C. INDONESIA 2014 AND BEYOND: A SELECTIVE LOOK

1. Seeing Indonesia as a middle-income country

As the first decade of the 21st century draws to a close, Indonesia has emerged as a middle-income economy, economically strong, politically stable, and with increasing confidence and global standing. This was unexpected a decade ago, when Indonesia experienced a severe economic crisis that resulted in the economic dislocation of millions of households, a sharp rise in poverty, a 13 percent decline in GDP, and near bankruptcy of the financial sector. The economic crisis triggered a dismantling of the previous political order, leading to a period of political turmoil characterized by several changes in government and the heightening of separatist tensions.

Over the past decade, Indonesia's fiscal and political systems have been transformed. Perhaps less mentioned, but ultimately just as important, Indonesia is also in the midst of a fundamental demographic and geographic shift. Indonesia is now an urban country with more than 50 percent of the population living in urban areas. Within the next five years, Indonesia will have a population of 250 million people, almost 60 percent of whom will live in cities. At the same time, with declining fertility rates and with the fraction of elderly yet to rise sharply, Indonesia will continue to enjoy a “demographic dividend” in the next decade as the working age population increases relative to the rest of the population.

Because of Indonesia’s achievements in the past decade, it is now possible to imagine a new Indonesia emerging in the decade ahead: an Indonesia in which every child receives a quality primary education and goes on to complete secondary education; an Indonesia where highways connecting Surabaya with Jakarta and Medan provide market access and an economic lifeline to the towns and villages along the way; an Indonesia that is globally competitive not just in the commodity-based sectors where it has a natural resource advantage but also in selected manufacturing and service industries; and an Indonesia where all Indonesians enjoy affordable access to quality health services. If Indonesia is able to build on the robust foundation of macroeconomic and political stability it has established thus far and accelerate growth while ensuring that growth is shared and is sustainable, it has the potential to become a dynamic, competitive and inclusive middle-income country in the decade ahead.

However, to realize the vision and potential of a rising Indonesia, much remains to be done. Growth has restarted and has been robust, but infrastructure continues to be poor and the investment climate remains weak. Higher levels of growth have not translated, to the extent hoped for, into greater poverty reduction, and a large percentage of the population remains vulnerable to poverty. On the employment front, there are positive signs of a turnaround in the last five years, but Indonesia still lags behind its more prosperous neighbors in creating higher value-added non-agricultural jobs. Because of geographic and income-related disparities and the poor quality of health, water and sanitation and education service delivery at the local level, Indonesia’s performance in terms of human development outcomes has been quite uneven over the last decade despite significant increases in public expenditures. There is considerable evidence as well that Indonesia’s environmental quality is deteriorating and its natural resources being unsustainably depleted.

Against the background of a strong fiscal position, the next five years provide an opportunity for Indonesia to address these structural weaknesses. But the task will not be easy and it will take time. Democratization and decentralization have fundamentally changed accountability structures and decision-making processes within government. These changes have highlighted systemic weaknesses in the processes and capacity for formulating and implementing policy and have made the process of implementing reforms a more challenging and time-consuming task. Government effectiveness has been limited by insufficient capacity and accountability of civil servants and by coordination problems within government. Because highly competitive elections have led to coalitional politics at the national level and in many regions, and greater voice in the political arena has been afforded to a wide range of non-state actors, the task of reaching consensus on critical policies and reforms has become that much more challenging. Decentralization has changed accountability structures or weakened them, as the division of roles and...
responsibilities between the various levels of government remains unclear in many spheres of government activity. At the same time, the tasks Indonesia faces, as an emerging middle-income economy, have become more difficult, in part because of its own past successes and in part because the global economic environment is rapidly changing.

An opportune moment to take on the task, at the threshold of a new decade, with a new government and a new five-year plan

But this is a particularly opportune moment for Indonesia to tackle this task. Having weathered the global downturn well, Indonesia is now much better positioned than most middle-income economies to think more proactively about development policy and spending priorities for the next five years and beyond. The newly reelected government will have the opportunity to implement an ambitious development program. In particular, the National Medium-Term Development Plan (RPJM) for 2010-2014, which is currently being finalized and will be submitted for parliamentary approval early in 2010, provides the government a crucial opportunity to shape Indonesia’s development prospects for the next five years and lay the foundations for the remainder of the coming decade. The government will face important policy and public expenditure choices. The institutional and policy reforms Indonesia prioritizes, the amount of resources it chooses to spend on development, where it chooses to spend these resources and how effectively it implements its development programs will substantially influence Indonesia’s longer-term economic and social prospects.

To contribute to and inform the public discussion about these important choices, this edition and this part of the Indonesia Economic Quarterly begins a selective look at Indonesia’s development prospects, priorities and challenges in the next five years and beyond. It does so by drawing on recently completed, forthcoming and ongoing analytic work undertaken by the World Bank to present salient facts and analyses on selected topics relevant for thinking about Indonesia’s medium-term development priorities and challenges. In this edition, the focus is on the demographic trends Indonesia will confront in the coming decade and the challenges and opportunities that these present in terms of creating jobs and financing healthcare.

2. Indonesia is entering a demographically critical decade

Indonesia has enjoyed a demographic dividend in the last forty years...

For the last forty years Indonesia has enjoyed a kind of demographic dividend as declines in fertility have reduced the fraction of children (ages 0 to 14) in the population without a corresponding increase in the fraction of elderly (ages 65 and over). And as a result, the dependency ratio—the ratio of children and elderly (i.e., dependents) to the working-age population—has steadily declined from over 0.8 in 1970 to about 0.5 in 2009 (Figure 42).

Figure 42: Indonesia’s demographic window of opportunity will close in the next decade

Sources: Demographic projections from BPS and UN Statistics.
...but this demographic window of opportunity will close in the next decade

But this demographic window of opportunity will close in the next decade. Sometime between 2020 and 2025 Indonesia’s dependency ratio will begin to rise again. And it will do so because the fraction of elderly in the population will begin to rise sharply, offsetting both the decline in the share of children as well as the increases in the working-age population. In the coming decade the number of Indonesians over the age of 65 is expected to increase by about 4 million, roughly the number by which it increased in the last decade. However, between 2020 and 2030, the number of elderly will rise by 8 million, and by 2030 the fraction of elderly in Indonesia’s population is projected to be around 10%. From a demographic perspective, therefore, the next decade will be critical for Indonesia.

3. Creating better jobs for Indonesia’s growing labor force

Indonesia’s window of demographic opportunity also creates a challenge to create many new, better quality jobs

Indonesia’s working-age population will grow in size by about 20 million over the next decade, or about 2 million per year. To make the most of its remaining demographic window of opportunity Indonesia will need to generate a large flow of new, good quality jobs.

The World Bank’s forthcoming Indonesia Jobs Report, scheduled for release in early 2010, reviews the main trends in Indonesia’s labor markets over the last two decades, will provide further ideas for how labor policies and programs can encourage job creation and better prepare disadvantaged workers to succeed in the labor market. The following paragraphs summarize some of the basic trends and developments in the Indonesian labor market described in the Report.

Accelerating poverty reduction depends on the creation of more jobs

Labor is one of the few assets of the poor. If provided with a good job, they have a chance to earn their way out of poverty. Indonesia experienced jobless growth from 1999 until 2003, which slowed down the rate of poverty reduction. The uneven performance of the labor market in Indonesia continues to raise concerns whether Indonesia is at risk of falling into a situation of jobless growth again. To ensure that the benefits of growth are be shared more broadly, economic growth must translate into more jobs.

Employment trends are improving but job creation is remains moderate

The employment rate, after falling for six years, is turning around and has been on an upward trend since 2006. More recently, the rate increased from 61.5 percent in August 2008 to 62.1 percent in August 2009. Employment gains have strongest among female workers, as well as rural and young workers. The core unemployment rate has stabilized during recent years and actually decreased from 8.39 percent in August 2008 to 7.87 percent in August 2009. Although an encouraging sign, stable unemployment rates can mask problems in the labor market if workers are being pushed into jobs that are less secure or provide poorer conditions. It is necessary, therefore, to also examine some indicators of the quality of employment.

Figure 43: Rising employment (per cent of working age population)

Figure 44: Stabilized unemployment (per cent of working age population)

The creation of ‘better’ jobs has leveled off

Two main indicators for the quality of employment are the share of active workers employed in the non-agricultural and in the formal sectors. Formal sector jobs are considered ‘better’ because regular salaries provide employees with more income security and they are entitled to additional benefits legislated by the Manpower Law (No. 13/2003). Similarly, non-agricultural jobs are more productive and offer higher wage premiums for
workers. Despite Indonesia’s economic recovery during 1999-2003, formal sectoral employment fell and workers were pushed into agricultural jobs. The quality of employment, however, has been gradually improving since 2003. Recent formal and non-agricultural job creation has stagnated, increasing by 0.22 and 0.63 percentage points, respectively, from August 2008 to August 2009.

Employment trends in Indonesia’s labor market have been positive, albeit gradual, since 2003. Nevertheless, the workforce remains highly informal. In 2007, 24.1 percent of the active workforce was informally employed in service and industrial jobs, while another 37.2 percent worked informally in agriculture. Some workers prefer the informal sector. Approximately one-quarter of informal workers earn more in this sector than they could expect to earn in a formal jobs. Most, however, would be better off in the formal sector. On average, workers in the informal sector earn 30 percent less than employees in the formal sector or employers. They do not benefit from non-wage benefits that formal sector workers expect, such as medical benefits or transportation and access to credit. Informal workers also report facing greater work stress than workers in the formal sector. Without accelerated job creation in the formal sector, most of these workers will remain in inferior informal jobs. Since informal workers tend to be poorer, stagnant formal employment growth will also slow-down the pace of poverty reduction in Indonesia.

But even in the formal sector, most employees are only slightly better off than informal workers. Jobs in the formal sector, however, are not necessarily better than those in the informal sector. 81 percent of employees in the formal sector work without a contract in place. On average, they earn approximately the same as agricultural or non-agricultural workers in the informal sectors. They are less likely to receive any of the non-wage benefits typically associated with formal sector employment, including severance pay, pension, credit and transportation benefits. For example, two-thirds of employees with permanent contracts and over one-half of workers with temporary contracts report receiving medical benefits.
Only one-quarter of contract-less workers, in contrast, receive these benefits. When disputes arise with employers, non-contractual employees are also disadvantaged. Without job documentation to use as evidence they face barriers in accessing industrial relations courts.

**Figure 49: Contract-less employees receive fewer non-wage benefits**

<table>
<thead>
<tr>
<th>Benefit</th>
<th>Permanent contract/ Employer</th>
<th>Fixed-term contract</th>
<th>No contract</th>
</tr>
</thead>
<tbody>
<tr>
<td>Severance</td>
<td>70%</td>
<td>50%</td>
<td>30%</td>
</tr>
<tr>
<td>Pension</td>
<td>60%</td>
<td>40%</td>
<td>20%</td>
</tr>
<tr>
<td>Medical</td>
<td>50%</td>
<td>30%</td>
<td>10%</td>
</tr>
<tr>
<td>Credit</td>
<td>40%</td>
<td>20%</td>
<td>0%</td>
</tr>
<tr>
<td>Transport</td>
<td>30%</td>
<td>10%</td>
<td>0%</td>
</tr>
<tr>
<td>Meal</td>
<td>20%</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>

Source: IFLS 2007

Debates continue on whether the pace of job creation could be accelerated.

The Manpower Law contributed to improvements in the creation of ‘better’ jobs by establishing a system to moderate minimum wages that, between 1999 and 2003, were rising rapidly. At the same time, the law significantly tightened hiring and firing regulations by restricting the use of temporary contracts and increasing severance rates. Since then, redundancy costs in Indonesia have continued to be the highest in the region. This has sparked an on-going controversy around the extent to which these regulations deter employers from hiring staff, and whether rigidities in the labor market are slowing the pace of job creation in the formal and non-agricultural sectors.

In the current debate surrounding labor reform, workers groups have focused on improving workers’ welfare through the enforcement of hiring and firing regulations. Workers with permanent or temporary contracts are concerned about improving worker protection. Informal workers, however, would benefit from policies that spur job creation in the formal and non-agricultural sectors, which would provide more opportunities for them to move into jobs with greater income security and benefits. Similarly, contract-less employees in the formal sector would benefit from policies that would encourage employers to employ more workers with permanent contracts. These workers, who represent the majority of the workforce, have little voice in shaping labor market policies that are negotiated in tripartite forums.

**Figure 50: Redundancy costs in Indonesia are the highest in the region**

<table>
<thead>
<tr>
<th>Country</th>
<th>Severance Costs (weeks of average earnings)</th>
</tr>
</thead>
<tbody>
<tr>
<td>East Asia &amp; Pacific</td>
<td>120</td>
</tr>
<tr>
<td>China</td>
<td>100</td>
</tr>
<tr>
<td>Indonesia</td>
<td>90</td>
</tr>
<tr>
<td>Malaysia</td>
<td>80</td>
</tr>
<tr>
<td>Philippines</td>
<td>70</td>
</tr>
<tr>
<td>Thailand</td>
<td>60</td>
</tr>
<tr>
<td>Vietnam</td>
<td>50</td>
</tr>
</tbody>
</table>

Sources: ‘Doing Business’ 2010

In a highly segmented workforce, policies must take the interests of the voiceless majority into account.

...with the aim to expand opportunities for work in ‘better’ jobs

Job creation helps to share the benefits of growth more broadly, providing opportunities for the poor to earn their way out of poverty. In a segmented labor force like Indonesia’s, however, job creation must focus on the creation of ‘better’ jobs in the preferred formal and non-agricultural sectors. The challenge faced by the new government, therefore, is to identify and support policies that encourage job creation to benefit the majority of workers seeking to find better jobs, while still ensuring adequate protection for formal sector workers. The World Bank’s forthcoming *Indonesia Jobs Report*, expected for release in early 2010, will provide further ideas how labor policies and programs can encourage job creation and better prepare disadvantaged workers to succeed in the labor market.
4. Financing healthcare for Indonesia’s growing labor force and aging population

With the passage of Law 40/2004 on the National Social Security System (SJSN) in 2004, Indonesia became one of only a handful of developing economies committed to providing universal health insurance coverage for its entire population through a mandatory public health insurance scheme. The SJSN law calls for universal coverage by 2020. The details and the time-line for implementation of any move towards universal coverage have yet to be fully fleshed out. But it is clear, especially given the demographic trends highlighted above, that a move towards universal coverage is likely to result in substantial increases in the cost for health spending over the coming decade. And policy choices regarding how the reform will be financed, which groups should be subsidized by the government, what specific health benefits should be covered, what changes are needed in the service delivery system and how to pay those who provide the care, and a host of other regulatory and administrative issues will determine the financial sustainability of any initiative as well as the quality and extent of coverage and ultimately, the improvements in health outcomes enjoyed by Indonesia’s population. A recently released World Bank report—Health Financing in Indonesia: A Reform Road Map—provides evidence and analyses meant to inform and assist the government as it develops and implements the move towards universal health insurance. This section provides a selective summary of the main messages of this report.

Health outcomes have improved significantly since 1980 when life expectancy was only 52 years compared to almost 70 today, and some 100 infants out of every 1000 died before their first birthday, compared to less than 30 today. The total fertility rate has declined from 4.7 children per woman to slightly above 2. Despite these impressive improvements, Indonesia’s achievements have been less impressive than some of its neighbors, and for certain health outcomes, such as maternal mortality, the country does not perform as well as other comparable income and health spending level countries.

Indonesia’s health delivery system expanded significantly over the past 40 years. Virtually all Indonesian’s have access to basic care through a network of 8000 Puskesmas and 22,200 Puskesmas Pembantu, and some 5,800 mobile health clinics. On the other hand, while Indonesia has far fewer hospital beds per capita compared to other comparable income countries, these beds are poorly utilized with occupancy rates on the order of 60 percent. In terms of human resources for health, while nurse mid-wives are readily available throughout the country, Indonesia’s health workforce overall is small relative to other similar income countries and concerns over quality and efficiency persist. Its physician workforce is very small relative to comparators, and there are severe shortages of specialists, which are particularly problematic given the proposed expansions in health insurance coverage and the oncoming non-communicable disease burden.
From a cross-country perspective, Indonesia’s health spending is relatively low, but the country gets reasonable ‘value for money’ in terms of some health outcomes as well as relatively good financial protection. Indonesia spends only slightly more than 2 percent of its GDP on health, about half the level of other comparable income countries. Half of all health spending is public. About one-third of health spending comes directly from out of pocket payments by households. Health is a relatively small share of the government’s budget, some 5 percent, although the share has been increasing since the implementation of the Askeskin program in 2004. Despite low spending health outcomes and financial protection are relatively good, although these latter results may be due to Indonesia’s relatively high education levels and extended family social structure.

Public health expenditures are playing an increasing important role…

Private health expenditure has, historically, played a more important role than public health spending in terms of overall health financing in Indonesia. However, this trend started to change beginning in 2004 as the government introduced major health insurance programs targeted at the poor. It is expected that public health expenditure will have an increasingly important role to play in subsequent years as the government extends universal coverage to the entire Indonesian population. The establishment of Jamkesmas/Askeskin in 2004 has had an impact on both total health spending and the public share of spending. Out-of-pocket payments still comprise a sizeable share of health spending however, and the challenge for the government is to channel these expenditures into risk-pooling mechanisms in order to effectively provide protection against catastrophic health spending.

…and all of the major health insurance programs are publicly owned

Private Voluntary Health Insurance (PVHI) is not well developed in Indonesia. Each of the three major existing health financing programs is publicly owned and coverage levels, until recently have been low:

- Civil servants and their dependents are covered under the ASKES program, which is administered by a for-profit state enterprise, P.T. Askes.
- Jamkesmas was originally designed to cover the poor but was expanded to also cover the near poor. It was originally administered by ASKES but in 2008 the Ministry of Health (MoH) took over most of the major administrative functions, including provider payment.
- Jamsostek is similar to a classic social insurance program for private sector employees in firms with 10 or more employees and is also administered by a for-profit state enterprise. Employers have the option to opt out, either by self-insuring or by purchasing private insurance for their employees. Both P.T. Askes and Jamsostek also sell private commercial policies.

Figure 52: Only about a third of Indonesia’s population enjoys health insurance coverage

Sources: World Bank staff estimates from SUSENAS surveys.
Given Indonesia’s existing health financing programs, the current policy debate, and the 2004 Social Security Law, two main approaches to universal coverage seem viable. Both options would result in universal coverage, and both would have sufficiently large numbers of enrollees for effective risk pooling. Irrespective of the approach chosen, however, crucial decisions regarding the benefit package, cost-sharing, payment/contracting arrangements and modalities to address supply-side constraints need to be made. The three approaches are:

- **A national health service** fully financed by the government, similar to the national systems in Sri Lanka and Malaysia. This “Jamkesmas for all” would involve expanding the general revenue financed Jamkesmas program for the poor and near poor to cover the entire population.

- **A single national mandatory health insurance system** where the government subsidizes the poor and other disadvantaged groups, similar to the systems in Thailand and Turkey. This would approximate the ‘new’ national Social Health Insurance (SHI) model (now called Mandatory Health Insurance (MHI)), where the MHI system is funded through both wage-based contributions for public and private sector workers (and retirees) and government general revenue contributions for the poor and other disadvantaged groups.

Whichever approach is adopted, movement to universal coverage will have a sizeable impact on Indonesia’s health spending. Micro-analyses of current program costs and utilization patterns after the introduction of Askeskin/Jamkesmas allow crude projections of future costs. For example, crude estimates of future Jamkesmas costs range from 20 percent of current Jamkesmas spending to sixfold increases, depending on the coverage expansion scenario and health inflation assumptions chosen. Demographics alone are likely to substantially raise health expenditures over the next decade as the fraction of elderly in the population increases and the number of outpatient visits as well as inpatient bed-days.

Successful implementation of the move towards universal coverage will require carefully sequenced implementation of targeted, effective, and fiscally sound policies. The Social Security Council and the Ministry of Health have taken important first steps, but more is needed. The drafting of the 2010-2014 Medium-term Development Plan (RPJM), the Ministry of Health’s own internal planning efforts in developing the next Renstra, and the potentially large and possibly unaffordable expenditure implications of expanding health insurance to some 76 million poor and near poor, make this an ideal time to refocus efforts on the comprehensive set of policies needed to effectively implement universal health coverage in the next decade.