rate is increased to 60 per cent of earnings, the required contribution rate of 1.35 per cent under the proposed design option will increase by 0.21 per cent to 1.56 per cent. A benefit rate of 45 per cent will reduce the contribution rate by 0.10 per cent to 1.25 per cent.
- If the maximum benefit duration of six months under the proposed design option is increased to nine months, the required contribution rate of 1.35 per cent will increase by 0.33 per cent to 1.68 per cent. If the maximum duration is reduced to three months, the

required contribution rate of 1.35 per cent will reduce by 0.49 per cent to 0.86 per cent.

The ILO remains available to provide support to design and assess further additional design options. The ILO reiterates its commitment to further assist the Government and social partners in Indonesia in defining the framework of their upcoming UI scheme with the dual objective of promoting employment and ensuring effective protection against unemployment.

Additional policy considerations

The following list summarizes the main additional policy considerations.

- **Transitional arrangement:** The proposed design option requires a minimum of 12 months' contributions over the previous 24-month period to qualify for a UI benefit. Therefore, no member will accumulate enough months of contribution in the UI scheme in the first year of its implementation to become eligible for benefits.

As contributions will be paid from day one, and to ensure the UI scheme meets its objectives, we recommend that a transitional arrangement be put in place. We recommend that UI scheme members who have accumulated at least 12 months of contributions over the previous 24-month period in JKK (that is, up to the date of claim) could be eligible for compensation. The cost of this transitional arrangement is estimated to be 13.8 trillion Indonesian rupiahs under the best estimate scenario for the proposed design option. The cost of the transitional arrangement could be paid by the Government or could be financed through an increase in the contribution rate over the projection period. The required increase in the contribution rate is estimated at 0.13 per cent under the best estimate scenario.

- **Covering construction or seasonal workers:** We recommend that the eligibility requirement for these workers be set as a minimum of 12 months of contributions in the 24-month period up to the claim. Such a condition is fair and equitable and will reduce the potential risks of abuse from temporary or seasonal workers who could otherwise claim benefits on a regular basis if there were less stringent conditions. Coverage of construction or seasonal workers should be compulsory and not voluntary to ensure equity and to avoid selection against the scheme.

- **Multiple claims:** We recommend that the eligibility condition of 12 months of contributions in a 24-month period applies after any claim made by the unemployed worker. This condition should therefore be “reset” after any claim to ensure simplicity, support sustainability and fairness.
 - **Part-time work:** When formerly unemployed workers find part-time work, UI schemes tend to adapt benefit levels to take into account this new reality but in such a way as to avoid disincentive effects. However, this requires significant compliance, record keeping and monitoring work, and we recommend that at least in the short term, no specific consideration is given to part-time workers.
 - **Complementarity with other sources of income replacement for unemployed workers:** Appropriate coordination between the UI scheme and the existing severance pay programme will ensure that both the overall support for unemployed workers and the financing of benefits are appropriate. We recommend that further consideration be given to reforming the severance pay system to ensure this happens and to reduce compliance issues. It is also worth noting that workers who withdraw their contributions from their JHT savings account on a regular basis (that is, each time they become unemployed) will face significant financial challenges at retirement. We recommend that JHT should be focused on retirement needs, and in order to ensure that both the UI and JHT schemes meet their main objectives, it is strongly recommended to prevent any further withdrawals from JHT on the basis of involuntary termination once the UI scheme is fully implemented.
 - **Setting future contribution rates:** Unemployment insurance schemes are short-term benefit schemes for which contributions may have to be modified more frequently than for pension schemes. It is recommended that the contribution rate of the UI scheme should be reviewed regularly after the results of an actuarial valuations are produced every two to three years, rather than having it locked-in for an indefinite period of time. The rate setting mechanism should also specify how the contribution rate is shared between employees, employers and the Government.
 - **Proper monitoring and data collection:** Once the UI scheme is implemented, it will be important to start collecting data and statistics on its members and beneficiaries with a view to allowing a better understanding of the interactions between the demography, the economy, the labour market and the scheme's experience. Collecting such data and statistics will not only contribute to an improved monitoring of the scheme, but also provide guidance to decision-makers for policy-setting.
 - **Extension of coverage to other workers:** The estimated cost of the scheme is defined as a percentage of insurable earnings. Therefore, if the scheme membership is extended to other workers with similar characteristics (age, sex, withdrawal experience, etc.) then the recommended contribution rate would still be broadly appropriate. If this is not the case, we recommend additional costings.
 - **Case management and employment services:** In order to achieve one of the main goals of the unemployment insurance scheme - which is to increase employability and help employees find suitable jobs - case management and employment services play a crucial role. It is therefore strongly recommended to study how case management and employment services can be efficiently handled in Indonesia.
 - **Compliance with ILO Conventions:** Although stakeholders can agree to adopt unemployment insurance provisions that differ from those proposed in this report, it is strongly recommended that the upcoming scheme's provisions comply with the internationally-recognized ILO Social Security (Minimum Standards) Convention, 1952 (No. 102).
- The ILO remains ready, on the basis of the discussions held in the preparation of this report, to continue to work with social partners in the implementation of the UI scheme with the dual objective of promoting employment and ensuring effective protection against unemployment.

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