

# Developing an Unemployment Insurance Scheme for Indonesia



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**SMERU WORKING PAPER**

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Meuthia Rosfadhila

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# ABSTRACT

## Developing an Unemployment Insurance Scheme for Indonesia

Meuthia Rosfadhila

Indonesia has experienced several economic slowdowns and crises leading to mass layoffs, the most recent being in 2014–2015 in which 26,000 people were dismissed from their jobs. Despite the existence of employment social security and health insurance programs, Indonesia still does not have an insurance scheme protecting the unemployed against poverty and assisting them before reemployment. Thus, this study aims to map out suitable unemployment insurance schemes to be implemented in Indonesia by comparing the strengths and weaknesses of existing insurance schemes based on theories and experiences of various countries. Results of the review are presented in recommendations of feasible short-term and long-term schemes. This study suggests that in the short run, Indonesia can start with the unemployment insurance savings account (UISA) scheme, which covers the permanent and temporary workers in the formal sector, and lowers the severance pay. Both employers and employees should contribute to the savings account. In the long run, the savings account should be combined with a government-funded unemployment assistance scheme. After a comprehensive labor database is ready, informal workers should also be included in the scheme. Apart from the main recommendations, in relation to tackling unemployment, this study also proposes creating employment service centers to provide training, vacancy information, and counseling for the unemployed as well as designing a system to monitor job search and participation in training activities.

**Keywords:** unemployment insurance, unemployment insurance savings account (UISA), severance pay, unemployment assistance

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# I. BACKGROUND

Due to economic slowdown, Indonesia's unemployment rate has increased from 5.7% in 2014 to 5.81% (7.45 million of people) in 2015 and led to a large number of laid off across country. By August 2015, the number of people who were dismissed from their job has reached 26.000 according to Ministry of Manpower data. Jawa Barat has the highest number of laid off for 12.000 workers and were followed by Banten (5.424), Jawa Timur (3.219), Kalimantan Timur (3.128) and Jakarta (1.430) (detikFinance, 2015). In addition to that there are 35.68 million of people underemployed, who work less than normal or full-time hours (Statistics Indonesia 2015). The latter are really prone to economic shocks which could push them into unemployment and poverty. Indonesia has experienced several economic crisis in the past that led to mass layoffs.

Indonesia has implemented its national social security system since the beginning of 2014. According to the Law No. 40/2004, all Indonesians will be covered by a health insurance program and four employment social security programs, namely workplace accident, old-age savings, pension, and death benefits. However, there is no such program which gives protection against unemployment in Indonesia.

The implementation of the unemployment insurance is still debatable in many countries as it can create moral hazard of the insured unemployed. The unemployment insurance will give disincentive to the insured to seek new job or may refuse a job offers. As the case with any insurance, we cannot get rid of the moral hazard on unemployment insurance but our concern is more on how to reduce it so that the benefits could compensate the cost.

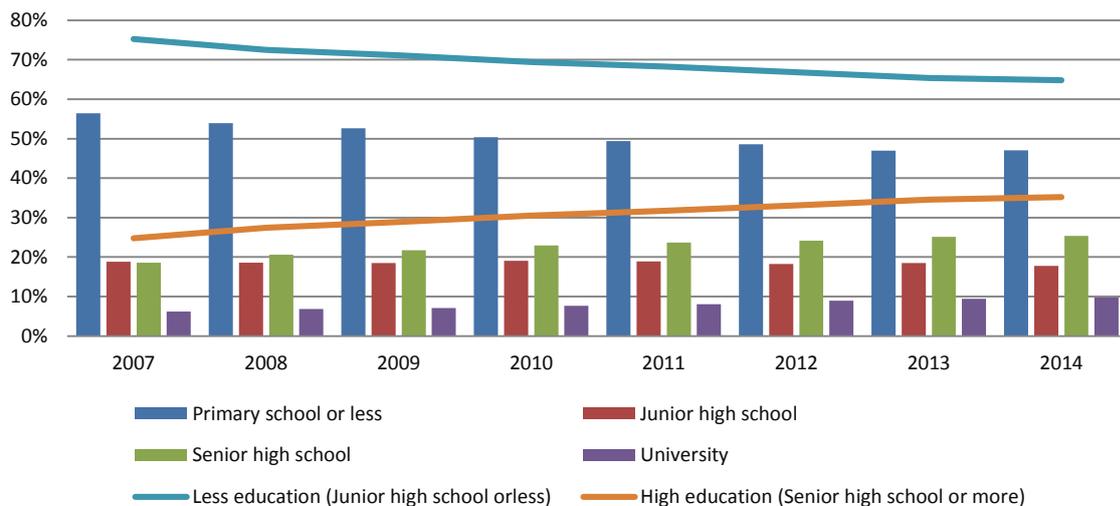
Experiences from other countries which provide unemployment insurance and employment services have proved that the schemes are one of the most effective and efficient mechanisms to protect the unemployed and their families against poverty and to assist them to return to employment (Schmitt, 2011). Therefore, Indonesia needs the unemployment insurance which not only to reduce the consequences of a shock but also to recover after that. In order to choose the right program, Indonesia needs to learn from the experience of other countries in implementing their unemployment insurance.

The main objective of this study is to review and compare different schemes of unemployment insurance with the emphasis on the strengths and weaknesses of the schemes based on theoretical point of views as well as experiences from other countries in order to analyze feasible options, which minimize the moral hazard for Indonesia's unemployment insurance scheme. The study will provide some inputs on feasible features of an unemployment insurance program in Indonesia.

This paper is structured as follows. The next section describes the condition of Indonesian labor market followed by labor protection for the unemployed and social security legislation in section 3. Section 4 reviews the different schemes of unemployment insurance based on theoretical approach and other countries experiences. Section 5 presents the issues in designing unemployment insurance for Indonesia and feasible options for developing unemployment insurance scheme for Indonesia. Section 6 gives conclusion.

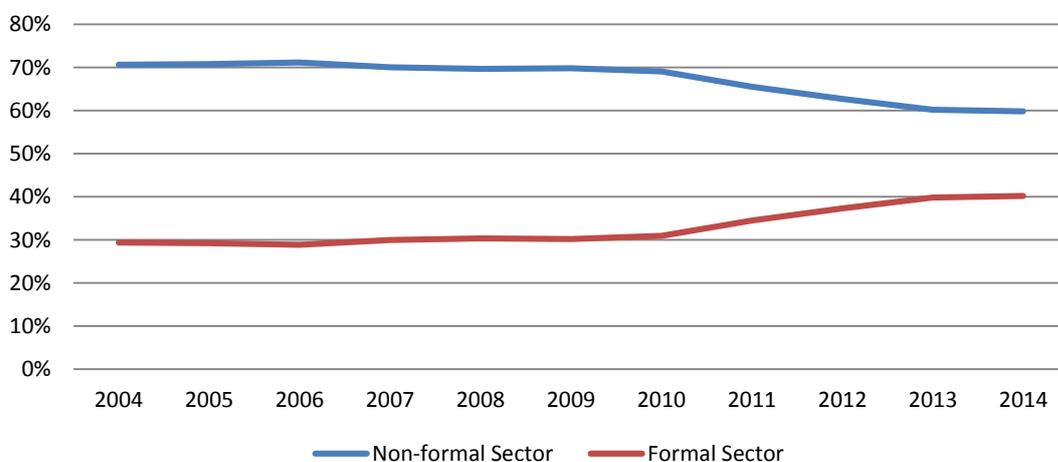
## II. THE CHARACTERISTICS OF INDONESIAN LABOR MARKET

According to Statistics Indonesia 2015, there are 128,3 million of people in the labor force from a population of 255.18 million, which means around a half of the population is in the labor force. The number has increased 21 percent during the last 14 years (2001-2015) with the average growth around 1.9% per year. Among the labor force, 94.19% are currently employed while the rest, around 5.81%, are unemployed.



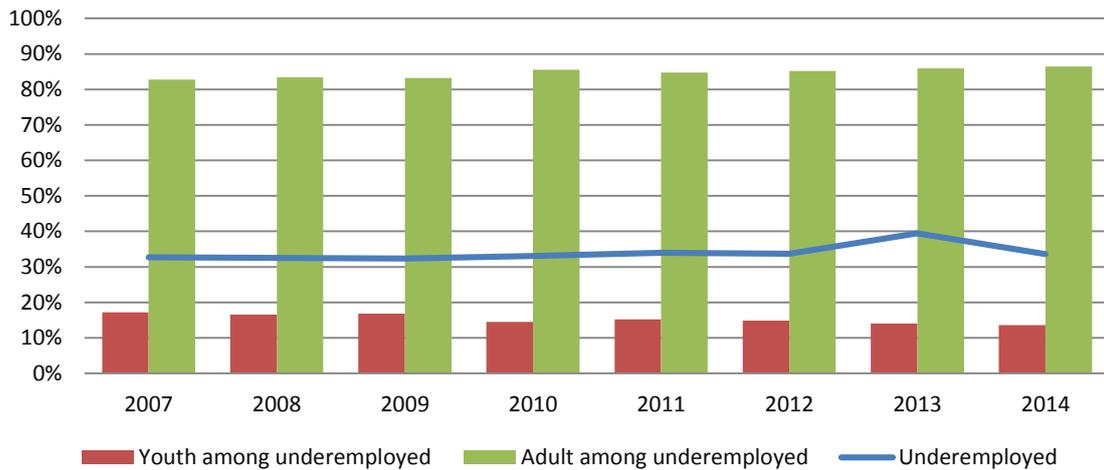
**Figure 1. Share of Education Level among the Employed**

The employed are dominated by less educated workers as more than half of them have an education level of junior high school or less (Figure 1). Around 50% of the employed have primary school degree and around 15% have junior high school degree in 2014. The rate has declined during the period between 2007-2014 from 75% to 65%. On the other hand, the number of educated workers has increased, especially for workers who have senior high school degree.



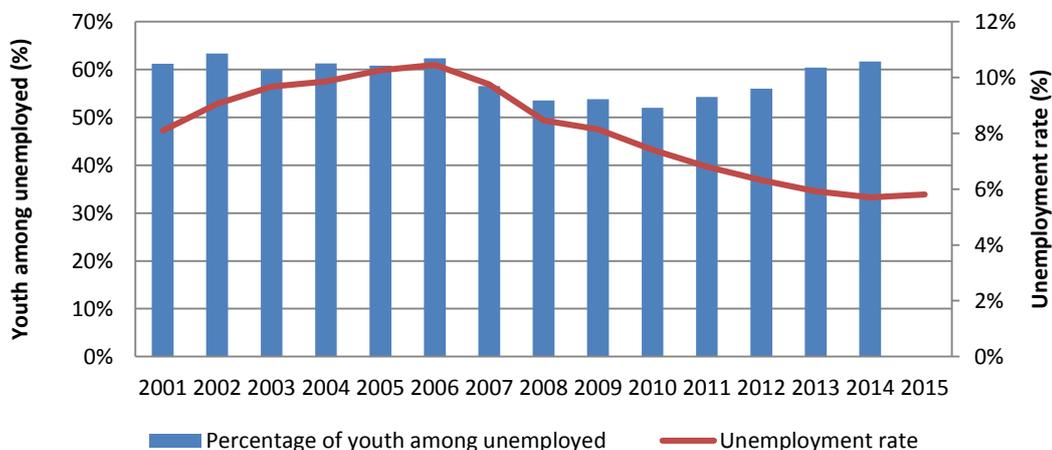
**Figure 2. Share of Formal and Informal Employment**

Like many other developing countries, most of employment in Indonesia is found in the informal sector, which is around 60% of total employment in 2014. The number has decreased during the last 5 years from around 70% in 2009 to 60% in 2014 (Figure 2). Statistics Indonesia defines informal sector workers based on the working status including self-employed without assistance, self-employed assisted by family worker or temporary workers, agricultural freelance worker; non-agricultural freelance worker and family worker or unpaid worker. Most of informal workers work in the agricultural sector and 88.17% of workers in agricultural sector are informal workers in 2014. Meanwhile the financial and electricity, water and gas are sectors that absorb most of the formal workers.



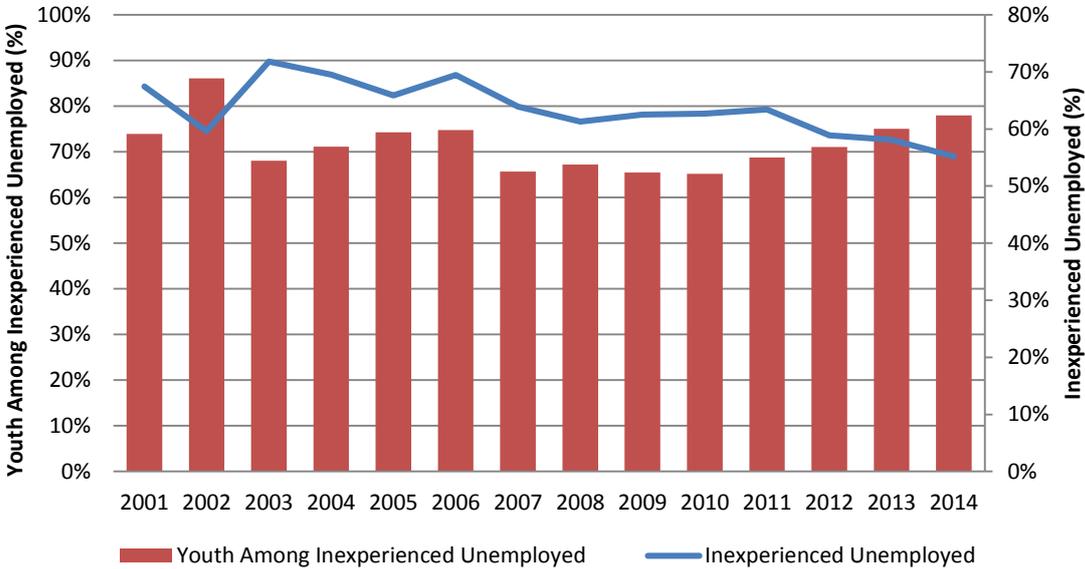
**Figure 3. Underemployment Rate**

The normal total working hours in Indonesia are 35 hours or more in a week, so workers who work less than normal hours are included in underemployment rate. There are more than 30 million workers who worked less than normal working hours in 2014, which is around a third of the total number of workforce (Figure 3). The share has relatively constant during period 2007-2014. Furthermore, if the number are differentiated between youth and adult, the share of adult workers takes the majority share among the underemployed. In 2014 almost 90% of the underemployed are workers with age above 24 years old, while only around tenth are youth with the age between 15-24 years old.



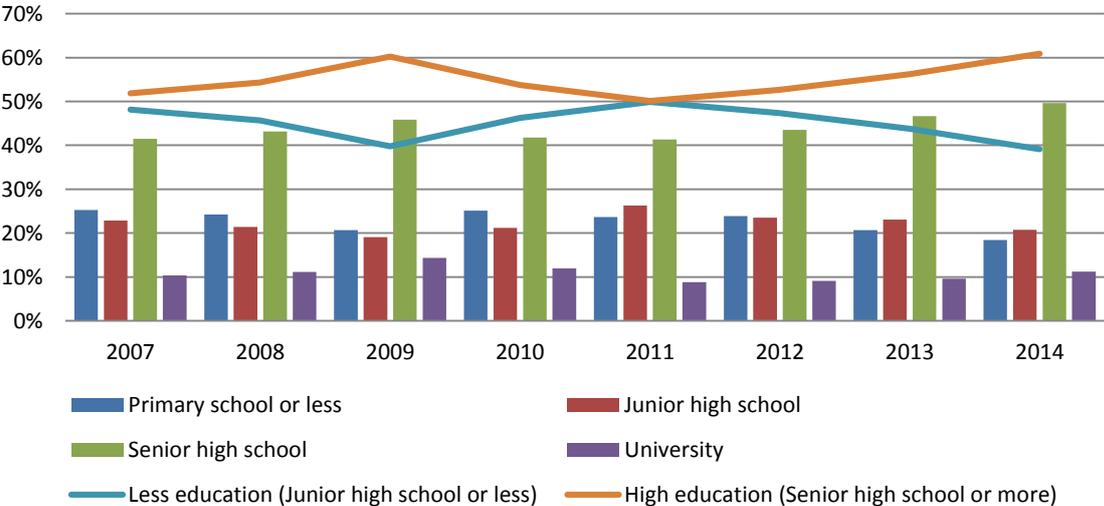
**Figure 4. Unemployment Rate 2001-2015**

The unemployment rate has a decreasing trend during the period of 2007-2014 and slightly increase from 5.7% in 2014 to 5.81% in 2015 (Figure 4). The number of people out of a job has increased by around 300,000 in 2015 in comparison with 2014. Different from the underemployed, most of the unemployed are young workers with the age between 15 -24 years old.



**Figure 5. Inexperienced Unemployed Rate**

The majority of the unemployed are inexperienced workers. During the last 3 years between 2011-2014, the inexperienced unemployment rate has a declining trend, however the proportion of the youth among of them has increased (Figure 5). The rate of inexperienced unemployed has decreased from 64% in 2011 to 55% in 2014, while at the same period the share of the youth among the inexperienced unemployed has increased 9 percentage points from 69% to 78%. Their lack of experience has made them difficult to find a job. A media tracking study by Akademika (2014) found that 83% of job advertising in Indonesia required working experiences from the applicants (Priyono, 2015).



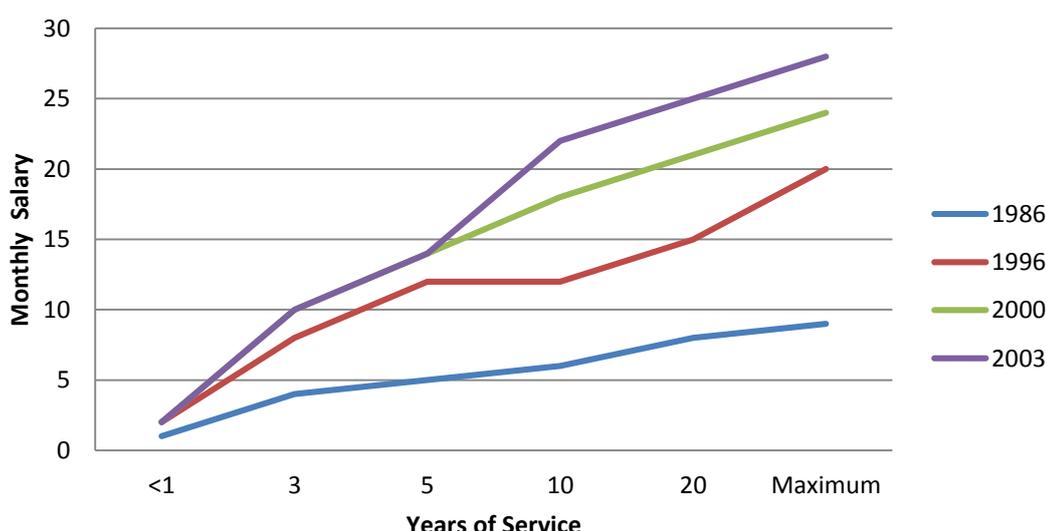
**Figure 6. Education Level of the Inexperienced Unemployed**

Looking at the education level of the inexperienced unemployed, the majority of them have relatively high level of education, which is senior high school or more (Figure 6). The fact that the majority of the unemployed are inexperienced young workers who have high education, then it is interesting to find out how the young people are able to cope living in unemployment condition. The Indonesian culture which allow young people to live with their parents makes it possible for them to be unemployed while in the meantime they are looking for a job. A study by Suryadarma et al (2013) shows that around 79% of the unemployed in rural area and 72% in urban area are still living with their parents, so that they can afford to be unemployed by receiving income transfer or other supports from their parents.

### III. LABOR PROTECTION FOR THE UNEMPLOYED AND SOCIAL SECURITY LEGISLATION

#### 3.1 Severance Pay

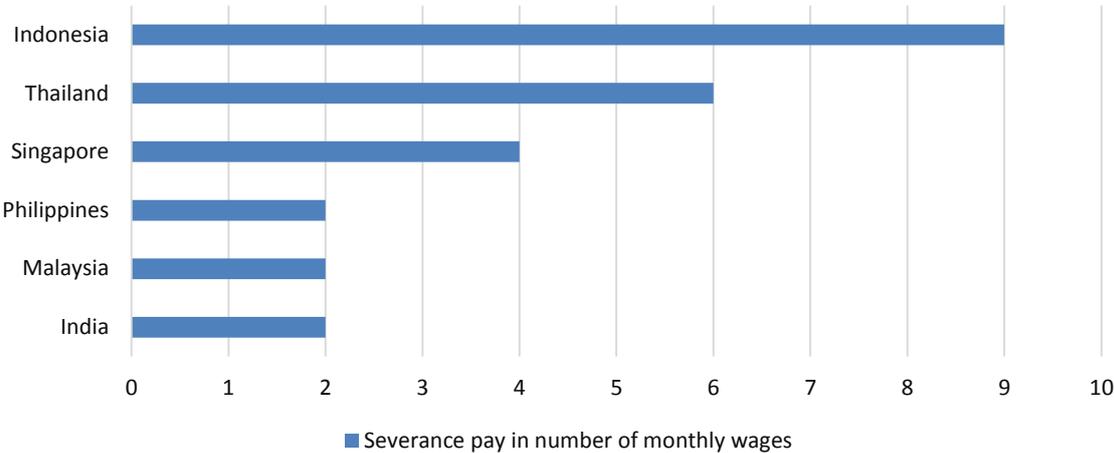
Indonesia does not have an unemployment insurance scheme. However, in order to protect laid off workers, Indonesia has legislated a severance pay system. As part of the standards of labor in security rights, the legislation on severance pay has been promulgated long before the 1998 Asian economic crisis. The first regulation on severance pay was enacted in 1986 and the rates has changed a couple of times until the last labor law No. 13/2003, which still in effect until now with some changes after being reviewed by the constitutional court. Figure 7 summarizes the Severance Pay in Indonesia during the 1986-2003 period. The graph shows that the rates of severance pay has increased threefold in nearly 20 years for workers with more than 20 years of services.



**Figure 7. Changes in the Magnitude of Severance Pay, 1986-2003**

Source: Indonesian Laws and Ministerial Decree 1986-2003.

In comparison with neighboring countries in Asia, Indonesia is one of the most generous countries in giving severance pay. According to a study by GIAT-UNPAD (2004), a laid-off worker with 4-years' experience in Indonesia gets more than fourfold of severance pay in number of monthly wages in comparison with India, Malaysia, and the Philippines (Figure 8). In addition to that Indonesia also has a higher severance pay in comparison with Singapore and Thailand (Manning, 2010).



**Figure 8. Severance Pay for A Worker with 4-years Experiences at the Firm and Dismissed for Economic Reasons**

Source: GIAT-UNPAD (2004) as cited in Manning (2010)

According to the Labor Law No. 13/2003, each employee is entitled to 3 kinds of benefits upon the termination of employment, namely severance pay (*uang pesangon*), reward for service time (*uang penghargaan masa kerja*), and compensation fee (*uang penggantian hak*). The benefits are paid based on the circumstances of their termination, the number of working years and the status of the employee whether they are employed as permanent workers or under temporary employment agreement. The reason of the termination of the job affects the liability of employers and the calculation payment as there are formulas for different circumstances in ending the work contract.

The components of wage used for calculating the benefit are composed of basic salary and fixed allowances. The following gives details for each of the 3 benefits.

**Table 1. Severance Pay (Article 156.2 of Law No. 13 of 2003)**

| Years of Services                    | Benefit         |
|--------------------------------------|-----------------|
| Less than 1 year                     | 1 month's wages |
| 1 year or more but less than 2 years | 2 month's wages |
| 2 year or more but less than 3 years | 3 month's wages |
| 3 year or more but less than 4 years | 4 month's wages |
| 4 year or more but less than 5 years | 5 month's wages |
| 5 year or more but less than 6 years | 6 month's wages |
| 6 year or more but less than 7 years | 7 month's wages |
| 7 year or more but less than 8 years | 8 month's wages |
| 8 years or more                      | 9 month's wages |

**Table 2. Service Pay (Article 156.3 of the Labor Law):**

| Years of Service                        | Benefit         |
|---|-----------------|
| 3 years or more but less than 6 years   | 2 months wages  |
| 6 years or more but less than 9 years   | 3 months wages  |
| 9 years or more but less than 12 years  | 4 months wages  |
| 12 years or more but less than 15 years | 5 months wages  |
| 15 years or more but less than 18 years | 6 months wages  |
| 18 years or more but less than 21 years | 7 months wages  |
| 21 years or more but less than 24 years | 8 months wages  |
| 24 years or more                        | 10 months wages |

Other compensations (Article 156.4 of the Labor Law) includes the compensation for annual leave, which is not taken by the employee; the travel expenses for workers and their families to return to the original location where they were accepted to work for the companies; housing allowance and medical costs, which is 15% of the total amount of severance and service payment; and other compensation which were stipulated under the employment agreement, company regulation or collective labor agreement. The temporary workers who were terminated before the contract period expires are not entitled to those 3 termination payment.

In addition to that the labor law also provides separation pay (uang pisah) and the amount is set under employment contract, company regulation and collective labor agreement. The separation pay is only provided to employees who their duties and functions are not related to employers' interest directly such as non-management workers and only to specific circumstances.

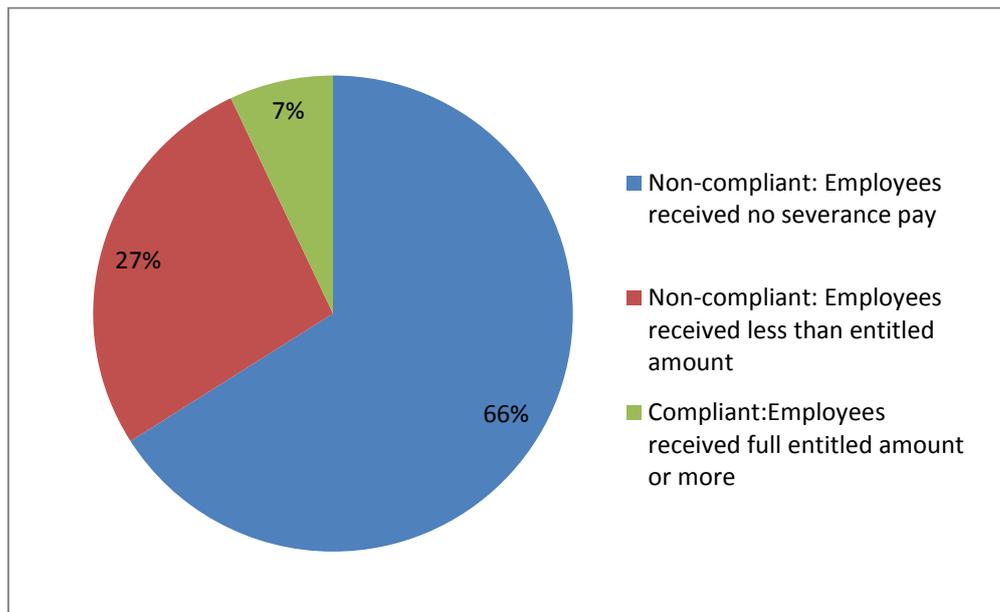
### 3.1.1 Severance Pay Compliance

Although the law has regulated the severance pay system, however, the compliance by firm is low as the enforcement of the regulation is low too. Sanctions are given to the employer only if the employee enforce their right through the legal process, whereas some of them are not aware of their right to severance pay. Furthermore, penalties are imposed only to employers who avoid paying severance pay but not for those who delay the payment. In order to avoid paying severance, most likely employers prefer to employ short-time contract or outsourced workers as they are not covered in the law. So far only oil and gas industry that has legal foundation<sup>1</sup> to maintain reserves in the employee severance fund undertaker, while other industries just have the obligation to record their severance pay as accrued liability and accounting expense in their financial statement. The latter does not guarantee the fulfillment of the workers' right for severance pay when they get laid off.

According to the Labor Force Survey data in 2008, around two-thirds of all eligible employees who separated from their job did not receive severance pay and only less than one-tenth that received full entitlement (Figure 9). Meanwhile only slightly above a quarter received less than their entitled amount. In addition to that women are less likely to receive their severance pay entitlement than men. There were 30% of eligible women who received severance pay in comparison with 37% of men. Employees under 25 years old, or have worked less than 4 years, or have wages less than Rp1 million per month were less likely to receive severance pay compared to their colleagues who have

<sup>1</sup>Government regulation No. 79/ 2010 about Operating Cost that Can be Recovered and Treatment For Income Tax In the Upstream Oil and Gas Bussiness Sector.

the opposite condition. So did workers of small firms in comparison with those working in the medium and large sized firms employing more than 20 employees (World bank, 2010).



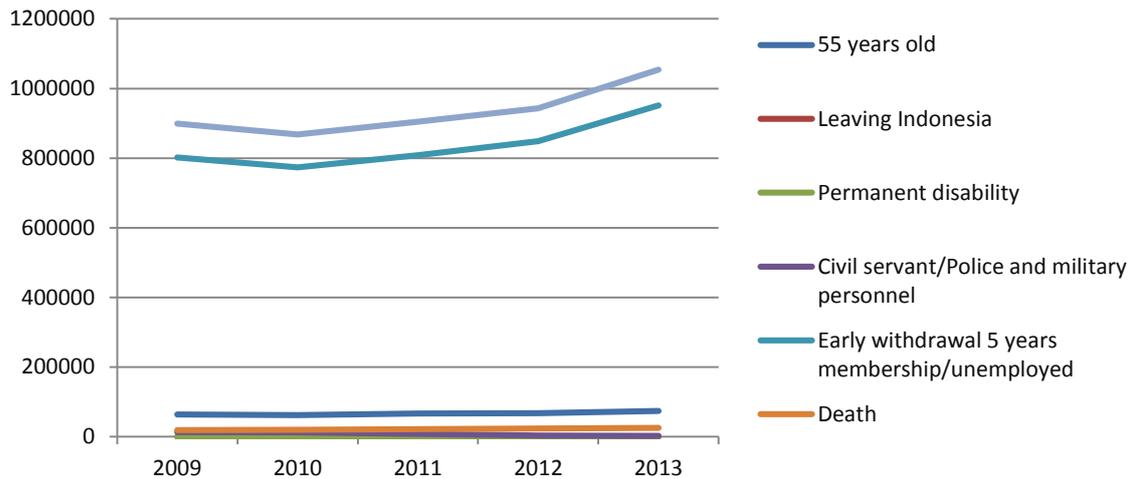
**Figure 9. Receipt of Severance Pay**

Source: World Bank, 2010

### 3.2 Old Age Benefit

Another way for the laid off workers to cope is by withdrawing their old age benefit. The program is mandatory for all employees working in formal sector and voluntary for the informal sector workers and it has been managed by Jamsostek, which was transformed to BPJS Ketenagakerjaan (Employment Social Security Agency) when the institution was established in 2014. The contribution rate for wage worker are based on their wage which is shared between employer and employee, each contributing 3.7% and 2% respectively. Meanwhile for the informal workers, the contribution is paid in nominal amount based on their wage range, which is around 2% of their wage. Although the main objective of the program is for retirement savings but members also have the right to withdraw the total amount in the accounts due to death, permanent disability and unemployed.

According to government regulation No. 46/2015, starting on 1 July 2015, the benefit of the old age can only be withdrawn if a member has reached the retirement age of 56 years, or died or has permanent disability. If a member's age has not reached 56 years, she/he should have already been a member for at least 10 years in order for she/he be able to withdraw 30% of the fund for housing or 10% for preparation before retirement age. However, this regulation had created protest as previously under Jamsostek a member can withdraw the benefit if they had been the contributors to the fund for five years or more and had become unemployed. According to the data from BPJS Ketenagakerjaan, around 90% of the claims are for early withdrawal claims after 5-year membership and being unemployed (Figure 3.4), which means that the Jamsostek old age benefit has been used mainly not for financing retirement savings.



**Figure 10. Number of Cases of Withdrawal of Old Age Benefit**

Source: Jamsostek Annual Report 2013

In response to the protest, the regulation was then changed into Government Regulation No. 60/2015, which reinstates the initial requirements, even more flexible as there is not any requirement for minimum years of membership to withdraw fund. According to the new regulation, a member can withdraw the fund when she/he dismissed from job plus additional waiting period of 1 month. The regulation has become effective since 1 September 2015.

### 3.3 Health Insurance

Since 1 January 2014 Indonesia has established the Indonesian National Health Insurance program which is managed by BPJS Kesehatan (Health Social Security Agency). All Indonesians are obliged to participate in the national program by paying the contribution, except the poor people, whose premiums are paid by the government. There are around 86.4 million of people who are included in non-contributory beneficiaries (PBI) and this number are increasing due to expansion of the beneficiaries. PBI covers not only the poor households but also the vulnerable people, including those have welfare problem (*Penyandang Masalah Kesejahteraan Sosial - PMKS*) such as street children, homeless people, and prisoners, which according to the data there are around 1.7 million people.

In addition, the national health insurance is still accessible for at least six months for a person who becomes unemployed. After that, if he/she still cannot get a job and pay the contribution, then his/her contribution to the national health insurance will be paid by the government, including his/her family member.

# IV. REVIEW OF UNEMPLOYMENT BENEFIT SCHEMES

## 4.1 General Background

There are four different types of unemployment benefit schemes that have been implemented around the world, namely severance pay, traditional unemployment insurance, unemployment assistance and unemployment insurance savings account. Each of the schemes has different characteristics that can be an advantage or a disadvantage in implementing it. In case of unemployment insurance scheme, the traditional system of unemployment insurance is often compared with unemployment insurance savings account as the later attempt to overcome the moral hazard of the traditional system. However, the systems of traditional unemployment insurance and unemployment insurance savings account are suitable for economies at different level of development and require different degrees of infrastructure (Ferrer and Riddell, 2009). Most developed countries implement the traditional Unemployment Insurance (UI), while Unemployment Insurance Savings Account (UISA) is typically applied in developing countries i.e. middle-income countries.

Meanwhile common protection implemented in developing countries is severance pay, which gives job protection but not workers protection. Severance pay makes firing workers costly to employers so that it will lengthen the duration of job tenure, which is expected to reduce the turnover of labor. However, severance pay does not protect workers along the duration of the risk as the fund might be not enough for those who get unemployed for a long period.

The next subsection will review the severance pay scheme system, the advantage and disadvantage of the scheme especially in comparison with unemployment insurance. Review of others unemployment benefits will follow after that.

## 4.2 Severance Pay

Severance pay has been applied in almost all countries across the world and considered as an early form of the scheme of unemployment compensation in the world. However, the program is likely to be more important in developing countries than in most of developed countries due to additional program of unemployment insurance in the latter. Initially severance payments were intended to protect workers against "unjust dismissal" by imposing additional costs on a firm that intends to fire a worker (Domeland & Gill, 2002). Nevertheless, most of developing countries has applied severance pay as the main protection of income in case of unemployment.

The main difference between severance pay and unemployment insurance is on their funding mechanism. Unemployment insurance shares the burden between employee, employer and/ or government, while severance pay puts the burden exclusively on employer. The lump-sum money which is paid to workers as severance pay is financed by the employer. In the case of declining economic growth, which leads to massive layoffs or bankruptcy, governments in some countries give financial assistance. The condition of economic downturn will create the chances of high employer's non-compliance especially if there is no legal requirement to reserve the fund.

As part of employment protection legislation, the idea behind the implementation of severance pay is to enhance job security. However, the effect of the program is still inconclusive due to its negative effects. One of the study conducted by Blanchard (2000) found that severance pay decreases the probability of workers to be unemployed, but on the other hand it also reduces the chance of being employed as severance pay may distort the job creation (Vodopivec, 2004). In addition to that severance pay also increases the informality as in the case of Latin America countries. Levenson and Maloney (1998) mentioned that the characteristics of small firms made them difficult to apply severance pay and would rather stay informal, which at the end increases the number of workers excluded from workers protection legislation (Domeland & Gill, 2002).

Meanwhile, the program requires simple administration particularly in comparison with traditional unemployment insurance, which will be discussed in the next section. The risk pooling of the program occurs at the level of firm so that it will minimize the job searching discouragement.

### 4.3 Traditional Unemployment Insurance

Traditional unemployment insurance has been implemented in most developed countries as income protection program for the unemployed. In Southeast Asia, Thailand and Vietnam are among the earlier countries that have implemented the program, while Laos has just started to implement its unemployment benefit in 2016. The unemployment insurance in Thailand took effect in July 2004 while in Vietnam since January 2009. Meanwhile the rest of the countries in the region have not established any unemployment benefits scheme yet.

The program is mandatory in most countries but usually only cover employees in the formal sector, while self-employed or informal sector workers are often excluded. As the program applies a pooling risk system among workers then compulsory membership is necessary in order to prevent adverse selection. The pooling risk offers an income redistribution since the benefit that is paid to the unemployed is at the expense of other workers' contribution. Experience from developed countries shows unemployment insurance gives better protection in smoothing workers' consumption after being dismissed from their jobs. However the effect is found to be not significant in developing countries (Vodopivec, 2004).

The major drawback in traditional unemployment insurance is the presence of moral hazard problem as the program gives disincentives for searching job and leaving unemployment among the unemployed. A study in Thailand shows the incidence of moral hazard in job search of the benefit recipients as there are a decreasing trend of the unemployment rate while the number of benefit recipients have risen (Jirakiattikul, 2013). Many studies found that there are positive correlation between replacement rate and rate of unemployment and the duration of entitlement and the unemployment spells (Vodopivec, 2004).

Vodopivec (2004) points out some country specific conditions which are required to support the performance of the program: (1) In order to minimize the moral hazard, it is important that a country has a strong administrative capacity to check the working status of the applicants and to monitor the continuing eligibility whether the recipients of the benefit are looking for a job actively. This requirement is difficult to implement in developing countries, where monitoring and enforcement are weak. With such condition, the implementation of the program deteriorates its effectiveness and increases the cost of the program. (2) The country with a large number of informal workers and underemployed will put the program into problem as it is going to be difficult to detect the recipients who already got a job in the informal sectors or have a part time job. Double-dipping

might happen when workers that have been unemployed for some time can work at lower paid part time job and at the same time still receiving the unemployment benefits.

The Vietnam's experience shows that many benefit recipients are actually not unemployed but they are working without a labor contract for different companies. In addition, due to the higher expected benefit of unemployment insurance than their contribution, some workers even take the unemployment benefits in the short run and return to work at the same place (VSS, 2011 as cited in Giang and Nguyen, 2011).

## 4.4 Unemployment Assistance

Unemployment assistance is a targeted income support program for the unemployed who do not have financial resources to maintain minimum standard of living. Recipients usually have to meet means-test indicator such as source of income and assets test below designated thresholds. Most of the countries implemented unemployment assistance as a complementary program of the traditional unemployment insurance. Workers receive the assistance only if their unemployment insurance have exhausted or they are not qualified for the first unemployment benefit program, for example because of weak labor market attachment e.g. seasonal workers and domestic workers. Only few countries apply self-standing unemployment assistance, namely Australia, Hong Kong, New Zealand, Serbia, Montenegro and Tunisia. The program typically financed by the government.

As it uses means-testing, the program can target the beneficiaries effectively and provide benefit to informal workers and youth. However, it creates high administrative cost and gives less protection for the high-income workers. The program can discourage workers for reemployment. In addition to that it can reduce the labor supply of the recipient's family due to means-testing indicators, which include sources of income among family members. This can contribute to persistence unemployment. Furthermore, high number of underemployed and unemployed will make it fiscally unsustainable (Vodopivec, 2004).

## 4.5 Unemployment Insurance Savings Account

Beside the traditional unemployment insurance, many countries have implemented Unemployment Insurance Savings Accounts (UISA) as an alternative program. The program applied typically in developing countries, mainly in Latin America countries, including Argentina, Brazil, Chile, Colombia, Ecuador, Panama, Peru and Venezuela.

UISA is a mandatory individual saving scheme where workers and/or employers have to make regular deposits, which can be withdrawn by workers in case of getting unemployed. The main difference between traditional unemployment insurance and UISA is on the share of risk. While the traditional unemployment insurance pools risks among workers, UISA puts the risk on individual based. The system can improve the incentive of the unemployed to search for a job and avoiding the moral hazard which is embedded in the traditional unemployment insurance due to the internalizing of the costs of the unemployment benefit. Nevertheless, the design of the program makes income redistribution among workers becomes impossible.

Up until now the countries which implement UISA only cover formal sector workers, however it is possible to include informal sector workers in the long run. Most countries allow workers to access the savings accounts upon the separation from the employer regardless the reason. With such

condition there is no need to monitor the continuing eligibility of the recipient, which is the main cause of moral hazard. Additionally, the elimination of monitoring task reduces the administration cost of the program.

In the case of pure UISA, the unemployed can withdraw their savings accounts as long as the balance is not negative. However, the balance might not be sufficient particularly for the young workers or those who have low level human capital. Therefore, it needs to be piggybacked by other funds or assistance. Some countries have implemented a combined scheme between UISA and other funds so that workers can borrow or get additional payment in case of lack of fund in their savings account.

Jordan has implemented the combined system of UISA and pension funds which connect the balance between the funds. The pension of the individuals will be adjusted downward in case their balance is negative within predetermined limits. Although the scheme can extend the consumption of the unemployed, but on the other hand it will deteriorate the sustainability of the pension funds. Meanwhile in Chile the UISA-cum-solidarity fund allows individuals to receive payments from solidarity fund after draining their savings account. This case of Chile's hybrid system is discussed in the following section.

## 4.6 The Hybrid System - The Case of Chile

Chile has implemented its unemployment insurance which combine the individual savings account and the solidarity fund since 2002. The hybrid system is financed by employers, employees and government and has been used as the model for developing countries (Sehnbruch and Carraza, 2015). The individual savings account is financed by employee and employer with the amount of the fixed percentage of the employee's gross wage. For permanent workers, employers pay 1.6% of gross wages and workers pay 0.6% of their gross wages into their individual savings account. Meanwhile the solidarity fund is financed by employer and from the state. Employers put in 0.8% of the gross wages into the fund and government contributes annually around US\$ 14 Million (Huneus, Leiva and Micco, 2012). However, by law only permanent workers who can access the solidarity fund while temporary workers are excluded from the access to solidarity fund. In case of the temporary workers, only employers who pay to the employee's savings account, which is 3% of the gross wages but none from the employees.

Although the savings account is individual and the money can be withdrawn independently but there are requirements to get the fund. The eligibility for the fund depends on the length of contribution period which are different according to the type of working contract. In order to receive the money, workers who have open-ended contracts have to have contributed minimum for 12 months and 6 months for the fixed-term contract workers for the last 24 months. Workers can get the money for any reason of unemployment including termination of the contract, retirement, voluntary quitting or other causes which make them leave their jobs. They can access their savings account for seven months in maximum or unlimited if the workers have sufficient savings. The waiting period to get the money is 30 days. The replacement rates for the first month is 50% and get 5 percentage points decrease each month until it reaches 20% or will remain constant after that if there is an excess savings in the account. If the fund is not used, it will be put in the pension fund once a worker gets retired.

Meanwhile the access to solidarity fund is opened in case workers i.e. permanent workers run out fund from their savings account. Other requirements are workers has to put in 12 monthly contributions in solidarity fund, continuous or intermittent, during the last 24 months, which the

last three being continuous under the same employer and the reason of the working termination is not those that are described in the Labor Code. The replacement rate refers to the average wage during the last 12 months contribution paid by workers and has the minimum and maximum amount of benefit. The fund starts at 50% rates of replacement for the first month and reduce each month by 5 percentage points until it reaches 30% as it is granted only for 5 months.

In order to avoid the moral hazard of the solidarity fund benefit, every month the beneficiaries are obliged to visit the Municipal Office of Labor Mediation (OMIL) to report about their unemployment status and get information for training or job offers. Any vocational training offer from National Training and Employment Service (SENCE) or job offer from OMIL with the wage offered at least 50% of the last monthly wage shall be accepted otherwise the fund will be suspended. Workers only get access 2 times in 5 years period to solidarity fund.

One of the study that examine the effectiveness of Chile unemployment insurance scheme in reducing the moral hazard problem was conducted by Hartley, van Ours and Vodopivec (2010). The study found that Chile's UISA improves the work incentives. However, the moral hazard effects patterns on unemployment duration dependency appear once the beneficiaries using the Solidarity Fund. The study also found that the increasing UISA's resources increases the probability of the recipients' exit from unemployment, which may reduce the need for solidarity funding at the end.

## V. ISSUES AND OPTIONS IN DESIGNING UNEMPLOYMENT INSURANCE SCHEME FOR INDONESIA

The different patterns between developed and developing countries in choosing the right unemployment benefit scheme shows that they are related to the level of development of a country. However, the scheme that a country chooses can be different from other countries which have similar level of development as each country has specific circumstances and needs. There are Indonesia-specific conditions that need to be considered in order to choose the right unemployment insurance scheme to be implemented, namely:

- The Indonesian labor market is characterized by a large number of informal workers and high rate of underemployment. This condition may exacerbate the moral hazard of a program which applies a pooling-risk system. Workers can work in the informal sectors and continue to receive the unemployment benefits if they do not declare their jobs as it is difficult to detect the working status of workers in the informal sectors.
- Meanwhile, the typical unemployed is a young worker who has relatively high education. Most of the unemployed youth are inexperienced workers who still live with their parents. The condition of being lack of skills and experience make them really vulnerable due to limited access to employment opportunities.
- The administrative capacity of Indonesia is still weak. There are no integrated job centers which provide training, counseling and job information and matching services. Moreover, a comprehensive database of workers to match supply and demand of workers is still absent. Those infrastructures are the basic needs of employment services whilst to be able to monitor workers' eligibility require more extensive and developed standard capacity (i.e. OECD-style Unemployment Insurance). Hitherto Indonesia has public employment services

center which are run by district offices of manpower (Disnaker). However, it does not work well since not all unemployed are registered in the centers and they only give limited information and links to formal sector jobs. According to ILO (2014) in 2011, only around 23% of jobseekers registered in employment services and the trend tend to decline overtime. In addition to that, there are also privately operated job-matching services (LPTKS), which are available for workers who are looking for job. But the number is small and the location are not spread across country evenly as it is also influenced by the availability of access to internet. Meanwhile the vocational training centers (BLK) are not functioned maximally especially in the local regions. Currently there are 279 BLK across the country which most of them belongs to the district governments. Among 263 BLK which are managed by district governments, only fifth of them (around 55 BLKs) are in good condition, while the rest of them are in medium and worst condition (Bisnis Indonesia, 6 April 2016).

Beside country specific features, policymakers need to take into account the effect of interactions of the program with existing programs and other regulations. The implementation of Law No. 13/2003 has invited a long debate between employers and workers as there are many controversial articles which need to be revised. The articles about outsourcing workers are perceived to be unfair since it will not give protection for the workers, while the employers believe that the law does not support the investment climate and the high level of severance pay has increased burden on them. The law has been reviewed judicially many times with some changes which make it really urgent to be revised.

Meanwhile the revision of government regulation on old age benefit was a misguidedness. As the purpose of the old-age benefit is for retirement savings then the revised regulation has put it into wrong direction. Nevertheless, the early withdrawal trend in old age benefit has shown that there is an urgent need to provide income security for those who lose their job and become unemployed. While at the same time it can be used as a measure to help sustain the demand during economic downturn.

## 5.1 Options for Developing an Unemployment Insurance Scheme in the Short Run

After reviewing different schemes of unemployment insurance which has been implemented around the world and match it with Indonesia-specific condition, then it is recommended that Indonesia selects UISA scheme to be implemented in the short run. A mandatory individual savings account is the most feasible option if Indonesia wants to give protection for the unemployed in the near future as it has minimum moral hazard while Indonesia does not have the infrastructure to support the implementation of the pooling risk system in unemployment insurance.

Workers and employers have to pay contribution to worker's savings account which can be withdrawn by workers for any reason of job dismissal. Minimizing the monitoring in eligibility of the scheme is advisable for Indonesia current condition as the infrastructure is not ready. The elimination of the requirement to access the account will increase the efficiency of the program. However, in order to minimize the incentive to withdraw all their savings, the program should be connected with their pension fund, so the unused money will be added to their pension fund.

The determination of percentage of the contribution, period of contribution, replacement rate, length of benefit need to be thoroughly calculated. A minimum length of contribution period is required to meet the fund adequacy for the unemployed. Level of benefit should be modest in term

of the replacement rate and the length of period to get it. So that it will give incentive for the workers to find a job and go back to work.

The program can start by covering the formal sector workers first, both permanent and temporary workers as a mandatory program. The coverage can expand easily if it is connected with pension fund so that it can use the pension membership data. The program should be administered by a public institution which has the capacity to manage the fund and workers' database too. The ability of the institution to reach the members who are living in rural area or isolated one has to be considered among the characteristics in choosing the right institution. The institution could be the existing social security carrier or establishing a new one since the law of national security system allow additional social security agency if needed. In addition to that there should be proactive system to support youth entering labor market and re-employment through employment service centers which provide not only training, job and apprenticeship information but also counseling and entrepreneurship. The information is obtained through collaboration with domestic and overseas private company.

Indonesian very generous but low compliance severance pay has proven to be ineffective to protect the workers. The severance pay system need to be reformed not only to improve the workers protection but also to support the employers' business too. In order to achieve that and establish a new one easily, the severance pay need to be reduced. To replace and adjust the amount of the severance pay to unemployment insurance will be more difficult due to the fact that Indonesia has a generous severance pay formula. By replacing severance pay, workers can get less benefit if they have long period of service years and a shorter unemployment spell but there is also possibility that the benefit will be not enough if the duration of unemployment benefit is limited. So to reduce severance pay is preferable than to replace it. In addition to that the employers' contribution to UISA will reduce the amount of severance pay that has to be paid later. To prevent the incident of noncompliance in severance payment, there should be a government regulation in which employers have to prefunding the severance pay. When the new scheme already set, the old age benefit regulation has to be reinstated to its original function for retirement savings.

## 5.2 Options for Developing an Unemployment Insurance Scheme in the Long Run

Although the majority of unemployed has a high education but most of them are young workers, and UISA might not be sufficient to protect them. Therefore, in the long run UISA should be completed by establishing an unemployment assistance scheme. Nevertheless, the unemployed has to drain their individual savings account first before getting the access to the assistance. Additional criteria are needed in order to prevent the moral hazard in accessing the assistance. The criteria can be the same with severance pay eligibility, plus other means testing indicators such as source of income and assets tests. To continue to get the assistance, the unemployed are required to access an employment center regularly as a proof that they are looking for a job. However, there should be a maximum limit to get the assistance.

The unemployment assistance is to be financed by the government. There is a possibility to include the informal sector workers in the long term once a comprehensive workers database has established. The government fund support will be legitimated when the informal sector workers start to participate in the program, as most of the poor people work in informal sectors.

## VI. CONCLUSIONS

As the infrastructure to support implementation of unemployment insurance is not ready yet, Indonesia can begin with individual savings account and balanced with reduced severance pay in the short run. In the long run, the scheme can be combined with unemployment assistance. In the short run the program can start to cover the formal sector first as mandatory, which include not only permanent workers but also temporary workers. Informal sector workers will be included in the long run when the comprehensive workers database already exist.

Regarding the eligibility, workers can withdraw the money in their savings account for any reason of job dismissal. The only requirement that has to be fulfilled by the workers is the minimum length of contribution period. In order to minimize the incentive to withdraw all their savings, the program should be connected with their pension fund. This means that the unused fund in their savings account will be put in their pension fund once they get retired.

In order to reduce the doubt in introducing the UISA scheme, severance pay needs to be reduced and government need to regulate the requirement to maintain reserves for severance pay. The amount of employers' contribution to UISA will reduce the total amount of severance pay.

In the long run, there should be additional criteria to access the government assistance after the depletion of savings account so that it can reduce the moral hazard. The criteria to get the severance pay can be used as additional criteria to filter the access to the assistance plus another means testing indicators such as source of income and assets tests. The access to the assistance must be limited too for a definite time. Nevertheless, the requirement to drain the individual savings account first to get the access to the assistance is already a kind of measurement to prevent moral hazard.

In addition to that a system that can monitor job-search and participation in training activities of workers should be well designed. But before that, to support the re-employment, an active employment service centers should be provided to give training, job information and counseling for the unemployed. To access the employment service centers should be among the requirements to access the assistance.

For the sources of financing, both workers and employers should contribute to the worker's savings account. The benefit should be modest in term of the replacement rate and the length of period to get it. So that it will give incentive for the workers to find a job and go back to work. For the assistance in the long run, government allocates the fund to all who are eligible. The government assistance will be legitimated when the informal sector workers start to participate in the program in the long run, as most of the poor people work in informal sectors.

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