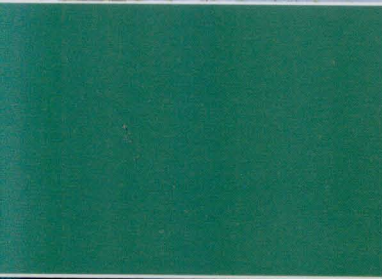
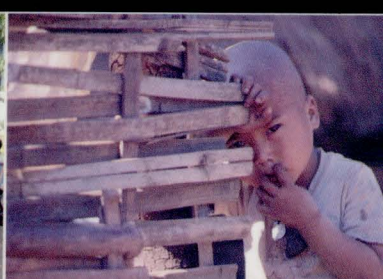
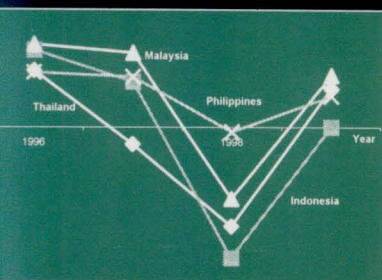


Social Impacts of the Asian Economic Crisis

in Thailand, Indonesia, Malaysia and the Philippines



Thailand Development Research Institute
With financial support from the Ford Foundation

Social Impacts of the Asian Economic Crisis in Thailand, Indonesia, Malaysia and the Philippines

With financial support from the Ford Foundation

Thailand Development Research Institute

September 2000

Social Impacts of the Asian Economic Crisis in Thailand, Indonesia, Malaysia and the Philippines

ISBN 974-87902-3-1

Published by
The Thailand Development Research Institute
565 Ramkhamhaeng 39, Wangthonglang
Bangkok 10310 Thailand

Tel: 662-718-5460
Fax: 662-718-5461, 662-718-5462
URL: <http://www.info.tdri.or.th>

Printed in December 2000
Printed in Thailand

Copyright @ 2000

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means (such as electronics, mechanics, photocopying, recording, or otherwise) without the prior written permission of the publisher.

Table of Contents

	Page
List of Tables	vii
List of Figures	xiii
Preface	xv
 Social Impacts of the Asian Economic Crisis in Thailand, Indonesia, Malaysia and the Philippines: Synthesis Report	
by <i>Srawooth Paitoonpong</i>	1
1. The Causes of the Crisis	3
Economic impact	6
Social impact	8
Employment	8
Poverty and income distribution	11
2. Education	12
Health	13
Other social problems	14
3. Social Safety Nets and Government Responses to the Social Impact	15
Summary and Conclusion	17
References	19

Social Responses to Economic Crisis in Thailand: Some Evidence during 1997-99

by <i>Sauwalak Kittiprapas, and Chedtha Intaravitak</i>	21
Executive Summary	23
1. Introduction	25
1.1 Causes of crisis	25
1.2 Impacts	27
2. Labor Market Adjustment	33
2.1 Overview	33
2.2 Uneven impact by sectors	35
2.3 Impacts on real average wage earnings	47
2.4 Labor markets by area and migration	53
2.5 Vulnerable and disadvantaged groups	61

3. Impact on Income, Poverty and Income Distribution.....	64
3.1 Income	64
3.2 Impacts on poverty and poverty profiles.....	65
3.3 Impacts on income distribution.....	72
4. Impacts on Social Sectors.....	73
4.1 Education: school dropouts and child labor	73
4.2 Health and environment deterioration.....	74
4.3 Impacts on community and family.....	76
5. Policy Responses to Address the Impacts on Social Sectors	78
5.1 Overall economic policies.....	78
5.2 Social policy responses	80
5.3. Social safety nets.....	81
6. Coping Strategies.....	86
7. Economic Prospects Affecting Social Impact	88
8. Conclusion.....	89
Appendix 1 Computing Real Wages on a Monthly Basis.....	93
Appendix 2 Measurement of Poverty and Inequality	95
References.....	97

The Social Impact of the Indonesian Economic Crisis

by *Tubagus Feridhamusetyawan*..... 99

Summary	101
1. Introduction	103
2. From Economic Collapse to Social Problems	104
2.1 Macroeconomic background.....	104
2.2 The transmission.....	108
2.3 The changing patterns of expenditure and income.....	111
3. The sources of data.....	114
4. The Labor Market.....	116
4.1 Labor force and unemployment	116
4.2 Tracing the patterns of labor displacement	119
4.3 Underemployment.....	123
4.4 The changing structure of the labor market	124
4.5 International labor migration	126
4.6 Earning and productivity.....	128

	Page
5. Education and Health	132
5.1 Education	132
5.2 Health	134
6. The Informal Sector	136
6.1 More competition.....	136
6.2 Lower demand	137
6.3 Lower income	137
6.4 Heterogeneous impact	137
6.5 Home-based workers	138
6.6 Farm workers.....	138
7. Distributional Impact.....	139
7.1 Regional distribution	139
7.2 Rich and poor	143
7.3 The vulnerable groups: women, children, and the elderly	144
8. Poverty	146
8.1 Early estimates.....	147
8.2 The BPS poverty figures.....	148
8.3 Poverty during the crisis: a summary.....	152
9. Food Insecurity.....	153
10. The Safety Net.....	155
10.1 Coping with the crisis: the government social safety nets	155
10.2 Coping strategies at the household level.....	158
11. Final Remarks and Policy Implications.....	162
11.1 Policy Implications	163
References.....	164

Some Social Consequences of the 1997-8 Economic Crisis in Malaysia

by *Jomo K. S., and Lee Hwok Aun* 167

Introduction.....	169
From Miracle To Debacle	170
A Crisis of A New Type?.....	173
Policy Responses: Deepening the Crisis	175
Banking System Distress	182
Boom and Bust.....	187

	Page
Recovery	194
Social Impacts	204
Income.....	204
Economic welfare	211
Government expenditure and social programs	218
Conclusion.....	221
References	225

Social Impact of the Asian Crisis in the Philippines

by *Gloria O. Pasadilla* 229

Executive Summary 231

I. The Philippine Economy: Before and During the Asian Crisis 233

 A. Pre-crisis economy..... 233

 B. Financial liberalization and economic vulnerability 235

 C. Immediate effects of the crisis and government response..... 242

 D. Two crises compared 246

II. Macroeconomic and Sectoral Impact of the Asian Crisis..... 250

 Effects on the industrial sector..... 251

 Effects on labor 254

 Effect on overseas Filipino workers (OFWs)..... 265

 Effects on prices..... 269

III. Effect of the Asian Crisis on Income Distribution..... 270

 The poor defined 271

 Factor income distribution by income class 271

 Results of the SAM impact analysis 272

IV. Social Impact of the Economic Crisis..... 274

 The spending of the poor..... 275

 Social impact..... 276

 Social safety nets and the Asian crisis..... 284

 Government responses 285

 Policy recommendations 286

Appendix A Computing the Net External Orientation of Industries..... 289

Appendix B Gross Value Added in Manufacturing by Industry Group, 1996-1999..... 291

Appendix C Social Accounting Matrix (SAM) Framework and Analysis 293

Bibliography..... 299

List of Tables

Page

Social Impacts of the Asian Economic Crisis in Thailand, Indonesia, Malaysia and the Philippines: Synthesis Report

by *Srawooth Paitoonpong* 1

Table 1	Growth rates of real GDP of Thailand, Indonesia, Malaysia and The Philippines, 1996-1999.....	7
Table 2	Export by destination of the four crisis-affected countries in 1996 (% of total exports).....	8
Table 3	Social impact issues in the four country studies.....	9

Social Responses to Economic Crisis in Thailand: Some Evidence during 1997-99

by *Sauwalak Kittiprapas, and Chedtha Intaravitak* 21

Table 4	Manufacturing production index	31
Table 5	Capacity utilization of certain industries	31
Table 6	Percentage change of gross domestic product by sector (seasonally adjusted)	32
Table 7	Key private investment indicators	33
Table 8	Key indexes of labor adjustment	34
Table 9	Percentage share of informal/formal sectors in dry and wet seasons.....	37
Table 10	Employment changes in formal and informal sectors.....	37
Table 11	Employment of private employees by sectors and formal/informal breakdown (Person).....	38
Table 12	Employment by formal/informal sectors by work status, February 1996-1999	41-42
Table 13	Employment by economic sector.....	43
Table 14	Changes in house worked by economic sector	46
Table 15	Real average wage earning (monthly) by work status	48
Table 16	Changes in average real wage earnings of private employees by economic sector	49
Table 17.1	Real average wage earning by education (total employees).....	51
Table 17.2	Real average wage earning by education (private employees).....	51
Table 18.1	Real average wages (monthly) by area (total employees)	52
Table 18.2	Real average wages (monthly) by area (private employees)	52
Table 19.1	Real average wage earnings (monthly) by region (total employees).....	54
Table 19.2	Real average wage earnings (monthly) by region (private employees).....	54
Table 20.1	Key indicators of labor markets in Bangkok	55
Table 20.2	Key indicators of labor market adjustments in other urban areas.....	56
Table 20.3	Key indicators of labor market adjustments in rural areas.....	57
Table 21	Long term unemployment (>1 year) as of August 1998: breakdown by area, education, age, sex	63

	Page
Table 22	Average real income by work status, 1996 and 1998 65
Table 23	Share of real income by sources, 1996 and 1998 65
Table 24	Unemployment rate by education: round 1, 1994-1998 75
Table 25	Government expenditure for 1997-2000 (million baht) 80
Table 26	Budgets for social services, by sub-sector 81
Table 27	Status of compensation payment to those losing employment from business closure or lay-off 82
Table 28	Responses to the crisis by the unemployed 87
Table 29	Needed assistance for government or NGOs 88

The Social Impact of the Indonesian Economic Crisis

<i>by Tubagus Feridhanusetyawan</i>	99
-------------------------------------------	----

Table 30	The growth of gross domestic product, 1996-1999 105
Table 31	Per-capita GDP during the crisis..... 105
Table 32	Selected monetary indicators 106
Table 33	The changing patterns in household expenditure (percent share) 112
Table 34	The changing structure of household income 112
Table 35	The changing structure of household expenditure 113
Table 36	Labor force in Indonesia, 1990-1999 117
Table 37	Unemployment rate in Indonesia, 1997-1999 118
Table 38	Reasons for job displacement, 1997/98 120
Table 39	Labor displacement by formal-informal, 1997/98 121
Table 40	Displacement of workers by sector, 1997/98..... 121
Table 41	Displacement by gender, 1997/98..... 122
Table 42	Labor displacement for male and female 123
Table 43	Employment status of Indonesian workers, 1990 - 1999 125
Table 44	The changing pattern of sectoral employment, 1990 - 1999 126
Table 45	Number of Indonesian overseas workers processed by the Ministry of Manpower, 1995-1999 127
Table 46	The number of foreign workers in Indonesia by main occupation..... 128
Table 47	Growth of real wages, 1997-1999..... 129
Table 48	Annual growth of wages v. productivity, 1989-1999 131
Table 49	Percentage change in school enrollment rates 133
Table 50	Differential impacts of the crisis 141
Table 51	Regional real wage and employment growth, 1997-99 142
Table 52	Changes in per capita expenditure by initial quartile per capita expenditure... 143
Table 53	The number of population living below the poverty line in Indonesia 149
Table 54	“Consistent” estimates of poverty rate, February 1996-February 1999 152
Table 55	Allocated government expenditure for the social safety net program..... 157
Table 56	Most common coping strategies (N = 403)..... 159
Table 57	Common and specific strategies by gender and marital status..... 160

Some Social Consequences of the 1997-8 Economic Crisis in Malaysia

by *Jomo K. S., and Lee Hwok Aun* 167

Table 58	Malaysia: selected macroeconomic indicators, 1991-1999	173
Table 59	Malaysia: economic growth, inflation, unemployment, and interest rates, 1984-1999 (percentages)	179
Table 60	Malaysia: base lending interest rates, 1985-2000	180
Table 61	Malaysia: non-performing loans, 1988-2000	183
Table 62	Malaysia: commercial banks' non-performing loans by sector, 1997-1999 (RM million at end of month)	185
Table 63	Malaysia: finance companies' non-performing loans by sector, 1997-1999 (RM million at end of month)	186
Table 64.1	Malaysia: annual changes in gross domestic product by economic activity, 1990-1999 (percentages; 1987 constant prices).....	188
Table 64.2	Malaysia: annual changes in gross domestic product by economic activity, 1990-1999 (%; 1978 constant prices).....	188
Table 65	Malaysia: quarterly change in gross domestic product by economic activity, 1997-1999 (year on year change, at 1987 prices)	189
Table 66	Malaysia: prices and export values of selected major commodities, 1991-2000.....	191
Table 67	Malaysia: domestic producer price indices, 1993-1999 (1989 = 100; % change).....	194
Table 68	Malaysia: producer price indices for imports, 1993-1999 (1989 = 100; % change).....	194
Table 69	ASEAN Four: comparative per capita gross domestic product growth, 1982-1999.....	197
Table 70.1	Malaysia: Federal government operating expenditure by sector, 1995-2000 (RM million)	201
Table 70.2	Malaysia: Federal government development expenditure by sector, 1995-1999 (RM million)	202
Table 71	Malaysia: Federal government revenue and expenditure, 1993-2000 (RM million; percentage annual changes in parentheses)	203
Table 72	Malaysia: Federal government revenue (selected components), 1995-2000 (RM million; percentage annual changes in parentheses)	205
Table 73	Malaysia: employment by sector, 1996-1999 (thousands; % in parantheses)	206
Table 74	Malaysia: number of collective agreements signed by sector, 1994-1998	208
Table 75	Malaysia: labor force participation and unemployment rates, 1991-1999.....	209
Table 76	Malaysia: registered unemployed by age and gender, 1994-1999	212
Table 77	malaysia: consumer price index (1994 = 100), 1993-1999 (percentage annual change)	213
Table 78	Malaysia: consumer price index for food items, 1997-1999 (% annual change).....	214
Table 79	Malaysia: incidence of poverty and number of poor households, 1995, 1997, 1998 and 2000 (percentage and thousands).....	218
Table 80	Malaysia: government budget allocations for education, 1997-1999.....	219
Table 81	Malaysia: government budget allocations for health, 1997-2000.....	220

Social Impact of the Asian Crisis in the Philippines

<i>by Gloria O. Pasadilla</i>	229
Table 82 Comparison of economic indicators in various administrations, 1980-1998	235
Table 83 Macroeconomic fundamentals, 1990-1996 in million dollars unless otherwise stated	235
Table 84 Capital flows, 1990-1999	236
Table 85 Direction of foreign direct investment, 1993-1999, in million dollars unless otherwise indicated	237
Table 86 Effects of capital inflows, 1991-1999, in million dollars unless otherwise stated	238
Table 87 Bank loan rejections, 1997-1998, as percent of firms	244
Table 88 Schedule of compliance allowance for probable loans, in percent of loan amount	245
Table 89 Minimum capital requirement for banks, in million pesos	246
Table 90 National government operational budget for 1999, in billion pesos	246
Table 91 Selected economic indicators 1983-1985 and 1997-1999	247
Table 92 Philippine banking system: selected ratios, 1990-1999 (in percent)	249
Table 93 Net external orientation of manufacturing industries, 1997	253
Table 94 Growth rates of manufacturing industries, according to net external orientation, 1994-1997	254
Table 95 Labor force participation, employment, and unemployment	255
Table 96 Establishments resorting to closure/retrenchment due to economic reasons and workers affected, 1997-1999	256
Table 97.1 Establishments resorting to closure/retrenchment due to economic reasons and workers affected by industry, 1998	257
Table 97.2 Establishments resorting to closure/retrenchment due to economic reasons and workers affected by industry, 1999	258
Table 98 Structure of workforce in Asia	258
Table 99 Establishments resorting to closure/retrenchment due to economic reasons and workers displaced by employment size, 1999	259
Table 100 Selected indicators of labor by area, 1997-1999	260
Table 101.1 Employed persons by age group and highest grade completed, in thousands	262
Table 101.2 Unemployed persons by age group and highest grade completed, in thousands	262
Table 102 Job generation, 1997-1999	263
Table 103 Employment by class of workers and by sector, in thousands	263
Table 104 Employment in the different sectors, 1998-1999	264
Table 105 Labor force and employment by occupation, 1997-1999	265
Table 106 Contribution of OFWs remittances to the current account, 1991 to 1999, in million dollars	266
Table 107 Deployment of OFWs by region of destination, 1975-1999	267
Table 108 OFW remittances, 1996 – 1999, in thousand dollars	268
Table 109 Consumer price index and its components	269
Table 110 Sectors with negative growth, 1997-1998	270
Table 111 Distribution of families by income class, 1997	271

Table 112	Sources of income by income class	272
Table 113	Simulation results: simulation shocks effects on selected SAM accounts	273
Table 114	Percent of families receiving income from selected sources, urban and rural	274
Table 115	Expenditure pattern of different income classes, 1997	275
Table 116	Financial crisis problems affecting the families.....	277
Table 117	Effect of 25% mandatory savings on health indicators.....	278
Table 118	Imports of antibiotics and first aid kits	279
Table 119	Change in prices of selected items, 1995 1998	279
Table 120	Effects of 25% mandatory savings on education	280
Table 121	Teacher and classroom shortages (elementary and secondary).....	281
Table 122	Drop out rates, 1993-1998	282
Table 123	Elementary and secondary participation rates, 1993-1999	283

List of Figures

Page

Social Responses to Economic Crisis in Thailand: Some Evidence during 1997-99

<i>by Sauwalak Kittiprapas, and Chedtha Intaravitak</i>	21
Figure 1 Overall crisis impacts and adjustment strategies of economic units.....	29
Figure 2a Underemployment rate in February and August (1994-1999).....	39
Figure 2b Number of unemployed workers from manufacturing who became unemployed due to the crisis and the time they became unemployed	40
Figure 3 Migration trends	60
Figure 4 Head count index to total poverty, by regions 1996 and 1998	66
Figure 5 Head count index by areas 1996 and 1998	66
Figure 6 Contribution of regions to total poverty by regions 1996 and 1998	67
Figure 7 Contribution of areas to total poverty by areas 1996 and 1998	67
Figure 8 Poverty by industry of employment of head of household, 1996 and 1998	68
Figure 9 Contribution to total poverty by industry of employment of head of household, 1996 and 1998	68
Figure 10 Poverty by employment of head of household 1996 and 1998.....	69
Figure 11 Contribution to poverty by work status of head of household, 1996 and 1998	70
Figure 12 Poverty by education of head of household 1996 and 1998	70
Figure 13 Contribution to total poverty by education of head of household 1996 and 1998	71
Figure 14 Poverty by gender of head of household 1996 and 1998.....	71
Figure 15 Poverty by household size, 1996 and 1998	72
Figure 16 Distribution of income by deciles (%).....	73

The Social Impact of the Indonesian Economic Crisis

<i>by Tubagus Feridhanusetyawan</i>	99
Figure 17 From economic collapse to social problems	110
Figure 18 Annual productivity and real wage index, 1989-1999	130
Figure 19 Annual growth of productivity and real wage, 1989-1999	130
Figure 20 “Consistent” estimates of poverty rate, February 1996 - August 1999.....	153

Some Social Consequences of the 1997-8 Economic Crisis in Malaysia

<i>by Jomo K. S., and Lee Hwok Aun</i>	167
Figure 21a Malaysia: commercial banks' monthly base lending rates and non-performing loans, 1997-1999	181
Figure 21b Malaysia: finance companies' monthly base lending rates and non-performing loans, 1997-1999	181
Figure 22 Malaysia: macroeconomic indicators, 1984-1998	190
Figure 23 ASEAN Four: GDP growth rates, 1982-1998	195

Social Impact of the Asian Crisis in the Philippines

<i>By Gloria O. Pasadilla</i>	229
Figure 24 Stock composite index, 1987-1999	238
Figure 25 Real estate prices, 1992-1999	239
Figure 26 Real effective exchange rates of ASEAN countries, 1989-1998	240
Figure 27 Net domestic credit, 1986-1999	240
Figure 28 PSE index vs. property index, 1994-1999	241
Figure 29 Growth rates of monetary aggregates: M3 and M 4, 1990-1999	241
Figure 30 Total inflation and core inflation, 1990-1997	241
Figure 31.1 Daily exchange rates, 1997-1999	243
Figure 31.2 Overnight lending rates, 1997-1999	243
Figure 32 Comparative real GVA growth rates of manufacturing and its subindustries, 1997-1999	252
Figure 33.1 Closures/retrenchments affected by region, 1998	260
Figure 33.2 Closures/retrenchments affected by region, 1999	260
Figure 34 OFWs by region, 1997-1998	269
Figure 35 Government housing loans committed and released	280
Figure 36 Construction of Public and Private Higher Education Institutes	282

Preface

This study on the social impacts of the Asian economic crisis in Thailand, Indonesia, Malaysia and the Philippines is the result of a collaborative research project coordinated by the Thailand Development Research Institute Foundation (TDRI) with financial support from the Ford Foundation through Grant Number 980-1490. The volume contains four country studies undertaken by country experts from respective countries in Thailand, Indonesia, Malaysia and the Philippines, and a synthesis of the country studies conducted by a staff member of TDRI.

TDRI would like to thank the Ford Foundation for financial support for the project, and also the institutes and scholars who have contributed to the success of the project, particularly the Center for Strategic and International Studies (CSIS) in Indonesia, the School of Economics, University of Asia and Pacific in the Philippines, and Professors K.S. Jomo and Lee Hwok Aun of the Faculty of Economics and Administration, University of Malaya. The kind assistance in project development from an early stage of Mrs Gary Suwannarat, formerly with the Ford Foundation Bangkok Office, is also gratefully acknowledged. Finally, contributions by the participants at the workshop and seminar to discuss the study plan and review the findings of the project are gratefully appreciated.

Social Impacts of the Asian Economic Crisis in Thailand, Indonesia, Malaysia and the Philippines

Synthesis Report

by

Srawooth Paitoonpong^{*}

Thailand Development Research Institute

^{*} Senior Research Specialist, TDRI. The able research assistance of Ms. Weerawan Sirikul and Ms. Uraiwan Ramangkoon is cordially acknowledged.

The Asian economic crisis that began in July 1997 has been accompanied by widespread social distress in the affected countries of Southeast Asia (Indonesia, Malaysia, Thailand, and the Philippines). A fall in output and incomes in these countries has been invariably accompanied by massive job losses as bankruptcies and cutbacks in production have multiplied. This has led to a sharp rise in open unemployment and underemployment. Job losses, falling wages, rising prices of essential goods and services, foreclosure on loans and/or rising cost of debt from private and public sources, decreased access to and/or increased cost of borrowing, etc. are severely affecting the life of the people, particularly the poor, in the crisis-ridden countries. By and large, negative social consequences are likely to persist long after the end of the financial crisis.

There are variations among the affected countries in many aspects: the level of development, the endowment and accumulation of capital both economic and social, the policies pursued, past experience on economic and financial problems, and so on. To foster an insight for policy formulation in the affected countries as well as other countries in the region, the Thailand Development Research Institute with generous financial support from the Ford Foundation has coordinated a collaborative research project on the Social Impacts of the Asian Economic Crisis in Indonesia, Malaysia, the Philippines, and Thailand.

The major goals of the project are: to document, as well as possible with existing information, the major social impacts of the crisis in Indonesia, Malaysia, Thailand, and the Philippines; to review the positive and negative effects of key policies on the poor, and to suggest appropriate changes in policy responses, both to improve the lot of the poor in the current crisis, and to improve the social and economic framework for dealing with future stress.

The primary objective of this paper is to provide an assessment of the social impact of the Asian financial crisis drawing on the findings of the four country studies. The information, speculation and views expressed regarding causes and impact of the crisis in the participating countries will be as much as possible based on the country studies, except where specifically noted.

1. The Causes of the Crisis

The “macroeconomic history” of the crisis differs considerably across the four countries. In general, however, it is agreed that rapid financial liberalization, with inadequate attention to problems of corporate governance and of prudential regulation, amid poor macroeconomic management, and other policy and institutional failures, are common factors underlying the problems of these four Asian economies. The previous growth of the four countries had been built on shaky and unsustainable foundations, to varying degrees. Differences in the extent of these structural weaknesses have resulted in differences in the depth and breadth of the impacts of the crisis in the four countries. In brief, the fundamental causes of the crisis, as documented by country studies, include: dramatic decline in export growth; structural weaknesses in local institutions; decreasing competitiveness; export market structure; increasingly liberal capital account policies; financial liberalization with fixed exchange rate; premature liberalization of financial institutions; weak or mismanaged financial mechanisms; weak public and corporate governance; “herd” investment, panic and moral hazards in the financial sector; crony capitalism; currency speculators’ attacks; IMF and domestic policy responses; and unstable and unsound political climate.

With such a long inventory of causes, it is hardly surprising that there does not exist a unanimity of views regarding the relative importance of each element. Clearly, there is not

one single explanation or cause but a complex set of problems that precipitated the crisis. An attempt has been made to group these problems into three fundamental causes of the crisis, viz., a dramatic decline in export growth, increasingly liberal capital account policies, and the “herd” behavior¹ of foreign market participants (Islam 2000: 2). Yet, it was not necessary for the four country studies to fully agree with this grouping of the fundamental causes of the crisis.

The Thai study takes the slow-down of export growth as a signal for the crisis. “Signs of an imminent economic crisis were apparent in 1996 when export growth slowed down and manufacturing competitiveness fell, especially in the second half of 1996, when the export growth rate sank suddenly to zero per cent with unclear reason’ (Sauwalak 2000: 2). Export slow-down played a big role in bringing about the crisis. The time prior to the crisis was a period of worldwide export downturn with a drop in demand for exports from Asian countries. The Japanese recession and depreciation of yen also led to decreasing demand for imports from other Asian countries. Thailand faced a sharp drop in export in 1996 from double-digit to zero growth rate.

The Thai study attributes the financial meltdown in mid-1997 largely to three policy errors: financial liberalization with a fixed exchange rate, premature liberalization of financial institutions, and failure to prudently supervise the financial institutions. Altogether, these largely mismanaged financial mechanisms gave rise to high speculation and a free flow of capital. What’s more, Thailand had been under heavy attacks on the Baht from currency speculators since late-1996 and exhausted its foreign reserve defending the currency. Capital flight began accelerating from late-1996 to mid-1997. With the failing government efforts to save the Baht, devaluation seemed imminent and there came a crisis of confidence in the currency.

Panic and moral hazards in the financial sector is another factor accelerating the tempo of the crisis. Prior to the crisis, the Thai financial system was already in a mess with high risk investment and moral hazards. Herding investment was mentioned in the Thai study to describe foreign investors’ behavior in diversifying investment without sufficient business information. Investors’ panic began when creditors started withdrawing their credit as they saw others doing the same. This led to rapid capital flight out of Thailand and the region.

Other factors causing the Thai crisis include the lack of transparency, weaknesses in local institutions, weak macro-economic management by government agencies, and problems of governance in both the public and the private sectors (“crony capitalism”). Structural weaknesses also mattered in the Thai case. Even before the crisis, Thailand was facing the problem of long run competitiveness, with more intensive use of inputs (cheap labor and raw materials) and mobilization of resources rather than increases in efficiency.

The bubble in Thailand burst in 1997 when several currency attacks since 1996 severely depleted the Bank of Thailand’s foreign reserve and the Baht was finally floated. With exports, and growth more generally, most adversely affected, the property market, construction sector, stock market and financial institutions were also put under strain, setting up the pegged Thai baht as the choice target in the region for currency speculation (Jomo and Lee 2000: 4). By mid-1997 Thailand had exhausted its foreign reserve. The baht was finally floated on July 2, 1997 and the Asian financial crisis arrived.

¹ In integrated financial markets, portfolio investors (e.g., mutual funds, hedge funds) tend to look upon a region or a sub-region as a single market. The problems confronted in one country may prompt them to pull out of the whole region/sub-region in a herd reaction (Islam, *ibid.*).

The currency crisis in Thailand was followed by currency devaluation in Malaysia and the Philippines in Mid-July and Indonesia in Mid-August of the same year.²

At the beginning, Indonesia, which faced the crisis two months after Thailand, seemed to be handling its situation better. It did not go through a long period of denial or a vain and costly attempt to defend the currency; it appeared to act more quickly and decisively in attacking financial sector weaknesses. However, a few key policy misjudgments, together with growing political and social uncertainties associated with the health and political plans of the then President Soeharto, combined to bring about the currency collapse and cause an economic recession much more severe than Thailand's.

The Malaysian study argues that the crisis began as a currency crisis that catapulted into a financial crisis. Jomo K. S. and Lee Kwok Aun do not quite agree with the many explanations for the crisis such as crony capitalism, poor macroeconomic management, corruption, lack of transparency and moral hazards. For example, crony capitalism—which has existed for some time—failed to explain how Malaysia sustained rapid growth for four decades after independence in 1957 without experiencing an earlier financial crisis of comparable magnitude. The crony capitalism explanation ignores the similarities with financial crises in developed and other developing economies, occurring with increasing frequency since late 1997 (Jomo and Lee 2000: 7). Crony capitalism only exacerbated the crisis in Malaysia.

Unlike Thailand or Indonesia, financial liberalization was not a major factor in the Malaysian crisis. Learning from the experience of the severe banking crisis of the late 1980s, Malaysia prudently improved its regulations, and as a result, its economy was not as badly undermined by liberalization as the other three economies. The level of Malaysia's foreign liabilities did not exceed its foreign exchange reserves.

The currency and financial crises in Malaysia became a crisis of the 'real economy' mainly due to the government's policy responses, and partly due to financial market demands and the IMF. The study pointed out that the crises have been due to the undermining of previous systems of international and national economic governance as a result of deregulation and other developments associated with financial liberalization and globalization. Thus, the erosion of effective financial governance at both international and national levels created conditions that led to the crises (Ibid.).

Other factors also played some part in bringing about the Malaysian crisis. The quasi-pegging of the ringgit to the US dollar and its appreciation before the crisis adversely affected Malaysian exports and growth. The domination of investment in domestic and primary production implied the failure to progress more rapidly to higher value-added production and eroded the export competitiveness. Furthermore, with the baht down in July 1997, the ringgit was under strong pressure. The monetary authorities tried to defend the ringgit but eventually gave up by the third week of July 1997. The cost of aborted ringgit defense was around nine billion ringgit or almost US\$4 billion. The ringgit fell precipitously after mid-July 1997, reaching 4.88 to the US dollar in early January 1998. The stock market fell even more severely.

For the Philippines the major cause of the crisis was mainly the speculative attacks on the currency. As Thailand's situation worsened in May 1997, Philippine authorities quickly reacted by intervening in exchange markets and by raising interest rates. After Thailand's move to a floating rate system on July 2, 1997, the Philippine peso was under intense speculative attack. Philippine monetary authorities tried to defend the average peso/dollar

² A simplified chronology of the Asian crisis can be found in Arndt and Hill (1999: 5).

value by further increases in interest rates as well as foreign exchange intervention. On July 11, the peso finally went on a float³ (to P29.45 to dollar from 26.37 the day before). It went down from P26.37 to a US dollar to P40/US\$ by the year end.

Another factor that aggravated the speculation was the political uncertainty arising from the growing tension associated with the "anti-charter-change" against the administration under former President Fidel Ramos. Further, the BSP, the Philippines' central bank, was said to have confused the market by being "in and out," leading to new signs of volatility.

From the level of P39.95/US\$ at the end of 1997, the peso reached P45.05/US\$ in early January 1998 in association with the continued instability in the region, particularly amid the threat of yuan devaluation, the weakening of the yen and the continued speculative attack on the Hong Kong dollar. By this time, the Philippine monetary authorities seemed to yield to the speculative attack by allowing the currency to depreciate along with the rest of the Asian currencies.

Economic impact

In general, the economic impact of the crisis in the four affected countries include, a dramatic decrease of GDP growth with uneven impact across economic sectors, domestic business collapse and insolvency, drastic local currency depreciation, inflation and increased cost of living, retrenchment and unemployment, substantial decrease in income, reduced personal consumption, and reduced government spending. The effect has been felt to a varying degree among the four countries. Thailand and Indonesia were severely affected while Malaysia and the Philippines were less.

In Thailand, the manufacturing sector has been heavily hit, though the impacts have been uneven within the sector. The capital intensive industries were affected earlier and more than the labor intensive industries. By looking at the change in quarterly GDP by sector, the Thai study suggested that the non-agricultural sectors combined have experienced larger negative impacts than the agricultural sector which also registered negative growth in mid-1997 and the first half of 1998. The construction sector experienced the largest negative value changes in late 1997-1998. The manufacturing sector GDP declined to negative values from the second quarter of 1997 but its growth became positive since the fourth quarter of 1998. The real estate and business sub-sector was adversely affected in 1997 and 1998, but began to turn around in 1999. It was observed that although agricultural exports increased during 1997-1998, the benefit of the baht devaluation decreased in 1999.

The Indonesian economic crisis is characterized by massive price adjustment and drastic economic contraction. The biggest factor contributing to the economic contraction was a sharp decrease in investment, while consumer spending was relatively constant. The sharp contraction in the real sector of the economy was accompanied by the movement of resources from the non-traded to the traded sectors, from the import-dependent to the export-oriented industries, and from the modern to the traditional sector. The inflation rate increase was dramatic, reaching 77.6 percent in 1998, from below 10 percent prior to the crisis. The growth rates of liquidity and the money supply increased very drastically in the first half of 1998 while the money in circulation increased by 60 percent in the first six months of 1998. The interest rate was very high in 1998 but started to fall in mid-1999 (decreasing from 30 percent in April and May 1999 to 13 percent in August of the same year). The exchange rates depreciated from Rp.2,400/US\$ before the crisis in July 1997, to Rp.15,000/US\$ in July 1998,

³ More precisely, the floatation range was broadened.

and around Rp.9,000/US\$ in September 1998. Tubagus Feridhanusetyawan maintains that the depreciation of the exchange rates was mainly due to the excessive monetary expansion to save the banking system from collapsing (Feridhanusetyawan 2000).

At the Seminar in Bangkok on May 26, 2000, to discuss the findings of the project, Peter Warr showed that the extent of the crises in Indonesia and Thailand could be compared more realistically with a use of the real GDP growth rates of the two countries and some kind of standardization as shown in Table 1. The annual growth rates of real GDP show that Thailand had been hit by the crisis since 1997, got worse in 1998 and recovered in 1999, whereas in 1997 Indonesia was not yet severely impacted by the crisis but was hit harder than Thailand in 1998 and did not recover in 1999. When the growth rate is standardized by using 1996 rates as reference (100), it was found that the economic slowdown in the two countries during 1998-1999 was at about the same level—the growth indices of Indonesia and Thailand in 1998 were, respectively, 9.6 and 12 percent less than the 1996 values. This implies that when the 1998 situation is compared with that in 1996, Thailand appears to have been hit harder than Indonesia. However, when 1997 rates are used as reference (when Thailand was already hit by the crisis), the index in 1998 reflects a less severe impact for Thailand than for Indonesia.

Using a similar approach, the real GDP growth rates of Malaysia and the Philippines indicate that both economies obviously contracted in 1998, Malaysia from 7.7 percent in 1997 to -7.5 percent in 1998, and the Philippines from 5.2 percent down to -0.5 percent between 1997 and 1998. While the real GDP growth indicates that the Malaysian economy grew faster than the Philippine in 1999, the standardized index shows that the Philippines was doing better than Malaysia in 1999, no matter what year (1996 or 1997) was used as reference.

Table 1 Growth rates of real GDP of Thailand, Indonesia, Malaysia and The Philippines, 1996-1999

	1996	1997	1998	1999
Growth rate of Real GDP				
Thailand	5.9	-1.8	-10.4	4.0
Indonesia	8.0	4.7	-13.7	0
Malaysia	8.6	7.7	-7.5	5.4
Philippines	5.7	5.2	-0.5	3.2
Level of Real GDP growth (1996= 100)				
Thailand	100	98.2	88.0	92.6
Indonesia	100	104.7	90.4	90.4
Malaysia	100	107.7	99.6	105.0
Philippines	100	105.2	104.7	108.1
Level of Real GDP growth (1997=100)				
Thailand	101.8	100	89.6	93.2
Indonesia	95.3	100	86.3	86.3
Malaysia	92.3	100	92.5	97.5
Philippines	94.8	100	99.5	102.7

Source: Jomo and Lee (2000: 6); Passadilla (2000: 15-20); and Peter Warr, Seminar on "Social Impacts of the Asian Economic Crisis," Bangkok, 26 May 2000 (commentary note).

Among the four affected countries, the Philippines was affected the least for several major reasons; its experience of the financial crisis during 1983-1985, the improved political and public governance in relation to financial and economic management, and its export market structure which is tied with the US and European markets. The Philippine exports to EU and NAFTA in 1996 accounted for as much as 53.6 percent of its total exports, the highest percentage for any country in Asia (Table 2). Thus, at the outbreak of the Asian crisis, the Philippine government declared that the country was not in crisis. A major reason for this confidence would have been the export factor. Export growth of the Philippines during this period was the highest in Asia (Passadilla 2000: 14).

An additional reason why the Philippines was less affected compared to Thailand, Indonesia and Malaysia is the timing of the crisis or "luck" as the author puts it. That is, the crisis struck while the Philippine bubble was still incipient (Ibid.: 20).

Table 2 Export by destination of the four crisis-affected countries in 1996
(% of total exports)

	Asian	Chinese econ.	EU	Japan	NAFTA
Thailand	19.0	10.6	15.1	15.8	18.6
Indonesia	13.4	9.9	15.1	26.3	16.4
Malaysia	27.0	12.0	13.3	12.9	20.7
Philippine	12.7	8.8	17.0	18.0	36.4
Singapore	32.7	14.0	11.8	7.2	17.4

Source: Asia Pacific Economics Profiles, Asia Pacific Economics Group, Financial Times, 1997.

Social impact

The examination and comparison of the social impact in the participating countries is constrained by a number of factors. As put by the Malaysian study, the actual impact of the economic recession is difficult to measure empirically and assess with accuracy and objectivity. The links between the cause and effect are not always direct or obvious, and are also subject to theoretical debate. There is also a need to distinguish other economic trends from the direct social impacts of the crisis even though they might occur simultaneously. In the case of Malaysia, as well as other countries, it is difficult to separate out the adverse impacts of international price movements or other non-economic changes (e.g., weather) on the economy during the crisis. Furthermore, the comparison among the participating countries is made more difficult by the use of different measurements of the effects.

Table 3 summarizes social impact issues covered by the four country studies. It may be observed that a larger number of issues are touched upon in the studies of the more affected economies (Thailand and Indonesia) than those of the less affected economies (Malaysia and the Philippines).

Employment

Employment problems during the crisis consisted of lay-off, wage cuts, reduced work hours, unemployment, underemployment, movement between formal and informal sectors, movement among economic sectors, occupational change, moving out or in the labor force, etc. While effects have differed in magnitude and composition in the four countries, there have been some similarities. For instance, labor market impacts were much more severe in urban than in rural areas. Decreases in employment, hours, and wages appear to have been

concentrated much more in the formal than in the informal sectors. And within the formal sector, construction and financial services have been especially hard hit.

Table 3 Social impact issues in the four country studies

Issue discussed		Thailand	Indonesia	Malaysia	Philippines
Employment		✓	✓	✓	
	Formal/informal/displaced	✓	✓		
	Unemployment	✓	✓	✓	✓
	Underemployment	✓	✓		✓
	Participation rate	✓	✓	✓	✓
	Sectoral mobility	✓	✓	✓	✓
	Retrenchment	✓		✓	✓
	Wage, real wage	✓	✓	✓	
	Strikes			✓	
	Geographical mobility	✓			
	Urban-rural migration	✓	✓		✓
	Overseas/guest workers	✓	✓		✓
Vulnerable, disadvantaged groups	Women	✓	✓	✓	
	Children	✓	✓	✓	✓
	Elderly	✓	✓	✓	
Poverty		✓	✓	✓	
Income distribution		✓	✓		✓
Education		✓	✓	✓	✓
Health		✓	✓	✓	✓
Housing/shelter		✓			✓
Environment		✓			
Community/family		✓			
Food security			✓		
Safety net		✓	✓	✓	✓

In Thailand, unemployment rates increased substantially from their usually low values: the dry season (February) rate having risen from 2.2 percent in 1997 to 4.6 percent in 1998 and 5.2 percent in 1999, while the wet season (August) rate from 0.9 percent in 1997 to 3.4 and 3.0 percent in 1998 and 1999, respectively.⁴ The reason why the unemployment rate did not rise too high was partly due to flexible wage rates. While the unemployment rate increased 2.4 percent during the dry season of 1997-1998, real average monthly wage earnings fell 4.62 percent. In addition, unemployment was also cushioned by the reduction in hours worked or underemployment. During the dry season, underemployment (work less than 30 hours per week) increased from 5.5 percent to 10.1 percent and 7.6 percent between 1997 and 1999. A similar increase was also evident in the wet season underemployment. Changes in underemployment rates are more sensitive to the crisis impacts than changes in unemployment rates. Another reason for low unemployment rates in spite of the crisis is the decrease in labor force participation rates, especially in 1998. An additional indicator of the employment

⁴ The unemployment rate used here is a percentage of the total labor force which includes the seasonally inactive labor force. The rate as a percentage of the "current labor force" exclusive of the seasonally inactive labor force will be slightly higher.

problem not usually mentioned in the Thai labor literature is the number of days spent looking for work. Sauwalak Kittiprapas reports that during the crisis the average number of days spent looking for work during the slack season (February), increased from 60 days in 1997 to 69.4 days in 1998 and jumped to 92.8 days in 1999. During the high season (August), it increased from 74 days in 1997 to 87.5 and 91 days in 1998 and 1999 respectively (Sauwalak 2000).

The movement of workers between the formal and informal sectors as reported by Sauwalak deserves a closer look. The definition adopted by her is broad and arbitrary. Her conclusion that the formal sector employment expanded instead of contracted seems to be against the fact that during the crisis, particularly in 1998, there was a large number of lay-off from formal establishments in the range of 355,000–656,000 workers (Srawooth 2000a: 13). Secondly, there was widespread downsizing of formal employment institutions both in the public and private sectors. Thirdly, there was a big drop in the number of workers in the construction sector during the crisis. However, while formal employment, as defined by Sauwalak, decreased by 498,930 persons between 1998 and 1999, during the dry season, informal employment increased by 32,965 persons; during the high (wet) season, employment in both sectors increased. Furthermore, the cut off point of those working in establishments employing 10 persons and more as formal employment, because of the reason that such employment is regulated by the labor law, may not be valid anymore. Starting from April 1, 2001, “all” establishments will have to enroll in the national social security system.

By economic sector, employment in construction dropped significantly while manufacturing and finance also lost some workers. The loss may have been absorbed by the services and commerce sectors. The magnitude of sectoral movement in 1999 was smaller compared to 1998.

In Indonesia, unemployment increased slightly from 4.7 percent in 1997 to 5.5 and 6.4 percent, respectively, in 1998 and 1999. This increasing trend suggests that the adjustment in the first year of the crisis was the adjustment in real wages due to inflation, with a slight increase in unemployment. When inflation decreased in 1999, thereby sharply increasing the real wages, employment finally had to adjust, and as a result, the unemployment rate was higher in 1999. The Indonesian study quoted Agrawal (1996) in concluding that unemployment in Indonesia is not a serious problem: first, the unemployed are mainly young people who have entered the job market for the first time, and second, the duration of unemployment is usually short—an indication of the relatively flexible nature of the labor market in Indonesia.

Unemployment in Malaysia during the crisis increased from 2.4 percent in 1997 to 3.2 and 3.0 percent, respectively, in 1998 and 1999. This level of unemployment was in fact lower than the rates in 1991 (4.6%) and 1992 (3.7%). Even so, Jomo and Lee (2000: 29) mention that the impact of the crisis in reducing employment came as a shock as Malaysia had been accustomed to sustained economic growth for many years. Employment in construction fell most sharply in 1998, while manufacturing, agriculture, as well as financial and business services also hard hit; manufacturing continued to experience severe job losses in 1999.

Surprisingly, the unemployment rate in the Philippines increased drastically in 1998 to 10.1 percent, from an average of 8.4 percent during 1990-1996. The figure could have been higher if the labor force participation rate did not decline from 66.7 percent in 1996 to 66.3 and 66.1 percent, respectively, in 1997 and 1998. The labor force dropout rate was most pronounced among the younger age bracket, i.e., the 15-24 age group, suggesting that most of the job cuts involved temporary and/or short-tenure rather than full-time and log-tenure jobs. Most of the unemployment occurred in Metro Manila. The majority of unemployment in 1997

and 1998 was in the lower skill market like production, clerical and agricultural work. Underemployment, on the other hand, declined slightly by 6.0 percent from 1997 to 1998.⁵

The crisis affected overseas Filipino workers (OFWs) a little less than was earlier expected. The OFWs have been an important source of foreign exchange for the Philippine economy for many years. They also helped ease the country's unemployment problem; without the overseas jobs, the unemployment rate would have increased by another 2 percentage points. The Asian market share of OFWs in 1997 increased to 42 percent from 27 percent in 1990. The affected economies of Indonesia, South Korea and Thailand employ less than 10 percent of the OFWs working in Asia. However, data on deployment and remittances show that growth has slowed. Foreign remittances dropped by 14 percent in 1998 from 1997. Although in the first half of 1999, total remittances picked up, remittances from Asia continued to drop.

Poverty and income distribution

In most affected countries, income losses were widespread across occupations and sectors. In the Thai public sector, civil servants were subject to pay cuts ranging from 5 to 10 percent, and a freeze has been imposed on salary increments for higher categories of civil servants. In the private sector, especially in construction, finance, and manufacturing, significant lay-off were obvious. The private sector faced even greater income reductions as a result of cuts in salary, overtime pay and other benefits. Workers in small and medium enterprises and the self-employed were expected to lose substantial income.

Calculations based on the Socio-economic Survey data of 1996 and 1998, reveal only minor changes in aggregated poverty and income distribution between the two years. The Thai study provides data on changes in average real income by work status and income components, poverty incidence, and poverty profiles by different classifications of households. The study applies a new poverty measurement based on the weighted calculation of calorie requirements, consumption basket and spatial price indices. Accordingly, the poverty lines based on this method, for rural and urban areas, respectively, were 8,878 and 10,924 baht in 1996, and 10,383 and 12,350 baht in 1998. With reference to these poverty lines, the study concludes that poverty incidence (by head count index) for the whole country increased marginally from 14 percent in 1996 to 14.29 percent in 1998. The number of people under the poverty line increased from 8.42 to 9.12 million or by 8.3 percent. Under a more conventional approach of poverty measurement, with lower poverty lines,⁶ NESDB indicates that the number of the poor was 6.8 million in 1996 and increased to 7.9 million in 1998 or by 16 percent (NESDB 1999: 4).

According to the Thai study, poverty incidence increased in almost every part of the country except in the North. Bangkok and the rural areas were more affected by the increase in poverty incidence. Yet, more than half of the poor were living in the Northeast. It was found that those in agriculture and construction were worse off during the crisis. The study indicates that the extremely high and low educated groups (higher education graduates and unskilled workers) were more affected by poverty than the others. The Thai study also examines changes in income shares by decile and income distribution. In contrast to the

⁵ In the Philippines, an employed person is considered underemployed if he/she is still actively looking for work. A person is "visibly underemployed" if he/she works less than 40 hours a week.

⁶ The official poverty lines based on the Kakwani approach were 8,736 baht for 1996 and 10,932 baht for 1998 (NESDB 1999: 2).

findings of another study (Knowles *et al.* 1999: 17), the Thai study suggests that income distribution slightly improved because the rich were more affected and lost greater income share than the poor.

A comparative analysis of the crisis-induced poverty in Indonesia is made difficult by the use of different methodologies and types of data. Keeping this in mind and with some adjustments, poverty incidence in Indonesia appears to have declined from 9.75 percent in February 1996 to 7.64 and 7.53 percent, respectively, in February and May of the following year. It went up to 13.1 percent in February and 16.07 percent in August 1998, and peaked at 17.35 percent during September and December 1998. By August 1999, the poverty rate came down to 9.79 percent, close to the level in 1996.

Based on the expenditure level, the distribution of real expenditure in Indonesia appears more even after the crisis. The data shows that the upper middle class was hit harder during the crisis. In general, the expenditure of the rich fell more than that of the poor.

In connection with poverty, food security became a crucial issue at the household level in Indonesia. Food prices increased by more than 118 percent in 1998, compared with the 78 percent increase in general inflation and a 17 percent increase in nominal wages, on average. The average price of rice increased from about Rp.1,000/kg just before the crisis in 1997 to about Rp.2,750 (a 275 percent increase) in early 1999.

The poverty rate in Malaysia increased from 6.1 percent in 1997 to 7.0 in 1998, reversing the long-standing trend of declining poverty, from 8.9 percent in 1995. The incidence of hardcore poverty - defined as households receiving less than half the poverty line income—also rose, from 1.4 percent to 1.7 percent. The number of households living below the poverty line increased from 346,000 in 1997 to 422,100 in 1998, i.e., by 22 percent, according to another social impacts survey.

The effect of the crisis on income distribution in the Philippines was examined through the SAM (social accounting matrix). The result shows that much of the effect fell on the middle income group, particularly those at the lower end (earning between P50,000–99,999 a year), and those in the urban sector. The highest income class was also affected by the crisis. On the other hand, the two poorest income groups (family income under P20,000 and between P20,000–49,999) were less adversely affected.

A study by the ADB (Knowles *et al.* 1999) shows that the incidence of poverty in the Philippines declined significantly from 44.2 percent in 1985 to 35.5 percent in 1994 and 32.1 percent in 1997. But there are no comparable post-crisis estimates of poverty incidence. The surveys of the Social Weather Stations, however, indicate an upward trend in self-rated poverty between 1997 and 1998.

2. Education

Possible impacts of the crisis on education include: an increase in the number of school dropouts (due to contraction of family income and the increasing cost of living as well as need for supplementary family labor); education budget cuts; reduced enrolments; and a reduced rate of transition to higher education. In Thailand, an official estimate suggested that in 1998 some 126,000 students dropped out due to the crisis, another 276,000 left school early (after primary or secondary schooling), and a number of others moved to lower-priced schools or shifted from urban schools to less expensive rural schools. In general, school enrolments dropped 7.2 percent for private schools and 1.8 percent for public schools.

In Indonesia, the secondary school enrolment rate dropped by only 5 percent from the level of 65 percent prior to the crisis. The decrease of the enrolment rate was more significant

in urban areas. The dropout rates among children aged 13-19 (secondary school) in urban communities increased from 11.1 percent in 1997 to 17.5 percent in 1998. In rural areas, it increased from 13.5 percent to 16.8 percent over the same period. The enrolment rates at the elementary level decreased slightly by 0.1 percent in rural areas, and 3.3 percent in urban areas. For the secondary level, the enrolment rates declined by 5.2 percent in urban areas and 2.5 percent in rural areas. By and large, the Indonesian impact of the crisis on education is not alarming, considering the fact that the dropout rate in Indonesia has already been quite high. This view is consistent with the findings of the ADB study that the crisis has not yet had a dramatic effect on school enrolment, particularly at the primary level (Knowles *et al.* 1999: 24).

Similar to Indonesia, primary school enrolment in Malaysia appears to have been fairly unaffected by the crisis. In fact, the number of under-enrolled primary schools (i.e., with less than 150 students) declined during 1997-1999. Secondary school enrolment did not show significant declines either, both at the start of the 1998 and 1999 school years.

However, the impact of recession on education may not be reflected in enrolment rates as families may choose to continue their children's education for many reasons and adjust family spending or apply other solutions, and may also receive direct or indirect forms of government support. For example, the cost of textbooks which is a major financial burden for low-income families could be subsidized by the government. The impact of the crisis on education in Malaysia is also difficult to assess because data on dropout rates are not publicly available, while other qualitative aspects of education are difficult to measure.

Tertiary education may be more obviously affected. Malaysia has a very high proportion of tertiary students studying abroad, especially in the UK, Australia, the US, Canada, India and Taiwan. The sudden increase in foreign education costs, due to the collapse of the ringgit, has compelled many students to seek alternatives locally. Some prospective students had to postpone or cancel their study plans.

The impact of the crisis on education in the Philippines is not clear (partly due to lack of data on drop out after 1998). At the elementary level, the dropout rate in the public schools declined from 8.3 percent in 1997 to 7.77 percent in 1998. For the private schools, the decline was from 4.3 percent to 3.93 percent over the same period. Between 1998 and 1999, however, the enrolment rates in elementary and secondary public schools increased, while those in private schools decreased, implying that there were some movements of students from private (more expensive) schools to public (less expensive) schools. On the supply side, the Philippine study indicates a reduction of education budget from 24.74 percent of government consumption in 1997 to 24.18 percent in 1998. This cut resulted in fewer classroom units and desks built, reduced provision of instructional materials, and limited training of personnel.

Health

The crisis could affect health conditions of the people in many ways. For an individual, the increased burden, more work for less money, change in work condition, increased tension, etc., could result in health problems. In addition, the decrease in health expenditure, private or public, due to the rising costs of health services or decrease in income, could affect the supply and consumption of health services.

In general, health problems due to the crisis in the affected countries are not clearly identified. In Thailand, the incidence of underweight children increased from 7.9 percent in 1996 to 11.84 percent and 12.29 percent, respectively, in 1997 and 1998. Mental health problems have become more critical. The number of out-patients increased from 778,457 in 1997 to 804,906 in 1998. In Indonesia, there has been a slight increase in the number of

population with health problems. The *Susenas* data shows that the percentage of population with serious health problems increased from 12.8 percent in 1997 to 14.6 percent in 1998. The results from the 100 Village Survey data show a higher increase in the number of persons with health problems, from 19.4 percent in 1997 to 27.5 percent in 1998. Health problems in Malaysia and the Philippines were not mentioned in the respective country reports.

While the impact of the crisis on health was not clearly identified in the country reports, its possibility can be inferred from the widespread reductions in health expenditure and budgets and increasing costs of drugs and medical services. In Thailand, the budget of the Ministry of Public Health (MOPH) for 1998 was 9 percent less than the previous year's. In real terms, the 1999 MOPH budget was 23 percent lower than that of 1997 (Knowles *et al.* 1999: 28).

In Indonesia, the decline in government spending on health services led to a shortage of medical supplies in the rural and village health stations (*Puskesmas* and *Posyandu*). The budget cuts also reduced the subsidy for drugs and medical supplies and eventually led to the increase in costs and prices of health treatments. The IFLS (Indonesian Family Life Surveys) show that, in general, public facilities appear to have been adversely affected by the reduced availability of drugs and supplies. Unlike what the trend in the other affected countries, these surveys show a decrease in the use of public services. There are possible reasons for this. One is the crisis-induced quality deterioration in the public health services (Knowles *et al.* 1999: 29), and second, a shift toward traditional health services (Feridhanusetyawan 2000: 35).

In Malaysia, some aspects of health-care have been severely affected by the crisis. There was a decline in budget allocations for public health, despite rising federal health expenditure. Increased health service costs have also reduced access of low-income households to affordable health care, and as a result, there has been a shift away from using private to public health services. In turn, various government health service facilities have become overloaded and overcrowded. Furthermore, there has been an increase of 30 percent in the price of imported drugs which comprise 60 percent of pharmaceutical drugs used in the country.

In the Philippines, the impact of the crisis on health was apparent in the fiscal budget reduction and increased peso value of medicines and other medical goods. At the onset of the crisis, a 25 percent mandatory saving was applied for all government departments. The Health Department budget dropped from 4.31 percent of the total government spending in 1996 to 3.52 percent in 1998. Such a million-peso reduction would inevitably result in reduced health-care services and decreased medical supplies. The reduction in supply of important medical items such as vaccines meant a decline in the quality of medical services. The Department of Health estimates more than 600,000 patients may not have been diagnosed for some illness and another 3.6 million may not have been provided laboratory services in one way or another.

Other social problems

Other social problems examined by the country studies include, food and nutrition (Philippines), housing and shelter (Philippines), environment (Thailand), community and family (Thailand), food security (Indonesia), and the disadvantaged (Thailand and Indonesia). By and large, these issues were broadly discussed, without clear identification of linkages to the crisis.

3. Social Safety Nets and Government Responses to the Social Impact

The crisis has resulted in a number of social problems and increasing need for social welfare. In general, the four Asian countries have not adequately developed formal “Western-style” social safety nets.⁷ Mostly, there is a limited mandatory compensation in the form of severance pay or other benefits for those who are laid off; there is no unemployment insurance, and other social security benefits for the unemployed are also very limited. Further, most of the social security benefits are not available to the self-employed or workers in the informal sector, who comprise the majority of the workforce in these countries. Thus, the vulnerable groups in these countries tend to rely primarily on informal and traditional safety nets provided through the family and/or community.

Current formal safety nets in Thailand include severance payment and a social security system. The severance payment, which is available only to those in the formal sector, amounts to 10 months of pay for those who have worked for at least three years. The present social security system covers private enterprises employing 10 workers or more, but not the self-employed, as erroneously reported in the Thai study. In fact, beginning April 1, 2001, the system will cover all establishments employing one person and more. As of September 1999, the beneficiaries of the social security system were 5.5 million workers (only about 15 percent of the total labor force). The Thai study’s review of the safety nets, particularly the existing programs prior to the crisis, was not exhaustive. There are, in fact, many more forms of safety nets provided both formally and informally. For example, for the public sector at least, there is a pension system for civil servants. The Ministry of Labor and Social Welfare also provides a number of welfare programs for the disadvantaged, such the elderly, the disabled, and the unemployed.

To cope with the crisis, the Thai government has adopted a number of rescue programs, which include the Asian Development Bank’s Social Sector Program Loans (SSPL) of US\$500 million aimed at supporting social projects via the ministries of Education, Public Health, Labor and Social Welfare, and Agriculture, and the World Bank loans of US\$300 million, disbursed through the Social Investment Program (SIP), aimed at creating employment and capacity building in communities and local governments.

In Indonesia, the social safety net (SSN) programs have not been effective. The implementation of the SSN has been not only late but also in disarray and full of controversy. The bureaucracy lacked the capacity to manage the programs. It was not only demoralized during the rapid progression of the crisis and political turmoil, but also lacked the experience in designing and implementing the program. The problem was also complicated when the issues were politicized during the year of political turbulence in 1998.

The SSN programs were spelled explicitly in the IMF reform package in June 1998—almost one full year after the crisis started in August 1997. In September 1998, the *BAPPENAS* (the national planning agency) announced that a nationwide SSN program was being developed. The announced program consisted of four elements: first, a food security program to guarantee the availability and affordability of food across society; second, a public works program to absorb the recently unemployed; third, a social protection program to maintain the standard of the health and education facilities and, fourth, the promotion of small and medium enterprises. The total cost of implementing the program was estimated at around Rp. 17 trillion, smaller than the earlier drafted amount of Rp. 25.5 trillion. The SSN was widely criticized as a total failure—not reaching the poor and corruption-tainted. The World

⁷ For definition, see Reddy (1998).

Bank had to delay the disbursement of the loan to Indonesia, partly because of some concern that the fund was not properly used. In Early 1999, the *Bappenas* admitted that the disbursement of the SSN fund had been very slow, and that the program did not run smoothly. It was also reported that only 30-40 percent of the fund was actually used.

One reason behind the failure was that the SSN was not properly designed but was an uncoordinated collection of programs submitted by various government departments. Another reason was the fact that the *Bappenas* did not have the full control and authority to channel the fund. Each department received its limited and partial budget from the Ministry of Finance, and there was no guarantee that the fund they received would be spent on SSN activities. Some government officials blamed on the late result of the social impact assessment, although this was not a good excuse. The main problem was bad implementation. In fact, several NGOs have asked foreign donors to stop their assistance for SSN programs.

The case of failure of the formal SSN in Indonesia points to the worthiness of the informal SSNs. First, the extended family is the most important source of the natural safety nets. Additionally, the agricultural sector and the informal sector also provided the other forms of natural safety nets. Further, considering the fact that involuntary participation of women in the informal labor market has increased, the female member of the family could also be considered as the provider of natural SSN.

Malaysia has been lauded in the international development discourse for its success in providing public services, especially health and education. Many lower income households have enjoyed some government transfers and services, and have even become dependent on and continue to expect of government subsidies. Generally, therefore, the crisis and the consequent changes in government social expenditure tend to be felt more by lower-income households. In response to the crisis, the following specific programs and funds were designated for certain sectors or needy groups. Under the auspices of the Ministry of Health and the Ministry of Education, an additional RM200 million were set aside for rural social infrastructure facilities. The Fund for Food program, with a start up allocation of RM300 million, was established to increase food production through provision of low-interest loans to small farmers and Farmers' Associations. An additional allocation of RM100 million for the Hardcore Poverty Development Program was designed to provide loans to the hard-core poor for income-earning activities through Amanah Ikhtiar Malaysia (AIM). The Small-Scale Entrepreneur Fund (RM100 million) and the Economic Business Group Fund (RM150 million) were set up to provide assistance to petty traders, hawkers and small entrepreneurs—including women entrepreneurs—in urban areas. The Small and Medium-Scale Industry (SMI) Fund, with startup financing of RM750 million, was mandated to aid small and medium scale businesses in expanding production. Loans were mainly channeled for the purchase of equipment and machinery. The National Higher Education Fund, with an initial RM320 million allocation, is meant to provide financial assistance to students in local universities and colleges.

The implementation of these programs has, however, been considered disappointing. For example, the Fund for Food Program, which provides low-interest loans to farmers, saw only RM199 million—out of an allocated RM700 million—approved as loans. Similarly, the Special Scheme for Low and Medium Cost Housing approved only RM241 million (out of the available RM2,000 million), while the Small-Scale Entrepreneur Fund approved RM882 million out of RM1.5 billion available. Whatever the reasons, substantial proportions of the credit program allocations have not been taken up, when they could have generated the much-needed economic activity or boosted demand.

In the Philippines, there are two major formal social safety nets. One is the Social Security System (SSS) for the private sector and the other is the Government Service

Insurance System (GSIS) for the public sector. Both systems have limited coverage and form. Only a small fraction of the systems will directly benefit people affected by the crisis as coverage for most people is limited to retirement. Benefits such as Sickness, Disability, and Hospitalization would not apply to the direct consequences of the crisis. The help that they have been able to provide to crisis-affected people is limited to loans, making funds available to displaced workers, educational, calamity and housing loans, and emergency loans.

The government has tapped the SSS some more for other types of loans. For example, the SSS was asked to work with the Guarantee Fund for Small and Medium Enterprises (GFSME) in providing funds for the newly created Enterprise Stabilization Guarantee Fund (ESGF). This is an additional burden on the SSS as its funds are not sufficient even to cover unemployment or other benefits for displaced workers or provide a more comprehensive health coverage for its members.

A safety net that can directly help the people affected by the crisis is the Public Employment Service Office (PESO) under the Department of Labor and Employment. The agency was set up to monitor worker layoffs at the local level, provide job placements, distribute information on job vacancies and available programs for retraining, entrepreneurship and credit/livelihood assistance. In 1998, the PESOs conducted job and livelihood fairs nationwide, placed 114,302 job applicants, and assisted 141,122 students through their career guidance programs.

In response to the social impact of the crisis, the Philippine government has also taken other direct measures. In February 1998, the government organized the National Economic Summit (NES) in its effort to coordinate inter-sectoral cooperative responses to the crisis. Four clusters of proposals were formed to prioritize and concretize the proposed programs. Two of the four clusters involve protecting jobs and enhancing productivity, and protecting the vulnerable groups. The government also provides rice assistance, especially in the drought-affected areas. It also provided training for 1,229 displaced workers and 10,774 scholarships in technical programs that would run for 1-3 years. However, the government's assistance was small-scale.

Summary and Conclusion

The present study is a synthesis of four country studies on the social impact of the 1997 Asian crisis in four countries in Southeast Asia—Thailand, Indonesia, Malaysia, and the Philippines. The crisis started in Thailand, and spread quickly to Indonesia, Malaysia and the Philippines. The causes of the crisis differ across the four countries. The major causes include rapid financial liberalization with problems of corporate and good governance, of prudential regulation, poor macroeconomic management, and other policy and institutional failures. Depending on their socio-economic and political backgrounds, the four countries have been affected by the crisis to a different degree. Thailand and Indonesia have been much harder hit compared to Malaysia and the Philippines.

The social impacts commonly addressed in the four country studies are unemployment and underemployment, poverty and income distribution, human development (education and health), and safety nets. Thailand and Indonesia encountered significantly increases in unemployment and underemployment. Malaysia was the least affected by unemployment; no underemployment was reported. In the Philippines, although unemployment went up slightly from the earlier trend, underemployment declined. During the crisis poverty in Thailand, Indonesia and Malaysia increased. The poverty incidence was not mentioned in the case of the Philippines. The crisis somewhat reduced income inequality in

most countries since it affected the middle and higher income classes more. This does not mean, however, that the lower income classes were not affected.

In most countries, education was not significantly affected by the crisis, except in Thailand where the number of school dropouts was 126,000 in 1998 and school enrolment dropped 7.2 percent for private schools and 1.8 percent for public schools that same year. The Philippines also reported some increase in the dropout rate during the crisis. In Indonesia and Malaysia, the impact of the crisis on education was less dramatic or not significant. In the health sector, the most commonly found problems were the increase in the cost of imported medicine and medical equipment, and decreases in the health budget. In conclusion, the crisis has not affected the social sector in general, although some of the impacts may not be identifiable clearly or in the short run, while some of the problems have already been mitigated through government responses or by other social safety nets (SSNs).

In this study, social safety nets are not clearly defined and most country studies apply the concept in the sense of social security and social welfare, except in the case of Indonesia where the SSN tends to be referred more strictly as emergency social funds which serve to protect individuals from falling below a defined minimum standard of living. By and large, the formal SSNs in the four countries are limited in coverage. In the case of Thailand, for example, only about 15 percent of the workforce are covered by the social security system and a handful of civil servants by the pension system. In Indonesia, SSNs (more strictly defined) have not been effective mainly because of poor implementation and partly due to corruption. In Malaysia, the basic social services which had been usually well provided were interrupted by the crisis and the consequent changes in the government expenditure tend to be felt more by the poor. The program measures by the government have been considered disappointing. The Philippine study mentions two major formal social safety nets—the Social Security System and the Government Service Insurance System. Both the systems have limited coverage. In addition, the Public Employment Service Office (PESO) and women's increase labor participation, contributing to family income, were quoted as safety nets that have directly helped the people affected by the crisis.

In conclusion, the country studies have provided a broad review and examination of the causes and social consequences of the Asian financial crisis, as well as the existing social safety nets and policy responses of the respective governments. Generally, the reviews of the social impact have been done in terms of "deviations" from the previous period rather than a rigorous identification of the social consequences of the financial crisis. The studies have not attempted to make economic evaluation of the social impact or social change during the crisis nor offered any qualitative assessment of the same. It has been, however, noted that the full impact of the crisis is difficult to assess for several major reasons: first, various concurrent developments complicate assessment of the actual impact; second, a great deal of relevant data has not been made available to the public; and, third, the available data may be suspect. Nevertheless, in the final analysis, the studies have informed that many government responses and actions have not been effective, or are not reaching the poor and the crisis-affected people, mainly because of poor management or implementation of the programs. Hence, much more needs to be done both in terms of further research on social impact of the crisis and actions to ensure that the crisis-affected and needy are well taken care of, not only by the government but by society, in general.

References

- Ammar Siamwalla, and Orapin Sopchokchai. 1998. *Responding to the Thai Economic Crisis*. Bangkok: United Nations Development Programme (UNDP).
- Arndt, H. W., and Hill, Hal (Eds.). 1999. *Southeast Asia's Economic Crisis: Origin, Lessons, and the Way Forward*. Singapore: Institute of Southeast Asian Studies.
- Feridhanusetyawan, Tubagus. 2000. "The Social Impact of The Indonesian Economic Crisis." Bangkok: Thailand Development Research Institute. (draft report)
- International Labor Organization (ILO). 1998. Employment Challenges of the Indonesian Economic Crisis. In ILO report. Bangkok.
- Islam, Azizul. 2000. "Comment As A Panelist," Background paper, *Symposium on Economic and Financial Recovery in Asia*. (Host Country Event in conjunction with UNCTAD X), Queen Sirikit National Convention Center, Bangkok, 17 February 2000. (Mimeo)
- Jomo, K. S., and Lee Hwok Aun. 2000. "Some Social Consequences of The 1997-8 Economic Crisis in Malaysia." Bangkok: Thailand Development Research Institute. (draft report).
- Knowles, James C., Pernia, Ernesto M., and Racelis, Mary. 1999. *Social Consequences of the Financial Crisis in Asia*. Asian Development Bank, Economics Staff Paper, Number 60. Manila.
- National Economic and Social Development Board (NESDB). 1999. *Indicators of Well-Being and Policy Analysis*. Newsletter of the National Economic and Social Development Board 3(1), January. Bangkok.
- Passadilla, Gloria O. 2000. "Social Impacts of the Asian Crisis in the Philippines." Bangkok: Thailand Development Research Institute. (draft report)
- Reddy, Sanjay. 1998. *Social Funds in Developing Countries: Recent Experiences and Lessons*. UNICEF Staff Working Papers, Number EPP-EVL-98-002. New York.
- Sauwalak Kittiprapas, and Chedtha Intaravitak. 2000. "Social Responses to Economic Crisis in Thailand: Some Evidence During 1997-99." Bangkok: Thailand Development Research Institute. (draft report)
- Srawooth Paitoonpong. 2000a. "Revitalizing the Thai Labor Market." Presented at the National Tripartite Seminar on "Labor Relations in Thailand and Globalization," organized by the Population and Social Research Institute, Mahidol University, in collaboration with ILO and JIL, 28 June 2000, Bangkok. (in Thai)
- _____. 2000b. "Social Impacts of Financial Crisis, Safety Nets and SIF in Thailand." Presented at the seminar on Social Funds and Safety Nets: Experiences of Latin America and Southeast Asia, organized by TDRI and Inter-American Development Bank, August 22, 2000, Bangkok.

Social Responses to Economic Crisis in Thailand: Some Evidence during 1997-99

by

**Sauwalak Kittiprapas
and
Chedtha Intaravitak^{*}**

Thailand Development Research Institute

^{*} We are grateful to Dr. Chalongphob Sussangkarn for his valuable guidance, Mr. Yos Vajragupta for his assistance in processing socio-economic survey data, and Ms. Uraiwan Ramangkoon for her assistance in preparing this document.

Executive Summary

The recent economic crisis in Thailand that began in 1997 has created a number of adverse impacts on the economic and social fabric of the Thai society. The severity of these impacts has, however, been uneven over different time periods and across different groups within society. For instance, the impacts were much more severe during the first year of the crisis (mid 1997-1998).

Identification of social impacts becomes difficult for two reasons. First, social indicators are fewer and less frequently and less comprehensively reported than are economic indicators. Even though, some social impacts can be gauged from economic indicators since social impacts are often created as a result of transmission of economic impacts on to social sectors. Social impacts, however, appear to be more implicit unlike the more explicit economic impacts. Second, there is a time lag both in the transmission of economic impacts on to the social sectors, and in responses to the social impacts thus created. Therefore, the social impacts of the crisis may not be apparent immediately and their actual severity may not have been observed during the period of this study, i.e., from mid-1997 to 1999.

Indicators on labor markets are the most frequently reported and aggregated than other social indicators. The labor force survey data show that labor market responses to rapid changes in the economic situation varied in different periods during the crisis. The labor market situation was the worst during the first year of the crisis than in the later years. This was reflected in the sharp rise in under-unemployment rates and worked hours, and in a combination of operational adjustments (e. g., labor hoarding, benefit and compensation cuts) during that time. The situation also varied from sector to sector and across different geographical areas, resulting in labor mobility across sectors and locations.

Nevertheless, impact on poverty during the crisis—assessed by comparing the socio-economic survey data for 1996 and 1998—does not show drastic changes in aggregated indicators. In fact, at the micro level, adverse impacts have spread unevenly across sectors, regions and areas, as well as among worker groups based on education levels. Similarly, unequal impacts across different groups of people are also expected in other social sectors, such as health and education. However, there are obstacles to witness such dis-aggregated impacts as these social indicators are less comprehensively and less frequently reported. Although existing data do not reflect drastic changes in these social indicators, their adverse impacts on the respective social sectors (e.g., deterioration in the quality of education, health, life, etc) may be implicit and become perceptible in the long term. Thus the implications of the crisis on the many social aspects of the Thai society may not be explicitly apparent in the early years of the crisis and over the short period this study covers.

However, there have been social responses in terms of coping strategies from both the government and households during this crisis period. At the government level, policy responses aimed at mitigating the impacts of the crisis have included the implementation of economic stimulus measures and social safety nets. Households, too, have been adjusting their behavior in consumption spending, as well as employment and income earning. Informal safety nets have also provided an alternative means to cushion the severe adverse impacts of this crisis.

1. Introduction

1.1 Causes of crisis

The recent East Asian financial and economic crisis which started in Thailand in mid-1997, with rapid consequences across the region, appeared without early warning. It exposed many weaknesses in region economies and governance, as well as the speed of impacts of globalized economies on capital movement.

This East Asian crisis is unique in terms of complexity of causes and severity of impacts. There is much to learn from this crisis, which rooted in a complex set of problems, not only the more obvious collapse of financial systems but also other fundamental weaknesses of an economic and institutional nature.

Thailand, in particular, started to show signs of an impending crisis much earlier than 1997. Financial liberalization policies of the early 1990s are usually blamed as the major cause of the financial turmoil in 1996-97, which built up into the crisis. A significant step toward financial liberalization in Thailand was the establishment of the Bangkok International Banking Facility (BIBF) in 1993 to facilitate international lending and borrowing. The BIBF was popular among Thai private investors because the interest rate on dollar loans was about 4-6 percent lower than domestic rates. By the end of 1996, the amount lent through BIBF had risen quickly from nothing to reach \$31.2 billion (Ammar 1997). However, this kind of liberalization without an adequate supervision and monitoring system, and in a fixed exchange rate environment, led to large capital inflows which largely went into speculative sectors such as real estate and stocks. There had been over-investment (largely in unproductive sectors) as capital inflows continued to increase, and soon the bubble burst.

In short, Thailand's financial meltdown in mid-1997 can be largely attributed to three policy errors: financial liberalization while keeping the currency exchange rate rigid; premature liberalization of financial institutions; and failure to prudently supervise financial institutions (Pakorn 2000). Altogether, these largely mismanaged financial mechanisms created a dangerous situation by permitting high speculation and a free flow of capital. Thailand had been under heavy attack on the baht from currency speculators since late 1996 and exhausted her foreign reserves defending the currency. Capital flight began accelerating from late 1996 to mid 1997, as, with the failing Government efforts to save the baht, devaluation seemed imminent and investors began losing faith in the currency. Indeed, preventive measures at that time could have helped abate the crisis somewhat, if not totally prevent it.

Another cause of the crisis was the situation of panic and moral hazard in the financial sector. Prior to the crisis, the Thai financial system was already in a mess. There were high risk investments and moral hazards (because of public-fund guarantees of bank liabilities). Also, the portfolio diversification of foreign investors had led to herding behavior. This is because the more portfolio diversification among many countries, the less incentives investors have to search for information on specific cases of individual countries, and this can lead to herd behavior—which can be irrational. Creditors began withdrawing their credit when they saw others doing the same, and soon there was an “investors’ panic” that not only led to capital flight from Thailand, but a contagion effect that spread across the entire region. Even before the crisis struck, foreign investors had began to react adversely to the weaknesses in the Thai economy.

Another major root of the crisis was the lack of transparency and weaknesses in local institutions, which was also becoming apparent before the crisis. Frauds in the financial sector, an indecisive Government, and the bail-out of problematic financial institutions made

the problem spin out of control. For example, financial mismanagement was glaringly obvious in the Bangkok Bank of Commerce (BBC) scandal that eventually led to the bank's collapse. The collapse in stock and property markets, in turn, exposed the weaknesses of the financial sector and led to the eventual closure of a large number of finance companies and business firms that had mushroomed during the economic heyday. Crony capitalism, a common problem in the affected Asian countries, was a crucial factor in the Thai crisis.

Macroeconomic management by Government agencies was even weaker. The Thai Government seemed to ignore the warnings about the weaknesses of the exchange rate and the financial system. There was weak coordination among the four key economic agencies concerned with macro-economic policy-making,⁸ as there was a fall in technocracy in general even before the crisis—particularly the Bank of Thailand, which had a poor performance in the 1990s (Ammar 1997). Unfortunately, an inherently weak political system could not offer a strong alternative to the shortfall in technocracy in strengthening policy management, and thus could not handle the crisis mess.

Problems of governance are found in both the public and corporate sectors. Not only the Government sector, but the private sector too is very much to blame for the 1997 financial crisis since it was the lack of discipline among private investors in foreign borrowing and unproductive spending that burdened the country with huge foreign debts when the currency depreciated. With cheaper interest rates for off-shore loans (as local rates were high) and the perceived fixed exchange rate, there was excessive borrowing and spending in speculative sectors, which built up huge amounts of short-term foreign debts.

However, weaknesses in the financial sector and governance (both in the public and corporate sectors) are not the only roots of the crisis. Structural weaknesses also mattered, and are perhaps the deep-rooted cause of the crisis. Signs of problems were apparent in the real sector long before the onset of the crisis. Thailand, even before the crisis, was facing the problem of long run competitiveness. Signs of an imminent economic crisis were apparent in 1996 when export growth slowed down and manufacturing competitiveness fell, especially in the second half of 1996, when the export growth rate sank suddenly to zero percent for unclear reason.

In Thailand, there was little indication of growth of technological capabilities or movement "up the ladder of comparative advantages." The contribution of total factor productivity (TFP) to growth in non-agriculture during 1981-1990 is rather small (about 2.2 percent), implying that Thailand's rapid growth in the past had been achieved by utilizing inputs (Pranee and Chalongsob 1996). A number of factors retarding long-term sustainable economic growth, i.e., low level of education, deficiencies in infrastructure development and environmental management, were apparent much before the crisis occurred.

The problem of competitiveness tends to support Krugman's argument that Asia's unsustainable growth (Krugman 1994) had arisen from the more intensive use of inputs (i.e., cheap labor and raw materials) and mobilization of resources rather than from increases in efficiency. Increased efficiency of labor would come from improved management or technological knowledge, which would underline sustainable and dynamic growth. The concern of increased labor efficiency goes beyond mere increases in labor productivity, which can be generated by machinery or infrastructure. Krugman argues that rapidly growing East Asian economies show little evidence of improvement in efficiency and technological progress, but instead rapid growth of inputs. The structural problem of the country's

⁸ These four were, the Ministry of Finance (MOF), the National Economic and Social Development Board (NESDB), the Bureau of Budget (BOB), and the Bank of Thailand (BOT), Thailand's central bank.

competitiveness has weakened the ability of its economic sectors to cushion the adverse impact of the economic crisis and severe recession that followed.

External factors also contributed to the problem. It was the period of a worldwide export downturn in a number of sectors, including the semiconductor industry. Dasgupta and Imai (1998) argue that it had been a period of downsizing in demand for world commodities, which led to a drop in demand for exports from Asian countries. In addition, Japanese recession and depreciation of yen led to lower demand for imports from other Asian countries. Exports from Asia declined both in quantity and value terms. Thailand faced a sharp drop in exports in 1996 from double digits to zero growth rate.

All problems were in concert in 1996 and became serious in early 1997, when the baht was heavily attacked and the Bank of Thailand spent a large amount of foreign reserves defending the currency. There were three heavy attacks on the baht in November-December 1996, in January-February 1997 and May-June 1997. By mid-1997 Thailand had exhausted her foreign reserves.⁹ This led to the inevitable floating of the baht on July 2, 1997, when the Asian regional financial crisis finally came to a head.

1.2 Impacts

The unexpected impact of the Thai economic crisis that broke in mid-1997 was the region-wide contagion effect following devalued currencies in Malaysia and the Philippines in mid-July and Indonesia in mid-August. Within a few months, the four currencies (including Thailand's) fell rapidly by 25-30 percent against the US dollar. The financial turmoil and recession in these countries led to reduced demand for Thai exports.

The crisis in Thailand was triggered by the collapse of the financial system, but it spread to the real economy. Not only large enterprises that had large amounts of foreign loans and workforces, but also small-scale enterprises were affected by the overall economic recession. Obviously, they were affected through the fall in aggregate demand and output. Even the export sector experienced difficulties because of the contagion effects throughout the region. As the baht's depreciation was followed by depreciation of other Asian currencies, Thai exports did not gain as much as they could have had the currency depreciation been limited to Thailand. Furthermore, some export-oriented sectors that would have benefited from the loss in value of the baht could not increase production due to severe credit shortages. High interest rates, coupled with the risk aversion behavior of lenders, resulted in reduced access to credit. Businesses faced difficulties from the lack of liquidity in the system.

Consequently, the real sectors were seriously hurt by the credit crunch, and many businesses and industries filed for bankruptcy or closed down. Downsizing, cost reductions and budget cuts in programs led to a sharp increase in unemployment, underemployment, and changes in working status and jobs. Vulnerable groups suffered from the reduction in work opportunities and welfare support. Investors lost confidence in the economy as GDP growth in 1998 declined—eight percent. However, the macro-economic situation improved in 1999 as the economy began to stabilize, and it continues to improve in 2000 with forecasts of 4 to 5 percent growth.

⁹ The reported foreign reserves came down from \$40 billion at the beginning of 1997 to \$33.5 billion at the end of June, on the eve of the floatation of the baht. However, the Bank of Thailand later admitted that it countered the speculative runs by forward selling some \$23 billion of the reserves.

Linkages of impacts and transmission to social adjustment

The discussion in this paper is set in a comprehensive framework covering the linkages of the overall impacts of the crisis to various economic and social units (sectors, agents, households and communities) and the adjustment responses in policies and coping strategies of these units. Figure 1 below describes these linkages.

The transmission of the impacts of the crisis to the social sectors can be explained as follows.

The financial and economic crisis in Thailand was provoked mainly by the freeing, in July 1997, of the local currency that had been pegged to a basket of currencies, in a bid to save it from the concerted attacks of overseas speculators. In fact, the economic slump that had begun even before the fall in the exchange rate had had adverse impacts on both the public and private sectors. Certainly, the impacts were uneven, with some sectors making gains and others running losses.

Local currency depreciation affected domestic commodity prices as well as causing changes in the earnings of the tradable sectors. As a result, some export-oriented sectors benefited, but import-oriented sectors were hurt. Relative price changes led to increased costs of living. The recession led to an overall decline in Government revenue and business profits, the results of which were transmitted to the social sectors. This in turn led to adjustments by various groups of people. Declines in Government budget allocations on social development programs led to a reduction in social services and welfare. The impacts of the widespread domestic business collapse led to an overall employment reduction and to an adjustment in the labor market, resulting in lower wages and increased poverty.

These combined impacts resulted in changes in household consumption expenditure patterns and real income. Consequently, families had to come up with coping strategies. The reduction in economic and social welfare eroded people's well being and human resource development in the long run. Of particular concern are vulnerable groups, which need Government assistance programs. Policy responses, in particular economic stimulus packages and social safety nets, have been aimed at mitigating these adverse impacts.

This paper discusses the above aspects of social responses, according to the linkages described. The first section briefly discusses the overall economic impacts, while the social impacts will be discussed in the following sections.

Economic sectoral impacts

Changes in the economic environment and policy directions are likely to have uneven impacts on different sectors and sub-sectors, with some gaining and others becoming worse off. The following paragraphs analyze the effects on various sectors.

Tourism and agriculture

Tourism and agriculture seem to have benefited in 1998, especially in-bound tourism. The number of in-bound tourists grew by 7.53 percent, and their total expenditure in baht terms grew by 9.7 percent in 1997/1998.¹⁰ Agricultural exports (in baht value) increased from 257,562 million baht in 1997 to 304,425 million baht in 1998.¹¹ However, at least for the agricultural sector, this beneficial effect decreased in 1999 when the prices of a number of agricultural crops (e.g., cassava, rice) declined and the advantages from the baht's depreciation lessened.

¹⁰ Statistics from the Tourism Authority of Thailand.

¹¹ Statistics from the Customs Department.

Sawwalak Kittiprapas and Chedtha Intaravitak



Although the agricultural sector appears less affected, or at least it weathered the crisis better than other production sectors, different degrees of impact appeared during certain shorter periods. Data from the Labor Force Survey of the National Statistical Office reveals that in different periods during the crisis, the number of workers changed drastically, and this may also be related to lag effects and external factors.

For example, the prices of major crops increased in the first year of the crisis from mid-1997 to mid-1998, partly due to the El Niño effect in neighboring countries. As the urban economy experienced more immediate and deeper impacts of the crisis, the flows of returning migrants to rural areas increased in 1998. With some lag adjustment of increasing prices in the previous year and the diminished negative effect of El Niño, Thai and world agricultural outputs increased in 1999. The reported number of workers in the agricultural sector in rural Thailand expanded in early 1999. However, the negative impacts of the crisis, arising from a decline in overall consumption, including that of products, resulted in the lowering of agricultural prices. The value of agricultural exports declined in 1999, both in baht and dollar terms. Consequently, agricultural income did not improve and migrants who returned to rural areas have started to move back to urban areas. Rural to urban migration flows increased again in 1999. However, even though the overall economic situation is improving in 2000, agricultural employment and export value are still declining. While the growth prospects of other sectors appear encouraging in 2000, the performance of the agricultural sector is not encouraging.

Manufacturing

The impacts on the manufacturing sub-sectors have also been uneven. The crisis seems to have affected capital intensive manufacturing activities first. As seen in the manufacturing production indices in Table 4, overall production indices declined during 1996-1998. However, significant drops are evident in construction materials, iron and steel products, and the transportation equipment sub-sectors.

Labor intensive activities such as beverages, food and tobacco manufacturing experienced smaller declines in their indices. In contrast, textiles and textile products were the only items to register higher production indices during 1997 to 1998.¹² In 1999 there was some improvement in the total index and a turnaround of sectors adversely affected in 1998, including construction materials, iron and steel products, transport equipment, petroleum products and others. The growth prospects for many manufacturing sectors are encouraging in 2000, boosted by increasing private consumption and exports.

Capacity utilization indices for the manufacturing sector in 1998 also show a declining trend, similar to that of the production index (Table 5). Within an overall reduction of the total industry index to 52.2 in 1998, heavy drops are evident in the construction materials and transport equipment sub-sectors, while minor falls are found in the beverages and foods sub-sector. The total index improved in 1999, particularly in the sub-sectors of transportation equipment, construction materials, and others.

Data from the two tables imply that labor intensive manufacturing activities suffered to a lesser degree from the adverse impacts of the crisis. This observation is supported by GDP growth rates by sector (Table 6).

¹² Data from the Labor Force Survey also indicate increasing employment in this sub-sector.

Table 4 Manufacturing production index 1/

(1995=100)

	1995	1996	1997	1998	Dec-98	Jun-99	Oct-99
1 Total Index	100.0	108.6	108.0	96.4	99.8	107.3	112.5
2 Foods	100.0	101.8	103.7	98.1	117.9	80.3	80.2
3 Beverages	100.0	106.2	122.1	121.3	156.7	158.5	152.3
4 Tobacco	100.0	112.0	100.9	80.4	75.2	81.5	68.3
5 Textiles & Textile Product	100.0	112.0	100.9	105.2	104.1	102.9	104.8
6 Petroleum Products	100.0	132.3	154.7	143.5	144.6	146.2	147.4
7 Construction Materials	100.0	111.2	108.9	67.9	58.8	85.4	84.9
8 Iron & Steel Products	100.0	106.3	103.8	71.1	60.9	83.8	84.6
9 Transportation Equipment	100.0	104.4	75.9	35.3	38.2	65.3	75.5
10 Others	100.0	112.0	108.2	109.0	99.1	123.5	144.9

1/ Accounting for 62 percent of the 1995 manufacturing sector value added. (1995 base year = 100).

Sources: 1. The Office of the Cane and Sugar Board.
 2. Thailand Tobacco Monopoly.
 3. The Excise Department.

Table 5 Capacity utilization of certain industries 1/

(Percent)

	1995	1996	1997	1998	Dec-98	Jun-99	Oct-99
1 Total	77.6	72.4	65.6	52.2	55.2	61.7	63.0
2 Foods	41.5	37.3	37.5	33.8	42.1	30.7	33.8
3 Beverages	82.3	83.0	79.1	77.2	103.9	113.0	108.6
4 Tobacco	75.2	84.2	75.8	60.4	56.5	61.2	51.4
5 Construction Materials	81.8	72.0	65.5	40.4	38.2	56.0	55.6
6 Transportation Equipment	81.5	67.6	48.5	24.4	25.8	36.0	40.7
7 Petroleum Products	93.3	85.7	90.1	83.9	84.6	85.5	86.2
8 Others	71.6	71.9	65.9	53.7	52.4	60.4	63.3

1/ Accounting for 44.5 percent of the 1995 manufacturing sector value added.

Sources: 1. The Office of the Cane and Sugar Board.
 2. Thailand Tobacco Monopoly.
 3. The Excise Department.
 4. Manufacturers of Respective Products.

Table 6 shows the percentage change in quarterly GDP by sectors during 1997-1998. Since mid-1997, the non-agricultural sectors have experienced larger negative impacts than the agricultural sector—which also showed negative values in mid-1997 and the first half of 1998. It is clear that the construction sector experienced the largest negative value changes in late 1997-1998, although this sector had registered positive changes during 1995-1996. Financial intermediation also had severe negative effects in 1997 and 1998, but it seems to have improved in the third quarter of 1999. Overall manufacturing quarterly GDP dropped to negative values from the second quarter of 1997, but it has experienced positive growth since the fourth quarter of 1998. Similar to the trend in the economic situation, the real estate and business activities sub-sector was adversely affected in 1997 and 1998, but it began to turn around in 1999.

Table 6 Percentage change of gross domestic product by sector (seasonally adjusted)

	1996				1997p				1998p1				1999p1		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
1. Agriculture	3.9	-0.3	1.1	-3.4	1.0	1.0	-0.7	0.1	-1.7	-1.3	2.3	3.5	-4.9	2.8	-1.9
2. Agriculture hunting and forestry	4.9	-0.7	1.3	-3.3	1.7	1.1	-0.4	-0.8	-2.1	-1.0	3.5	-0.1	-4.0	5.1	-3.2
3. Fishing	-0.4	1.7	0.3	-3.8	-2.7	0.8	-1.9	4.5	0.3	-2.9	-3.6	22.7	-8.8	-7.5	4.7
4. Non-agriculture	0.9	3.6	0.0	-0.8	-1.2	0.6	-0.8	-3.9	-5.9	-3.2	-1.9	3	3.2	-0.9	2.9
5. Mining and quarrying	11.0	1.6	4.0	18.2	-2.1	4.9	4.6	-1.1	-4.2	-4.4	-1.3	1.9	3.5	2.3	-0.8
6. Manufacturing	1.6	3.0	1.2	-1.4	2.5	-0.7	-2.0	-4.7	-6.4	-1.1	-3.5	7.5	4.0	1.6	3.3
7. Electricity, gas and water supply	-1.0	-1.5	2.2	2.4	0.6	2.9	1.1	-1.3	1.4	-3.2	-5.1	-5.1	9.6	-3.3	10
8. Construction	6.2	-1.2	-8.3	8.6	-28.8	5.9	2.0	-17.2	-18.6	-5.7	-10.2	-13.1	3.0	-0.4	10.3
9. Wholesale and retail trade, repair of vehicles and personal and household goods	-1.9	5.1	-2.6	-4.5	2.0	0.8	-0.8	-2.9	-5.9	-2.8	0.1	2.2	3.6	0.1	1.1
10. Hotels and restaurants	-2.5	8.6	-4.0	-0.4	1.3	0.6	-6.2	-3.3	-2.0	-1.6	3.2	3.3	3.0	-4.2	7.3
11. Transport, storage and communication	-2.1	6.4	1.5	-1.7	-0.4	3.5	3.1	-3.4	-0.6	-6.8	4.1	6.5	-1.5	0.2	-4.1
12. Financial intermediation	0.6	5.3	4.0	-3.8	-4.5	-4.1	-3.3	-5.8	-13.4	-16.3	-10.5	-16	26	-25.5	14.8
13. Real estate, renting and business activities	-1.2	4.3	1.3	0.2	1.1	-3.4	-1.0	-0.6	-7.8	0.5	-5.3	-5.8	2.0	4.6	2.0
14. Public administration and defence; compulsory social security	5.6	0.8	1.0	0.3	-0.7	2.5	-0.3	3.3	-0.5	2.7	2.1	2.7	-4.2	-2.2	4.3
15. Education	4.6	1.1	0.9	1.5	0.6	5.2	-0.3	0.2	3.6	0.6	6.7	14.7	-13.3	-2.6	2.1
16. Health and social work	3.4	4.6	4.1	1.9	-2.2	5.6	-0.3	3.2	-4.4	-0.3	4.9	-6.3	6.6	-2.5	4.4
17. Other community, social and personal service activities	8.5	4.4	4.6	-1.5	-1.7	1.6	2.7	4.6	-6.7	-5.8	-5.5	7.8	-0.8	0.7	1.4
18. Private household with employed persons	-0.5	-0.4	-0.1	-0.2	1.2	-0.4	0.0	-0.2	2.8	-0.4	0.1	-0.2	-0.6	-0.3	0.1
19. Gross domestic product	1.2	3.2	0.1	-1.1	-1.0	0.6	-0.8	-3.6	-5.5	-3.0	-1.5	3.0	2.3	-0.5	2.4

Source: Bank of Thailand.

Minor effects are observed in the public administration and defense and compulsory social security sectors, which even registered positive changes during much of 1998. The growth of this sector during the crisis is supported by increasing employment in the public sector. Growth in the education sector is likely to have had only a minor effect as changes in this sector's quarterly GDP were positive in late-1997 and 1998. On the other hand, quarterly GDP growth in the health and social work sectors was negative during much of 1998.

Improvement in the 1999 manufacturing production indexes, capacity utilization indexes, and GDP are supported by an increase in key private investment indicators. Table 7 shows that these indicators have been improving since mid-1999.

Table 7 Key private investment indicators

	1999									
	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Private investment index	-73.3	-49.6	-16.7	41.3	148.9	259.1	486.2	725.7	1,035.6	1,210.5
(% changes of 12-month MA)	21.0	18.6	-16.2	-14.5	-10.9	-9.0	-7.0	-5.0	0.0	0.0
Import value of capital goods (baht)	-15.0	-2.3	-9.3	9.8	-7.6	12.7	18.9	28.9	39.7	na
Import value of capital goods (US\$)	-5.4	2.9	-4.7	25.5	3.1	23.2	21.2	24.5	31.4	na
Domestic cement consumption	-12.7	-12.7	-15.2	3.0	5.6	-7.3	1.3	-14.3	-0.6	14.6
Commercial banks' credit for industry	-4.4	-2.9	-3.7	-3.2	-1.6	-1.8	-2.2	-2.5	-0.3	na
Commercial banks' credit for construction	3.6	7.1	5.6	0.5	3.0	5.7	na	0.6	0.6	na

Source: *Thailand Economic Monitor* (January 2000), The World Bank.

In sum, the adverse economic impacts of the crisis have been uneven and more concentrated in some sectors, such as construction, finance, and agriculture, than others. However, the impacts have changed according to the economic situation at different periods of time. Thus, the magnitude and severity of the impacts on economic and social sectors varies depending on the overall economic situation and adjustments within these sectors at certain periods. The following sections, then, explore these adjustments and the impacts on the labor market, poverty, and the social sectors.

2. Labor Market Adjustment

2.1 Overview

The crisis has changed the Thai labor market from a “tight” to a “surplus” structure. However, data reveals that the Thai labor market has adjusted to the crisis with certain degrees of flexibility, in terms of wage adjustment and labor mobility (among areas and sectors), which helps cushion the impact of unemployment. In addition, the problems of workers seem to be implicit in terms of underemployment rather than obvious unemployment.

During the era of rapid growth before the crisis, the Thai labor market tightened. This is clearly evident from the low open unemployment rates and from the rapid rise in wage rates. One observation is that Thai authorities have had to accept low-skilled economic refugees from neighboring countries (Yongyuth 1998). When the bubble burst, many employees were laid off and unemployment increased. The crisis has given the Thai labor market a more labor-surplus structure (for unskilled and medium skilled workers), with some degree of segmentation (for workers with specific high skills).

There has been adjustment in the Thai labor market since the onset of the crisis. Table 8 summarizes some key indicators in order to see the overall adjustment.

Table 8 Key indexes of labor adjustment

Key Indicators : all areas	Dry Season (Round 1)				Wet Season (Round 3)			
	1996	1997	1998	1999	1996	1997	1998	1999
Employed	29,986,639	30,171,436	29,355,528	29,946,399	32,234,265	32,962,602	32,200,505	32,124,003
Unemployed (exclude seasonally unemployed)	640,724	697,592	1,479,269	1,714,720	353,171	293,230	1,137,926	984,226
Seasonally unemployed	1,154,782	1,033,474	1,250,315	1,070,640	163,336	105,336	77,245	137,473
Total Labor force	31,782,145	31,902,502	32,085,112	32,731,759	32,750,772	33,361,168	33,415,676	33,245,702
Out of labor force	13,579,103	14,169,356	14,723,464	14,766,713	12,942,482	13,040,842	13,754,078	14,593,323
Average real wage (monthly)	5,220	5,503	5,249	5,292	5,688	5,950	5,720	5,564
Total hours worked/ week	1,539,874,004	1,544,566,093	1,419,299,332	1,488,408,801	1,657,300,530	1,653,139,798	1,640,736,631	1,610,648,331
Average hours worked/ week	51.4	51.2	48.3	49.7	51.4	50.2	51.0	50.0
Average time looking for work (days)	86.4	60.1	69.4	92.8	68.4	74.0	87.5	91.0
Labor force participation rate	70.1	69.2	68.5	68.9	71.7	71.9	70.8	69.5
Unemployment rate	2.0	2.2	4.6	5.2	1.1	0.9	3.4	3.0
Underemployment rate (<30 hours/week)	5.9	5.5	10.1	7.6	5.3	9.1	6.6	7.0

Source: Labor Force Survey, National Statistical Office.

The crisis in 1997 reversed the situation of labor scarcity of 1995-1996, creating a situation of labor surplus. The unemployment rate, however, is not too high because wage adjustment is relatively flexible (Manning 1999). While the unemployment rate increased 2.4 percent during the dry season of 1997-1998, real average wage earnings (monthly) fell 4.62 percent over the same period. Also, a reduction in the number of hours worked is even more evident as underemployment seems to be more crucial than unemployment. This is especially obvious in the first year of the crisis. While the unemployment rate increased from 2.2 percent in 1997 to 4.6 percent in 1998 and 5.2 percent in February (dry season) 1999, underemployment (less than 30 hrs.)¹³ increased from 5.5 percent to 10.1 percent and 7.6 percent over the same period. Changes in the indicators in the wet seasons (August) show similar results as those of the dry season as the unemployment and underemployment rates increased, while real wages declined in 1998. Changes in the underemployment rate are more sensitive than changes in the unemployment rate.

The trend of the underemployment rate is consistent with the trend of average hours worked during 1996-1999 as year-on-year indicators deteriorated in the first year of the crisis (August 1997 and February 1998) and improved in the second year (August 1998 and February 1999). This is consistent with the improvement in the economic situation in early 1999 following the severe economic recession of 1997 and 1998.

Labor force participation gradually dropped in 1997 and 1998 for both the dry and wet seasons, and improved slightly in the dry season of 1999. Also, the number of people out of the labor force increased over the same period. This may due to the fact that fewer job opportunities in the labor market discouraged participation.

However, considering the period of getting a job indicated by the average number of days looking for work this indicator has continued to increase in both the dry and wet seasons since the onset of the crisis. It increased from 60 days to 69.4 days and 92.8 days in February 1997, 1998, and 1999 respectively. Similarly, it increased from 74 to 87.5 days and 91 days in August 1997, 1998, and 1999, respectively. The longer time spent finding jobs may reflect the more limited job opportunities in labor market. In other words, it indicates a degree of labor segmentation, especially in Bangkok where the unemployed spent the longest average number of days looking for jobs. In addition, as people were still spending a longer time finding jobs in 1999, it means the improvement in the economic indicators of 1999 had not yet significantly created new job opportunities.

Nevertheless, data in August 1999 has not yet confirmed a significant improvement in other indicators. While the unemployment rate of 3 percent shows a little improvement, other indicators, such as the average number of hours worked and the real average wage, declined, which is also consistent with the rising underemployment rate 7 percent). Labor force participation also dropped to 69.5 percent in August 1999 from 70.8 percent in 1998. Seasonal unemployment in the wet season of 1999 was as high as 137,473 persons, about double the previous year.

2.2 Uneven impact by sectors

In considering the labor market impact by sectors, we can study two dimensions:

- 1) The formal and informal sectors and
- 2) The disaggregating economic sectors.

¹³ Underemployment rate in this paper is defined as the number of workers who work less than 30 hours a week over the total labor force.

2.2.1 Formal and informal¹⁴ sectoral employment

Thai labor market is “bi-segmented” into the formal and informal sectors. Generally speaking, the formal sector is characterized by the modern sector, with formal employment contracts regulated by the labor law on such issues as minimum wages and other welfare benefits requirements. This sector usually exhibits some degree of impediment to new entrants and wages are quite rigid, i.e., they do not completely respond to the forces of supply and demand. On the other hand, the informal sector is normally characterized by the more traditional sector with very small enterprises and where wages are highly flexible and where new entrants have easy access.

It is clear from Table 9 that, in the past, the formal/informal split more or less followed the development of the industrialization process of the Thai economy with continuing expansion of the formal sector's share and a diminishing share of the informal sector. The crisis, however, had adverse impacts on the real sector and reversed this trend.

When an economy goes into deep recession the expectation is that the formal sector will reduce its number of employees. They will then be absorbed into the informal sector, causing it to expand. However, our data analysis reveals that this process may have a time lag.

Contrary to expectations, the formal/ informal employment share expanded in the first year of the crisis.¹⁵ The share of the formal sector expanded in the dry season of 1998; while the formal/informal split stayed the same in the wet season of 1998 and started to reverse in the dry season of 1999, when the share of the informal sector expanded (see Table 9.1).

This trend supports the hypothesis that the share of the informal sector expanded to absorb labor in the second year of the crisis. However, in late 1999 the economy started to recovery and, thus, data in the wet season (August) of 1999 shows that the formal sector gradually started to expand its employment, as well as working hours (see Table 9.2). The trends of formal/informal employment and working hours are consistent during these periods.

The crisis in 1997 in Thailand may reflect a unique characteristic in the immediate impact on employment, where the informal sector was affected immediately, during the first year. According to data in Table 9, informal employment contracted in the dry season of 1998, although it absorbed more labor in the wet season of 1997. Table 10 shows that, in contrast to expectations, the share of formal employment rose (2.6 percent or 250,000) and the share of informal employment declined in the dry season of 1998 (–5.2 percent or –1,065,574).

The contraction of the informal sector in 1998 resulted in the main from a decline in the number of informal private employees (about 936,000 jobs lost in the dry season of 1998) (see Table 11 (a & b)). Although the reduction in the number of private employees covered most sectors, it was especially noticeable in the finance and real estate sector, which contracted about 50 percent from 1997, followed by construction, which contracted about 37 percent.

The first informal private employees to be affected were those who were relatively unskilled and who worked on a temporary basis in small enterprises as they had fewer options to adjust to the crisis. In the first year of the crisis, starting in July 1997, Thailand experienced

¹⁴ The definition of formal/ informal in this paper follows Chalongphob (1987). Those who work in the formal sector are (i) public employees or in state enterprises; (ii) private employees, employers, own account workers, or unpaid family workers with the size of establishments greater than 10 workers; (iii) groups (iv) occupations with a size of less than 10 workers but where some occupation could reasonably be classified in the formal sector, e.g., lawyers, doctors, executives, etc.

¹⁵ This is due to the complexity of the economic situation during the first year of the crisis when the informal sector was the first to be hit.

sharp contractions in its fiscal and monetary policies and experienced severe credit crunches, which badly hurt the real sector, especially small operations.

Table 9 Percentage share of informal/formal sectors in dry and wet seasons

Year	9.1 Share of informal / formal employment (persons)				9.2 Share of informal / formal working hours (hours)			
	Dry Season		Wet Season		Dry Season		Wet Season	
	Informal	Formal	Informal	Formal	Informal	Formal	Informal	Formal
1994	70.8	29.2	76.2	23.8	72.4	27.6	78.3	21.7
1995	63.3	30.7	74.5	25.5	70.9	29.1	76.6	23.4
1996	68.0	32.0	73.5	26.5	69.2	30.8	75.1	24.9
1997	68.1	31.9	73.2	26.8	69.6	30.4	76.7	23.3
1998	66.4	33.6	73.2	26.8	69.0	31.0	75.4	24.6
1999	68.6	31.4	72.2	27.8	70.0	30.0	74.2	25.8

Source: Labor Force Survey, National Statistical Office.

Table 10 Employment changes in formal and informal sectors

Unit: Person

Dry season	1994	1995	1996	1997	1998	1999
Informal	20,124,872	20,066,625	20,390,456	20,544,933	19,479,359	20,545,380
<i>Change from previous year</i>		-58,247	323,831	154,477	-1,065,574	1,066,021
<i>Percentage change from previous year</i>		-0.3	1.6	0.8	-5.2	5.5
Formal	8,312,594	8,879,841	9,596,183	9,626,505	9,876,171	9,401,017
<i>Change from previous year</i>		567,247	716,342	30,322	249,666	-475,154
<i>Percentage change from previous year</i>		6.8	8.1	0.3	2.6	-4.8
Total	28,437,466	28,946,466	29,986,639	30,171,438	29,355,530	
Wet season						
Informal	24,632,711	24,295,383	23,702,649	24,126,579	23,575,602	
<i>Change from previous year</i>		-337,328	-592,734	423,930	-550,977	
<i>Percentage change from previous year</i>		-1.4	-2.4	1.8	-2.3	
Formal	7,694,113	8,294,640	8,531,618	8,836,021	8,624,907	
<i>Change from previous year</i>		600,527	236,978	304,403	-211,114	
<i>Percentage change from previous year</i>		7.8	2.9	3.6	-2.4	
Total	32,326,824	32,590,023	32,234,267	32,962,600	32,200,509	

Source: Labor Force Survey, National Statistical Office.

In contrast, larger formal enterprises had more options to deal with the crisis, such as more credit channels, reducing wages and bonuses and working hours, so they were able to stay in business, at least in the shorter term. In addition, formal private employment in some export-oriented activities (i.e., agriculture and manufacturing) expanded, possibly as a result of the depreciation of the baht.

Despite the strong negative impact of the crisis on employment, expansion in these two exporting sectors helped alleviate the severe reduction of formal employment in other sectors. Also, most of the increase in formal employment in February 1998 was due to a huge jump in the number of public employees and state enterprise employees (which continued in the wet season of 1998 and started to stabilize in 1999). This resulted from an expansion in Government and other public services, public utilities and transportation sectors during that period.

Table 11 Employment of private employees by sectors and formal/informal breakdown (Person)**(a) Dry season (February)**

Formal	1994	1995	1996	1997	1998	1999	97-98 change	%	98-99 change	%
Agriculture	721,142	653,735	698,559	612,197	974,252	840,477	362,055	59.1	-133,775	-13.7
Manufacturing	2,141,647	2,360,991	2,675,095	2,658,775	2,802,767	2,648,050	143,992	5.4	-154,717	-5.5
Construction	1,034,077	1,309,901	1,590,699	1,404,989	959,982	653,844	-445,007	-31.7	-306,138	-31.9
Commerce	526,473	637,479	705,074	755,098	702,469	725,250	-52,629	-7.0	22,781	3.2
Finance & real estate	235,596	179,970	235,397	287,161	245,087	235,821	-42,074	-14.7	-9,266	-3.8
Services	786,254	806,153	885,968	973,778	986,316	1,068,501	12,538	1.3	82,185	8.3
Total	5,445,189	5,948,229	6,790,792	6,691,998	6,670,873	6,171,943	-21,125	-0.3	-498,930	-7.5
Informal										
Agriculture	1,428,090	1,351,759	1,436,765	1,379,455	1,099,329	1,158,657	-280,126	-20.3	59,328	5.4
Manufacturing	969,472	1,030,469	875,384	950,153	809,111	830,666	-141,042	-14.8	21,555	2.7
Construction	977,320	1,093,606	1,230,999	1,318,886	826,086	708,931	-492,800	-37.4	-117,155	-14.2
Commerce	451,644	472,004	583,238	492,452	505,732	538,646	13,280	2.7	32,914	6.5
Finance & real estate	20,639	18,816	15,804	23,976	11,915	9,149	-12,061	-50.3	-2,766	-23.2
Services	647,071	785,632	720,195	763,388	739,383	778,472	-24,005	-3.1	39,089	5.3
Total	4,494,236	4,752,286	4,862,385	4,928,310	3,991,556	4,024,521	-936,754	-19.0	32,965	0.8

(b) Wet season (August)

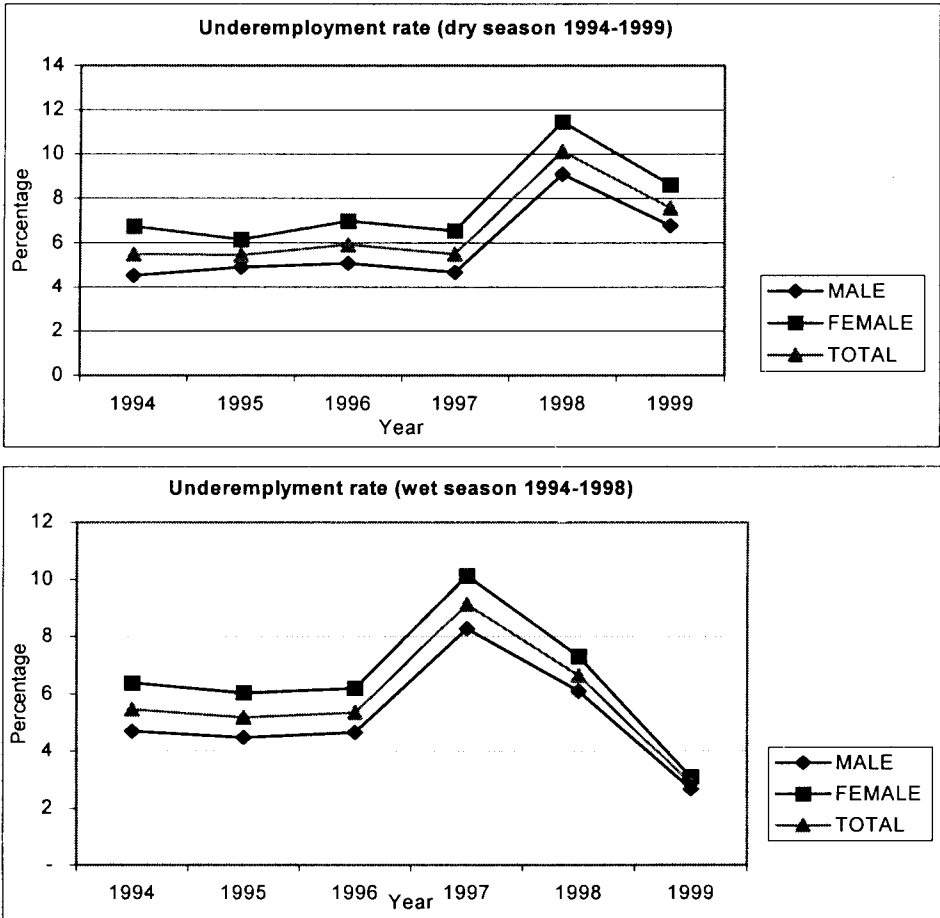
Formal	1994	1995	1996	1997	1998	1999	97-98 change	%	98-99 change	%
Agriculture	379,061	329,288	387,999	320,455	391,690	478,586	71,235	22.2	86,896	22.2
Manufacturing	2,104,451	2,362,989	2,478,752	2,542,418	2,625,837	2,620,419	83,419	3.3	-5,418	-0.2
Construction	808,387	939,127	1,083,183	950,431	585,981	540,537	-364,450	-38.3	-45,444	-7.8
Commerce	518,466	711,428	760,262	845,801	662,523	749,024	183,278	21.7	86,501	13.1
Finance & real estate	231,040	198,678	217,013	309,080	233,389	271,701	75,691	24.5	38,312	16.4
Services	806,985	822,327	819,093	1,005,639	906,113	994,405	99,526	9.9	88,292	9.7
Total	4,848,390	5,363,837	5,746,302	5,973,824	5,405,533	5,654,672	-568,291	-9.5	249,139	4.6
Informal										
Agriculture	1,485,191	1,302,939	1,175,363	1,256,120	1,338,995	1,330,634	82,875	6.6	-8,361	-0.6
Manufacturing	658,701	793,222	823,418	750,987	603,491	686,386	147,496	19.6	82,895	13.7
Construction	702,046	643,410	859,089	854,967	519,072	570,395	335,895	39.3	51,323	9.9
Commerce	365,770	424,812	504,823	535,287	503,082	552,756	32,205	6.0	49,674	9.9
Finance & real estate	23,112	19,144	16,200	15,143	14,019	9,862	-1,124	-7.4	-4,157	-29.7
Services	603,555	636,582	721,982	653,363	655,338	707,296	1,975	0.3	51,958	7.9
Total	3,838,375	3,820,109	4,100,875	4,065,867	3,633,997	3,857,329	431,870	10.6	223,332	6.1

Source: Labor Force Survey, National Statistical Office.

The negative impacts on the formal sector are apparent in August 1998 when the sector sharply contracted in terms of employment (-2.4 percent or -211,000). As expected, the reduction resulted from widespread lay-offs among private employees. Formal employment of private employees dropped sharply in August 1998 (-9.5 percent or -568,000) and continued to drop in February 1999 (-7.5 percent or -498,930) despite its previously increasing trend of about 7 percent average annual growth between 1994-1997. An increase in formal private employment in agriculture and manufacturing in early 1997 was dominated by a more evident contraction in the number of employees in construction, commerce, finance and real estate, and services, resulting in a net reduction of formal private employees. As the benefits gained from the baht's depreciation disappeared in February 1999, the formal agriculture and manufacturing sectors started to show a decline in employment, allied with a continuing decline in construction. The reduction in the number of formal private employees in August 1998 and February 1999 is an expected adjustment of the labor market during an economic recession.

One reason for the high number of lay offs before August 1998 could be the implementation of severance payments in August 1998. Before the enactment of the increase in severance payments from six to 10 months in March 1998, formal employers could reduce labor costs by keeping workers highly underemployed rather than immediately lay them off. This makes the underemployment rate in February 1998 very high, as seen in Figure 2A.

Figure 2a Underemployment rate in February and August (1994-1999)

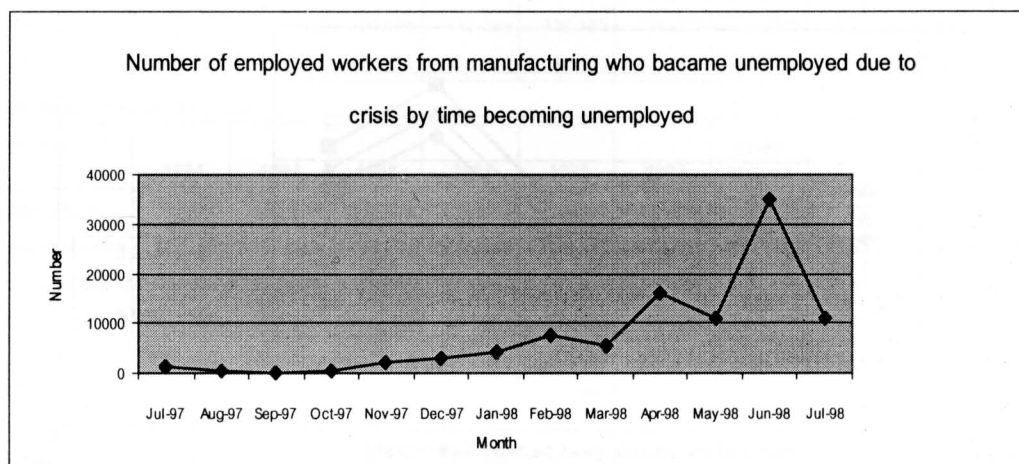


To avoid increased severance payments from August 1998, formal employees chose to lay off workers before that time (confirmed by Figure 2B). This contributed to a sharp drop in private employees in the survey period in August 1998, especially when compared to February 1998.

The absorption of the informal sector is evident from data in February 1999 when informal employment expanded, mainly from own account and unpaid family workers, as well as informal employers. This also contributed to a large increase in agricultural employment in early 1999. The formal sector, on the other hand, exhibited a strong negative impact of the crisis in February 1999, with a reduction of -4.8 percent or -475,000 workers, resulting from huge lay-offs in formal private employees. The reduction in formal employees out-weighted the increase in formal own account and unpaid family workers. Thus, the share of formal/informal employment expanded in February 1999 data, as hypothetically expected in the second year of the crisis. The contraction of the informal sector in August 1999 is particularly associated with the sharp contraction in agricultural employment at that time.

The contrasting adjustments of the formal/informal sectors in the first and the second years of the crisis¹⁶ reveal that the economic impacts in the two years were of different magnitude and complexity. Therefore, there was an adjustment lag for informal employment absorption once the crisis struck.

Figure 2b Number of unemployed workers from manufacturing who became unemployed due to the crisis* and the time they became unemployed



Note: * Unemployed labor who became unemployed due to the crisis are defined as those unemployed since July 1997 with reasons for unemployment per one of the following:

- Dissolved off
- firms (for owners)
- Firms stopped operations (for employees)
- Being laid Reduced wages and/or other fringe benefits

¹⁶ Data in February 1998 (dry season) can reflect the situation in the first year and that in February 1999 can reflect the situation in the second year.

Table 12 Employment by formal/informal sectors by work status, February 1996-1999

Unit: Person

	1994	1995	1996	1997	1998	1999
Private employees						
<i>Informal</i>	4,494,236	4,752,286	4,862,385	4,928,310	3,991,556	4,024,521
Change from previous year		258,050	110,099	65,925	-936,754	32,965
Percentage change from previous year		5.7	2.3	1.4	-19.0	0.8
<i>Formal</i>	5,445,189	5,948,229	6,790,792	6,691,998	6,670,873	6,171,943
Change from previous year		503,040	842,563	-98,794	-21,125	-498,930
Percentage change from previous year		9.2	14.2	-1.5	-0.3	-7.5
<i>Total</i>	9,939,425	10,700,515	11,653,177	11,620,308	10,662,429	10,196,464
Change from previous year		761,090	952,662	-32,869	-957,879	-465,965
Percentage change from previous year		7.7	8.9	-0.3	-8.2	-4.4
Public employees						
<i>Informal</i>						
Change from previous year						
Percentage change from previous year						
<i>Formal</i>	2,016,840	2,045,962	1,971,357	2,044,628	2,200,862	2,211,175
Change from previous year		29,122	-74,605	73,271	156,234	10,313
Percentage change from previous year		1.4	-3.6	3.7	7.6	0.5
<i>Total</i>	2,016,840	2,045,962	1,971,357	2,044,628	2,200,862	2,211,175
Change from previous year		29,122	-74,605	73,271	156,234	10,313
Percentage change from previous year		1.4	-3.6	3.7	7.6	0.5
Employers						
<i>Informal</i>	308,580	243,991	410,519	312,572	306,501	434,891
Change from previous year		-64,589	166,528	-97,947	-6,071	128,390
Percentage change from previous year		-20.9	68.3	-23.9	-1.9	41.9
<i>Formal</i>	383,583	428,345	424,131	453,486	473,490	503,434
Change from previous year		44,762	-4,214	29,355	20,004	29,944
Percentage change from previous year		11.7	-1.0	6.9	4.4	6.3
<i>Total</i>	692,163	672,336	834,650	766,058	779,991	938,325
Change from previous year		-19,827	162,314	-68,592	13,933	158,334
Percentage change from previous year		-2.9	24.1	-8.2	1.8	20.3
Own account workers						
<i>Informal</i>	9,403,696	9,372,621	9,259,873	9,207,725	9,412,397	9,993,787
Change from previous year		-31,075	-112,748	-52,148	204,672	581,390
Percentage change from previous year		-0.3	-1.2	-0.6	2.2	6.2
<i>Formal</i>	44,167	65,038	54,669	49,922	50,034	66,411
Change from previous year		20,871	-10,369	-4,747	112	16,377
Percentage change from previous year		47.3	-15.9	-8.7	0.2	32.7
<i>Total</i>	9,447,863	9,437,659	9,314,542	9,257,647	9,462,431	10,060,198
Change from previous year		-10,204	-123,117	-56,895	204,784	597,767
Percentage change from previous year		-0.1	-1.3	-0.6	2.2	6.3

(Continued on page 42)

Table 12 (Continued)

	Unit: Person					
	1994	1995	1996	1997	1998	1999
Unpaid family workers						
<i>Informal</i>	5,918,360	5,697,727	5,857,679	6,096,326	5,768,905	6,092,181
Change from previous year		-220,633	159,952	238,647	-327,421	323,276
Percentage change from previous year		-3.7	2.8	4.1	-5.4	5.6
<i>Formal</i>	19,458	36,227	27,788	26,680	27,413	37,378
Change from previous year		16,769	-8,439	-1,108	733	9,965
Percentage change from previous year		86.2	-23.3	-4.0	2.7	36.4
<i>Total</i>	5,937,818	5,733,954	5,885,467	6,123,006	5,796,318	6,129,559
Change from previous year		-203,864	151,513	237,539	-326,688	333,241
Percentage change from previous year		-3.4	2.6	4.0	-5.3	5.7
State enterprise employees						
<i>Informal</i>						
Change from previous year						
Percentage change from previous year						
<i>Formal</i>	403,357	356,040	327,446	359,791	453,499	410,676
Change from previous year		-47,317	-28,594	32,345	93,708	-42,823
Percentage change from previous year		-11.7	-8.0	9.9	26.0	-9.4
<i>Total</i>	403,357	356,040	327,446	359,791	453,499	410,676
Change from previous year		-47,317	-28,594	32,345	93,708	-42,823
Percentage change from previous year		-11.7	-8.0	9.9	26.0	-9.4

Source: Labor Force Survey, National Statistical Office.

2.2.2 Employment by economic sectors

Labor adjustments can also be seen from labor movement among economic sectors. From Table 13, it is obvious that employment in construction dropped significantly. The manufacturing and finance and real estate sectors also lost employment. On the other hand, services and commerce gained more employment. However, the magnitude of the changes in sectoral employment in 1999 was smaller than that of 1998. Detailed discussion of employment changes in each sector is as follows:

Although actual employment in the agricultural sector contracted in 1998, its employment share increased for both 1998 and early 1999. This is clearly illustrated in February 1999 when the sector gained a large number of workers (about 900,000) and employment share (about 2.2 percent). The pattern of employment changes in the agricultural sector is interesting. Detailed data on formal/informal employment indicates that while the formal sector mainly private employees absorbed more employment in February 1998, the informal sector mainly own account and unpaid family workers absorbed more employment in February 1999. The increase in the formal private sector in 1998 was likely due to the positive effects of the baht's depreciation, which benefited large enterprises involved in export activities.

Table 13 Employment by economic sector

	1994	1995	1996	1997	1998	1999	97-98 change	%	98-99 change	%
(a) Dry season (Round 1)										
Agriculture	12,621,038 44.4	11,811,629 40.8	12,093,552 40.3	11,895,014 39.4	11,626,798 39.6	12,532,424 41.8	-268,216	-2.3	905,626	7.8
Manufacturing	4,511,992 15.9	4,888,533 16.9	5,016,052 16.7	5,046,384 16.7	4,974,658 16.9	4,920,604 16.4	-71,726	-1.4	-54,054	-1.1
Construction	2,283,629 8.0	2,637,677 9.1	3,113,754 10.4	2,977,499 9.9	2,035,383 6.9	1,552,203 5.2	-942,116	-31.6	-483,180	-23.7
Commerce	3,627,836 12.8	3,994,460 13.8	4,123,593 13.8	4,204,441 13.9	4,386,574 14.9	4,478,510 15.0	182,133	4.3	91,936	2.1
Finance & real estate	325,905 1.1	263,942 0.9	311,971 1.0	381,901 1.3	344,736 1.2	329,616 1.1	-37,165	-9.7	-15,120	-4.4
Services	5,067,066 17.8	5,350,227 18.5	5,327,716 17.8	5,666,197 18.8	5,987,379 20.4	6,133,043 20.5	321,183	5.7	145,664	2.4
Total	28,437,465 100.0	28,946,468 100.0	29,986,639 100.0	30,171,435 100.0	29,355,529 100.0	29,946,400 100.0	-815,907	-2.7	590,871	2.0
(b) Wet season (Round 3)										
Agriculture	18,144,856 56.1	16,948,379 52.0	16,128,041 50.0	16,581,001 50.3	16,520,255 51.3	15,599,634 48.6	-60,746	-0.4	-920,621	-5.6
Manufacturing	3,840,035 11.9	4,420,696 13.6	4,380,415 13.6	4,329,333 13.1	4,230,485 13.1	4,443,699 13.8	-98,848	-2.3	213,214	5.0
Construction	1,696,318 5.2	1,845,175 5.7	2,171,002 6.7	2,011,323 6.1	1,280,678 4.0	1,284,887 4.0	-730,645	-36.3	4,208	0.3
Commerce	3,338,314 10.3	3,811,646 11.7	4,050,197 12.6	4,166,377 12.6	4,125,751 12.8	4,393,224 13.7	-40,626	-1.0	267,472	6.5
Finance & real estate	321,570 1.0	284,335 0.9	292,497 0.9	404,414 1.2	346,437 1.1	349,554 1.1	-57,977	-14.3	3,117	0.9
Services	4,985,736 15.4	5,279,791 16.2	5,212,114 16.2	5,470,153 16.6	5,696,899 17.7	6,053,006 18.8	226,746	4.1	356,106	6.3
Total	32,326,828 100.0	32,590,023 100.0	32,234,265 100.0	32,962,601 100.0	32,200,506 100.0	32,124,003 100.00	-762,096	-2.3	-76,503	-0.2

Sources: Labor Force Survey, National Statistical Office.

However, formal agricultural employment, mainly resulting from the decline in the number of formal private employees, dropped 11 percent in 1999, which may be attributed to the negation of the beneficial effects of the baht's depreciation when most agricultural product prices declined to pre-crisis levels.

On the other hand, it is interesting to note that agriculture's informal sector, which contracted in both the dry and wet seasons of 1998, drastically gained employment in the dry season of 1999 (about one million). This is consistent with the fact that rural employment in 1999 increased by about 500,000 persons. This is also consistent with the fact that employment possibilities for urban-rural migrants increased. However, this trend reversed in August 1999 when total agricultural employment contracted by about 920,000, and its employment share declined. This contrasts with other sectors' improvement in employment in late 1999, compared with the previous year. This may reflect that the agricultural sector may not be able to continue expanding employment in the long term.

Manufacturing showed a very small reduction in employment, despite the generally accepted severe negative impact of the crisis on the sector. There was a reduction of 72,000 workers or -1.4 percent in the dry season of 1998, then -99,000 or -2.3 percent in the wet season of 1998, and finally -54,000 or -1.1 percent in the dry season 1999.

However, greater impacts on the manufacturing sector appear in terms of changes in hours worked, rather than changes in the numbers of employment. In fact, "formal" employment in the manufacturing sector actually expanded in both the dry and wet seasons of 1998; and it only contracted in the dry season 1999. The shifting of private employees from the informal to the formal sector in manufacturing may partly be attributed to a long-term trend as the Thai manufacturing sector becomes increasingly modernized.

Similar to agricultural employment, the depreciation of the baht appears to have had a positive impact on some "formal" labor intensive and export-oriented manufacturing firms in 1998, while this advantage disappeared in 1999. On the other hand, the informal manufacturing sector for both the dry and wet seasons in 1998 contracted, with a slight increase in the dry season of 1999.

In sum, despite the negligible effect on manufacturing employment as a whole, the effect of the crisis on the industry was unequally distributed between the formal and informal sectors. There was almost a balancing effect, with employment expansion in the formal sector offsetting contraction in its informal counterpart. Manufacturing employment expanded further in August 1999 (5 percent), consistent with improving manufacturing production indexes in 1999.

Construction appeared to be the hardest-hit sector with an employment reduction of 942,000 or -31.6 percent in the dry season of 1998, -731,000 or -36.3 percent in the wet season of 1998, and -483,000 or -23.7 percent in the dry season of 1999. It is worth noting that employment in this sector had started to decline since 1996, possibly reflecting over-supply well before the crisis. Data in August 1999 shows a slight improvement in employment (0.3 percent) for the first time. This is also consistent with the improvement of the construction sector's production indexes in 1999.

Although employment in finance and real estate is relatively small, it shows a significant percentage decline. Employment dropped -37,000 or -9.7 percent in the dry season of 1998, -58,000 or -14.3 percent in the wet season, and -15,000 or -4.4 percent in the dry season of 1999. This continuing decline in employment possibly reflects the ongoing closure of failed financial companies since the middle of 1997. However, data in August 1999 shows a slight turnaround in employment at 0.9 percent.

For the commerce industry (wholesale and retail), except for a small drop in the wet season of 1998, employment increased by 4.3 percent in the dry season of 1998 and 2.1

percent in 1999. Detailed data reveals that this expansion is due to expansion in the “informal” commercial sector, which is comprised primarily of own account and unpaid family workers.

The continuing expansion of the informal commercial sector was reflected in a 7.6 percent increase in employment in the dry season of 1998, 3.7 percent in the wet season of 1998 and 1 percent increase in 1999. On the other hand, the commercial “formal” sector, which is comprised primarily of private employees, experienced a sharp decline in employment in both the dry and wet seasons of 1998 (−7.6 percent and −16.8 percent respectively), starting to pick up only in 1999 (+6.8 percent).

This analysis sheds some light on the public perception that some people previously working in the formal sector have tried to create their own businesses in the informal sector. With the majority of commercial workers in the informal sector, entry for new workers is relatively easy. Figures show that since the crisis broke in the middle of 1997, unemployed people have sought work in the informal commercial sector mostly in the dry and wet seasons of 1998. As the economy as a whole started to improve in 1999, sectoral employment expanded, with an especially significant expansion of 6.5 percent in August 1999.

The services industry also continued its general increasing trend of employment for both the dry and wet seasons of 1998 and the dry season 1999. The most significant contribution to an increase in employment in the dry and wet seasons of 1998 came from a noticeable jump in employment in Government public services (e.g., federal, provincial, and local administration) and other public services (e.g., schools, hospitals, professional association, etc.). This is consistent with the previous observation of a huge jump in the number of public servants when formal employment expanded. Another contributing factor was a surge in employment in personal and other services e.g., laundry, accommodation, restaurants, etc. One might reasonably expect the “personal and other services” sub-sector to comprise primarily workers in the informal sector. This is consistent with previous observations of an increase in informal own account workers in the service industry. This service sub-sector could also be regarded as another option for laid-off workers, as with the “commerce informal sector” discussed earlier. Similar to the commerce sector, employment in the services sector increased significantly in August 1999, consistent with the overall improvement of the economic situation.

Changes in the total and average numbers of hours worked by sector

The adverse effects of the crisis are more severe in terms of a drop in the number of hours worked than an explicit change in unemployment. Changes in total hours worked in the economy are an indicator underlining changes in underemployment and employment. Changes in total and average numbers of hours worked are presented in Table 14.

The immediate impact of the economic collapse can be seen in the drastic decline in the total hours worked in the dry season of 1998, in which construction's hours registered the largest decline (−35.5%), followed by manufacturing (−14.1%) and finance and real estate (−13.5%). The drops in total hours worked for each sector were more than the drops in employment. Even the services sector, which gained employment, experienced a decline in total hours worked (−4.5%). The decline in hours worked was, however, less dramatic and started to improve in the wet season of 1998 and the dry season 1999.

Obviously, the manufacturing sector experienced a sharp drop in sectoral hours worked, accounting for −14.1 percent, which was much higher than the drop in employment, −1.4 percent. The fact that the manufacturing sector experienced the largest reduction in hours worked but a smaller contraction in employment in February 1998 may point to labor

Table 14 Changes in house worked by economic sector

Unit: Hours

Dry season		1994	1995	1996	1997	1998	1999	1997-1998	%	1998-1999	%
Agriculture	Average	51	50	50	50	49	48	-1	-1.8	-1	-1.6
	Total	643,967,143	596,443,547	606,518,005	596,406,603	572,391,723	607,089,823	-24,014,880	-4.0	34,698,100	6.1
Manufacturing	Average	51	51	51	51	44	50	-7	-12.9	6	13.3
	Total	228,731,238	247,028,970	255,848,977	255,133,275	219,068,599	245,513,801	-36,064,676	-14.1	26,445,202	12.1
Construction	Average	54	54	55	54	51	52	-3	-5.5	1	1.3
	Total	124,365,114	141,705,586	170,467,689	162,263,459	104,777,893	80,959,448	-57,485,566	-35.4	-23,818,445	-22.7
Commerce	Average	56	56	56	56	52	55	-4	-6.8	3	5.4
	Total	203,271,136	223,521,440	232,798,306	235,412,269	228,951,075	246,466,761	-6,461,194	-2.7	17,515,686	7.7
Finance & real estate	Average	43	44	43	43	41	42	-2	-4.2	1	2.5
	Total	14,048,681	11,631,408	13,536,959	16,388,781	14,175,639	13,888,951	-2,213,142	-13.5	-286,688	-2.0
Service	Average	48	48	49	49	47	48	-2	-5.0	1	2.7
	Total	244,954,419	258,437,444	260,704,067	278,961,707	279,934,404	294,490,017	972,698	0.3	14,555,613	5.2
Total	Average	51	51	51	51	48	50	-3	-5.6	1	2.8
	Total	1,459,337,730	1,478,768,395	1,539,874,004	1,544,566,093	1,419,299,332	1,488,408,801	-125,266,761	-8.1	69,109,469	4.9
Wet season		1994	1995	1996	1997	1998	1999	1997-1998	%	1998-1999	%
Agriculture	Average	53	53	51	52	52	50	0	-0.9	-2	-3.1
	Total	963,952,694	898,249,453	828,187,472	862,436,691	851,182,700	778,861,458	-11,253,992	-1.3	-72,321,242	-8.5
Manufacturing	Average	51	50	51	47	50	50	2	4.6	0.1	0.3
	Total	194,103,976	222,512,900	221,888,335	205,163,336	209,604,883	220,769,320	4,441,547	2.2	11,164,437	5.3
Construction	Average	54	54	53	51	52	51	0	0.5	-0.43	-0.8
	Total	91,142,338	99,030,469	115,464,374	103,224,841	66,055,934	65,714,635	-37,168,908	-36.0	-341,298	-0.5
Commerce	Average	56	56	56	54	55	55	1	2.6	0.03	0.1
	Total	186,554,123	212,182,862	225,518,888	224,141,702	227,760,409	242,671,591	3,618,707	1.6	14,911,182	6.5
Finance & real estate	Average	43	43	44	38	42	42	5	12.5	0.08	0.2
	Total	13,808,568	12,338,638	12,961,766	15,169,282	14,612,591	14,773,670	-556,690	-3.7	161,079	1.1
Service	Average	48	49	49	44	48	48	3	7.3	-0.10	-0.2
	Total	240,940,532	256,946,727	253,279,694	243,003,946	271,520,115	287,857,656	28,516,169	11.7	16,337,541	6.0
Total	Average	52	52	51	50	51	50	1	1.6	-0.8	-1.6
	Total	1,690,502,231	1,701,261,049	1,657,300,530	1,653,139,798	1,640,736,631	1,610,648,331	-12,403,166	-0.8	-30,088,300	-1.8

Source: Labor Force Survey, National Statistical Office.

hoarding behavior on the part of “formal” employers. One possible reason for labor hoarding in the dry season of 1998 and huge lay offs after February 1998 is the following. Initially, employers tried to keep workers employed, though highly “underemployed,” to avoid severance payments. However, once employers realized that they would have to pay 10 months severance, not six, from August 1998, they rushed to lay off workers before the law came into effect. After huge lay offs prior to August 1998, the average number of hours worked in manufacturing expanded, significantly in August 1998 (4.6%) and February 1999 (13.3%).

In order to shed more light on the labor hoarding behavior, one needs to focus on the change in the number of hours worked by private employees because this group is probably the most prone to the problem. Application of the formal/informal sector divide is also revealing. It shows that “formal” private employees exhibited labor hoarding behavior similar to that discussed earlier i.e., average hours worked dropped dramatically (–10.3%) in the dry season of 1998, then gradually reverted to pre-crisis levels in the wet season of 1998 and the dry season of 1999 (+5.4% and +9.1%).

Informal private employees, while showing similar changes in the average hours worked, the size of the swing was not as large as that for the formal sector. Average hours worked in the informal sector dropped 5.9 percent in the dry season of 1998, stayed the same in the wet season of 1998, and slightly increased by 1 percent in the dry season of 1999. This implies that labor hoarding behavior was more severe in the formal sector than its informal counterpart. This is not surprising as one would expect the informal sector to have more flexibility, and it should be able to adjust more swiftly in terms of employment when there is a shock to aggregate demand, resulting in less evident labor hoarding. Also, there is the possibility that the informal sector was not covered by the laws on severance payments, so it was able to adjust its labor force more easily. Note also that the labor-hoarding phenomenon among “formal” private employees is especially strong in the manufacturing sector.

Average hours worked is a good indicator to consider underemployment in an economic sector. This Table reveals that in the “formal” sector, manufacturing had the largest contraction in average hours worked, followed by commerce. However, in the “informal” sector, commerce had the largest contraction, followed by manufacturing and services. This is due to inter-sectoral movement following the onset of the crisis, in which the commerce and service sectors, with largely informal employment, experienced increases in the numbers of workers, but declines in average working hours.

2.3 Impacts on real average wage earnings¹⁷

This section focuses only on changes in the real wage earnings of employees because other workers (i.e., own account and unpaid family workers) do not receive returns on a wage basis. To compare changes in the wage earnings of different groups of workers, real wage earnings can be classified into various categories in order to see how workers in different groups or sectors are affected via one indicator of wage income.

¹⁷ Wages are computed from private, public and state enterprise employees as shown in Appendix 1. As wage data of own account and unpaid family workers are not available, these groups of workers are not included in this calculation. Income in kind cannot be computed also. Therefore, to consider wage data from the Labor Force Survey alone may not reflect real changes in the income earnings of each sector.

2.3.1 Real wage earning by work status

Table 15 shows that the average real wage earnings of private employees had the largest contraction in 1998. In fact, private wages are the best indicator for assessing the impact of the economic crisis on wage changes since the wages of public and state enterprise employees normally show an increasing trend. However, the drop in real wages in the public sector in 1998 was accompanied by a clear jump in public sector employment in 1998 (as discussed in section 2.2). Wages of state enterprise employees, which were unaffected in 1998 and increased as a normal trend, contracted by about 6 percent and 2.7 percent in February and August 1999, respectively.

Table 15 Real average wage earning (monthly) by work status

Unit: baht/month

	Dry season (Round 1)					Wet season (Round 3)				
	1995	1996	1997	1998	1999	1995	1996	1997	1998	1999
Private Employee	4,130 -0.02	4,492 8.8	4,796 6.8	4,313 -10.1	4,350 0.9	4,879 7.5	4,895 0.3	5,148 5.2	4,694 -8.8	4,667 -0.6
Public Employee	7,985 5.1	8,274 3.6	8,241 -0.4	7,772 -5.7	8,001 2.9	8,207 4.0	8,437 2.8	8,363 -0.9	7,937 -5.1	7,775 -2.0
State Enterprise Employee	12,685 0.7	12,741 0.4	12,780 0.3	15,003 17.4	14,088 -6.1	13,133 -2.8	12,480 -5.0	14,212 13.9	14,791 4.1	14,390 -2.7
Total	4,964 -0.2	5,220 5.2	5,503 5.4	5,249 -4.6	5,292 0.8	5,728 4.8	5,688 -0.7	5,950 4.6	5,720 -3.9	5,564 -2.7

Source: Labor Force Survey, National Statistical Office.

2.3.2 Real wage earning by sector

In considering real wage changes by sector, the wage changes of private employees will be given particular consideration for the reason given above.

Wage adjustment in the informal sector was smaller than in the formal sector. During 1997-1998, real wage reduction of private employees in the formal sector amounted to about 15 percent, and in the informal sector to about 5 to 6 percent, with the highest reductions in the manufacturing sector (-18 percent and -14 percent in the formal and informal sectors, respectively). This difference was largely due to the fact that the formal sector attempted to achieve a smaller employment reduction at the cost of a larger adjustment in wages in the dry season of 1998, while in the informal sector, a temporary reduction in employment necessitated only a smaller wage adjustment (in comparison to the formal sector).

Table 16 shows that wage adjustment of private employees was obvious in many sectors, with a total reduction of about 10 percent. Therefore, during the first year of the crisis, wage reduction is more obvious than an increasing unemployment rate. Before the recession, the labor market had tightened and average wage levels in these sectors had increased. Wage levels declined sharply afterward as a result of flexibility in the labor market due to a surplus of labor. Therefore, the impact on the decline in average wages is more apparent than rising unemployment.

Table 16 Changes in average real wage earnings of private employees by economic sector

Unit: baht/month

	February					August				
	1995	1996	1997	1998	1999	1995	1996	1997	1998	1999
Agriculture										
Average	2,302	2,473	2,697	2,574	2,363	2,502	2,621	2,835	2,324	2,291
Change from previous year	-37	171	224	-123	-211	-14	120	213	-510	-33
Percentage change	-1.6	7.4	9.1	-4.6	-8.2	-0.6	4.8	8.1	-18.0	-1.4
Manufacturing										
Average	4,336	4,920	5,167	4,366	4,677	5,262	5,109	5,326	4,972	4,997
Change from previous year	-239	584	247	-801	312	413	-153	217	-354	25
Percentage change	-5.2	13.5	5.0	-15.5	7.1	8.5	-2.9	4.3	-6.6	0.5
Construction										
Average	3,779	3,880	3,929	3,663	3,759	4,564	4,140	4,243	4,080	3,874
Change from previous year	279	100	49	-266	96	543	-425	103	-163	-206
Percentage change	8.0	2.7	1.3	-6.8	2.6	13.5	-9.3	2.5	-3.8	-5.1
Commerce										
Average	5,232	5,842	5,960	5,571	4,870	5,700	6,301	6,110	5,681	5,233
Change from previous year	-148	610	118	-389	-701	-180	601	-191	-429	-448
Percentage change	-2.7	11.7	2.0	-6.5	-12.6	-3.1	10.5	-3.0	-7.0	-7.9
Finance & real estate										
Average	12,009	12,683	12,292	11,531	11,249	12,661	12,928	12,001	11,112	13,029
Change from previous year	382	674	-391	-761	-282	255	268	-927	-889	1917
Percentage change	3.3	5.6	-3.1	-6.2	-2.4	2.1	2.1	-7.2	-7.4	17.3
Service										
Average	4,772	4,942	5,614	5,010	5,049	5,253	5,326	5,839	5,426	5,253
Change from previous year	225	170	672	-604	39	359	72	513	-413	-173
Percentage change	5.0	3.6	13.6	-10.8	0.8	7.3	1.4	9.6	-7.1	-3.2
Total										
Average	4,130	4,492	4,796	4,313	4,350	4,879	4,895	5,148	4,694	4,667
Change from previous year	-1	362	304	-483	37	342	15	253	-454	-27
Percentage change	0.0	8.8	6.8	-10.1	0.9	7.5	0.3	5.2	-8.8	-0.6

Source: Labor Force Survey, National Statistical Office.

For agriculture, the benefits derived from the baht's depreciation did not appear to result in an improvement in real wages, as evidenced by a continual decline after the crisis in real wages in the formal sector despite an increase in formal employment in the dry and wet seasons of 1998 (as discussed earlier). Real wages in the informal sector also exhibited a declining trend after the crisis, especially in the wet season of 1998. Thus, adjustments in the agricultural sector clearly result from wage reductions rather than from unemployment as the sector absorbed a higher share of employment in both 1998 and 1999.

The manufacturing sector experienced a huge drop in real wages in the dry-season of 1998 and further declined in the wet season of 1998, in both the formal and informal sectors. Wage reductions in the manufacturing sector were the largest in comparison to all other sectors as its private wages contracted by 15.5 percent in the dry season and by 6.6 percent in the wet season of 1998. Similar to the agricultural sector, wage decline was much more severe

than declines in the employment figures. However, there was an increase in wages in 1999 for both the formal and informal sectors following the overall improvement in manufacturing production.

Wages in the finance and real estate sector experienced a sharp drop in 1998 and started to rise in late 1999. Thus, this sector was more affected by the immediate impact of the crisis in 1998, both in terms of private employment and wage reduction. When compared to other sectors, average wage levels are relatively high. This may be due to a concentration of relatively highly educated workers in the sector.

However, it is interesting that wage decline in construction has not been as dramatic as employment reduction. Overall wage reduction ranged between 7 percent to 5 percent during 1998-mid-1999. More detailed disaggregated data also shows that wages in the informal sector declined by less than 10 percent. Although the immediate decline in formal sector wages in the dry season of 1998 was 10.7 percent, it dropped to only 2 percent in the wet season of 1998. Thus, the construction sector seems to be the only one in which wage adjustment is less severe than unemployment. This may partly be due to the fact that wage levels in this sector are already relatively low, leaving a narrow margin for further reduction. As most of the workers are unskilled, wages are not so high. Thus, adjustments to cope with the recession were more in terms of employment reduction than wage reduction.

2.3.3 Real wage earning by education level

Table 17.1 indicates wage changes by education levels. Unskilled labor (education less than primary level) were hit hardest in terms of wage reduction in 1998 (13.3 percent in the dry season and 15.3 percent in the wet season), but the situation improved in 1999. The relatively high-skilled groups (secondary to university levels), mostly among private employees (Table 17.2), were also affected significantly in terms of wage reduction. The relatively large wage reduction in high and low educated groups is consistent with relatively large wage reductions in occupations such as professionals, executives, miners and farmers. The situation of wage reduction is, however, less dramatic and showed some improvement in 1999.

2.3.4 Real wage earning by areas

Tables 18.1 and 18.2 show that among all areas, wage reduction in Bangkok was the highest in the dry season of 1998 (–10 percent for total employees and –16 percent for private employees) while that in rural areas was lowest. On the other hand, wage reduction in rural areas was the highest in the wet season of 1998 (–6.6 percent for total employees and –13 percent of private employees), while in Bangkok it was the lowest in the same period. This may be due to labor mobility from Bangkok to rural areas, especially in the wet season, to work in the agricultural sector.

Bangkok's real wage began to increase in the dry season of 1999, when in other areas it was still negative, and it had a less negative effect in the wet season of 1999. Wages of all employees in rural areas underwent the largest negative changes in 1999. This indicates that overall rural economy and wage earning levels were still declining in 1999 when the overall economy, particularly Bangkok's, had started to improve. In other words, the benefits from the economic turnaround had not yet reached rural areas. Overall wage adjustment in other urban areas falls between that of Bangkok and the rural areas for both years; that is, other urban areas faced the second severest impact after Bangkok in the dry season of 1998, and the second-best improvement after Bangkok in 1999.

Table 17.1 Real average wage earning by education (total employees)

Unit: baht, % change

	Dry season (Round 1)					Wet season (Round 3)				
	1995	1996	1997	1998	1999	1995	1996	1997	1998	1999
Non or < primary										
Average	2,583	2,606	2,857	2,478	2,429	3,155	2,703	2,954	2,504	2,535
Change	200	23	251	-379	-49	301	-452	251	-450	31
Percentage	8.40	0.88	9.64	-13.28	-1.98	10.56	-14.32	9.28	-15.24	1.2
1. Primary										
Average	3,274	3,546	3,673	3,328	3,323	3,667	3,805	3,780	3,493	3,372
Change	76	272	127	-345	-5	199	137	-24	-287	-121
Percentage	2.38	8.31	3.57	-9.38	-0.15	5.74	3.75	-0.64	-7.60	-3.5
2. Secondary										
Average	5,414	5,479	5,581	4,926	4,876	6,434	5,713	5,605	5,189	4,911
Change	-227	65	102	-655	-51	831	-721	-108	-415	-278.46
Percentage	-4.02	1.19	1.86	-11.73	-1.03	14.84	-11.20	-1.90	-7.41	-5.4
3. Vocational										
Average	7,776	7,837	7,574	7,555	7,289	8,751	8,163	8,615	7,310	7,550
Change	-74	61	-263	-19	-266	509	-588	452	-1305	240
Percentage	-0.94	0.79	-3.35	-0.25	-3.52	6.17	-6.72	5.54	-15.15	3.3
4. University										
Average	11,951	13,207	13,309	11,910	11,408	11,984	12,787	13,291	12,018	11,357
Change	-553	1256	103	-1399	-501	-801	803	504	-1272	-661
Percentage	-4.42	10.51	0.78	-10.51	-4.21	-6.27	6.70	3.94	-9.57	-5.5
5. Teacher training										
Average	10,328	10,363	10,274	9,901	10,067	10,522	10,643	10,549	10,143	10,012
Change	700	35	-90	-373	166	811	120	-93	-407	-131
Percentage	7.27	0.34	-0.87	-3.63	1.68	8.35	1.14	-0.88	-3.85	-1.3
Total										
Average	4,964	5,220	5,503	5,249	5,292	5,728	5,688	5,950	5,720	5,564
Change	-9	256	283	-254	43	262	-40	262	-230	-156
Percentage	-0.17	5.15	5.42	-4.62	0.82	4.79	-0.70	4.60	-3.87	-2.7

Table 17.2 Real average wage earning by education (private employees)

Unit: baht, % change

	Dry season (Round 1)					Wet season (Round 3)				
	1995	1996	1997	1998	1999	1995	1996	1997	1998	1999
None or < primary										
Average	2,490	2,599	2,845	2,473	2,417	3,070	2,665	2,948	2,458	2,515
Change	114	109	245	-372	-56	235	-405	283	-490	57
Percentage	4.8	4.4	9.4	-13.1	-2.2	8.3	-13.2	10.6	-16.6	2.3
1. Primary										
Average	3,182	3,456	3,588	3,154	3,189	3,531	3,680	3,675	3,313	3,233
Change	105	274	133	-435	36	245	148	-5	-362	-80
Percentage	3.4	8.6	3.8	-12.1	1.1	7.4	4.2	-0.1	-9.9	-2.4
2. Secondary										
Average	4,761	4,976	5,135	4,430	4,369	5,962	5,283	5,172	4,568	4,415
Change	-195	215	158	-704	-62	1,032	-679	-111	-604	-153
Percentage	-3.9	4.5	3.2	-13.7	-1.4	20.9	-11.4	-2.1	-11.7	-3.3
3. Vocational										
Average	7,522	7,359	7,265	6,967	6,570	8,734	7,643	8,134	6,572	6,855
Change	574	-163	-95	-298	-397	1,373	-1,090	491	-1,562	283
Percentage	8.3	-2.2	-1.3	-4.1	-5.7	18.7	-12.5	6.4	-19.2	4.3
4. University										
Average	12,780	14,655	14,460	12,378	11,552	12,707	13,812	14,369	12,155	12,036
Change	-1,362	1,875	-195	-2,082	-826	-1,354	1,104	557	-2,214	-119
Percentage	-9.6	14.7	-1.3	-14.4	-6.7	-9.6	8.7	4.0	-15.4	-1.0
5. Teacher training										
Average	7,500	7,928	8,332	7,392	7,259	9,356	8,378	9,408	8,433	8,063
Change	-350	427	405	-940	-134	2,096	-977	1,030	-976	-370
Percentage	-4.5	5.7	5.1	-11.3	-1.8	28.9	-10.4	12.3	-10.4	-4.4
Total										
Average	4,130	4,492	4,796	4,313	4,350	4,879	4,895	5,148	4,694	4,667
Change	-1	362	304	-483	37	342	15	253	-454	-27
Percentage	-0.02	8.8	6.8	-10.1	0.9	7.5	0.3	5.2	-8.8	-0.6

Source: Labor Force Survey, National Statistical Office.

Table 18.1 Real average wages (monthly) by area (total employees)

	Dry season (Round 1)					Wet season (Round 3)				
	1995	1996	1997	1998	1999	1995	1996	1997	1998	1999
1 Bangkok										
Average	7,436	7,786	8,646	7,775	8,374	8,679	7,975	8,809	8,795	8,772
Change	-829	350	860	-871	599	36	-704	834	-14	-23
Percentage	-10.0	4.7	11.1	-10.1	7.7	0.4	-8.1	10.5	-0.2	-0.3
2 Urban (exclude Bangkok)										
Average	5,918	6,273	6,384	6,016	5,975	6,352	6,534	6,510	6,146	6,084
Change	296	355	111	-368	-41	574	183	-25	-364	-62
Percentage	5.3	6	1.8	-5.8	-0.7	9.9	2.9	-0.4	-5.6	-1
3 Rural (exclude Bangkok)										
Average	3,764	3,924	4,071	3,939	3,854	4,252	4,379	4,413	4,121	3,989
Change	163	160	147	-132	-86	252	127	34	-293	-132
Percentage	4.5	4.2	3.7	-3.2	-2.2	6.3	3	0.8	-6.6	3.2
Total										
Average	4,964	5,220	5,503	5,249	5,292	5,728	5,688	5,950	5,720	5,564
Change	-9	256	283	-254	43	262	-40	262	-230	-156
Percentage	-0.2	5.2	5.4	-4.6	0.8	4.8	-0.7	4.6	-3.9	-2.7

Table 18.2 Real average wages (monthly) by area (private employees)

	Dry season (Round 1)					Wet season (Round 3)				
	1995	1996	1997	1998	1999	1995	1996	1997	1998	1999
1. Bangkok										
Average	6,737	7,282	8,062	6,765	7,332	8,193	7,509	8,188	7,771	7,903
Change	-737	545	780	-1,297	567	420	-684	678	-417	132
Percentage	-9.9	8.1	10.7	-16.1	8.4	5.4	-8.3	9.0	-5.1	1.7
2. Urban (exclude Bangkok)										
Average	4,446	4,904	5,093	4,586	4,449	4,885	5,202	5,112	4,688	4,681
Change	252	458	189	-507	-137	557	317	-90	-423	-7
Percentage	6.0	10.3	3.9	-9.9	-3.0	12.9	6.5	-1.7	-8.3	-0.2
3. Rural (exclude Bangkok)										
Average	3,149	3,403	3,585	3,283	3,218	3,504	3,723	3,798	3,300	3,313
Change	105	253	183	-303	-64	174	219	75	-498	13
Percentage	3.5	8.0	5.4	-8.4	-2.0	5.2	6.3	2.0	-13.1	0.4
Total										
Average	4,130	4,492	4,796	4,313	4,350	4,879	4,895	5,148	4,694	4,667
Change	-1	362	304	-483	37	342	15	253	-454	-27
Percentage	-0.02	8.8	6.8	-10.1	0.9	7.5	0.3	5.2	-8.8	-0.6

Source: Labor Force Survey, National Statistical Office.

2.3.5 Real wage earnings by region

When broken down by region, as in Tables 19.1 and 19.2, wage reduction in Bangkok was still the largest in the dry season of 1998, followed by the Central region. The Northeast had the largest reduction in the wet season of 1998 (8.6 percent and 15.2 percent for the private sector). Bangkok and the Central region saw wage increases in the dry season of 1999, a trend consistent with wage adjustment by area. In other words, more developed regions (i.e., Bangkok and the Central region) received immediate negative impacts from the crisis in terms of early recession, which then spread to less developed rural areas. When the economy started to recover, these more developed regions were the first to benefit. Although there was a drop in overall wage earnings in the wet season of 1999, the reduction in Bangkok was the smallest.

2.4 Labor markets by area and migration

One commonly occurring adjustment in a labor market in response to a crisis situation is labor movement between areas and regions. This section will highlight the situation in labor markets in different areas, and the impact of the crisis on labor migration. Given Bangkok's high domination of the urban sector, the city is considered separately. The discussion thus focuses on three areas: Bangkok, other urban areas, and rural areas.

2.4.1 Impacts on labor markets by area: Bangkok, other urban, and rural

Bangkok

Bangkok appears to have been more profoundly and rapidly affected by the economic changes than other areas, as shown in Tables 20.1, 20.2, 20.3. The area is most susceptible to the immediate impacts recession, but it is also able to draw benefits from economic expansion once the economy picks up.

Bangkok was the hardest hit in the first year of the crisis in terms of a reduction in total working hours, average working hours, and rising underemployment. Due to a sharp contraction in total and average working hours in August 1997 and February 1998, underemployment in Bangkok rose sharply during the same periods (about 13 percent and 18 percent, respectively) and the rates were the highest of all areas. Accordingly, average real monthly wages dropped sharply in the dry season (February) of 1998, although they started to pick up in the dry season of 1999 when working hours and underemployment improved. Bangkok's labor market showed the first signs of improvement in the second year of the crisis when the economy started to bottom out.

Indicators on total working hours and underemployment show significant improvement in early 1999. However, the unemployment rate continued to increase in early 1999. This may imply that there was some lag in terms of production and job creation. Although increasing production in the economy has increased employee working hours, the economy has not yet expanded sufficiently to generate new jobs, due to existing overcapacity. As a result, job searches are still time consuming and difficult, indicated by the continual increase in the average number of days spent looking for work.

Indicators in August 1999 followed the national trend of the labor market as underemployment rose slightly while the unemployment rate dropped. However, this is probably due to a sharp reduction in labor force participation in Bangkok, as its rate dropped to 64.9 percent, with about 161,000 persons leaving the labor market. Opportunities to find work are still not promising in the segmented labor market of Bangkok, and the average time spent looking for jobs continues to increase, discouraging labor force participation.

Table 19.1 Real average wage earnings (monthly) by region (total employees)

Unit: baht/month

	Dry season (Round 1)					Wet season (Round 3)				
	1995	1996	1997	1998	1999	1995	1996	1997	1998	1999
1 Bangkok										
Average	7,436	7,786	8,646	7,775	8,374	8,679	7,975	8,809	8,795	8,772
Change	-829	350	860	-871	599	36	-704	834	-14	-23
Percentage	-10.0	4.7	11.1	-10.1	7.7	0.4	-8.1	10.5	-0.2	-0.27
2 Central										
Average	5,000	5,435	5,441	5,045	5,000	5,446	5,818	5,520	5,211	5,112
Change	240	435	6	-397	-44	367	372	-298	-309	-99
Percentage	5.1	8.7	0.1	-7.3	-0.9	7.2	6.8	-5.1	-5.6	-1.9
3 Northern										
Average	3,828	3,981	4,234	4,327	3,980	4,182	4,236	4,537	4,361	4,006
Change	-67	152	253	93	-347	54	54	301	-176	-355
Percentage	-1.7	4.0	6.4	2.2	-8.0	1.3	1.3	7.1	-3.9	-8.1
4 Northeastern										
Average	3,850	3,954	4,109	3,960	4,127	4,659	4,699	4,781	4,372	4,447
Change	268	104	154	-149	167	436	40	82	-409	75
Percentage	7.5	2.7	3.9	-3.6	4.2	10.3	0.9	1.8	-8.6	1.7
5 South										
Average	5,107	4,989	5,318	5,012	4,654	5,301	5,016	5,376	4,980	4,784
Change	637	-118	330	-306	-359	770	-285	360	-396	-196
Percentage	14.3	-2.3	6.6	-5.8	-7.2	17.0	-5.4	7.2	-7.4	-4
Total										
Average	4,964	5,220	5,503	5,249	5,292	5,728	5,688	5,950	5,720	5,564
Change	-9	256	283	-254	43	262	-40	262	-230	-156
Percentage	-0.2	5.2	5.4	-4.6	0.8	4.8	-0.7	4.6	-3.9	-2.7

Table 19.2 Real average wage earnings (monthly) by region (private employees)

Unit: baht/month

	Dry season (Round 1)					Wet season (Round 3)				
	1995	1996	1997	1998	1999	1995	1996	1997	1998	1999
1 Bangkok										
Average	6,737	7,282	8,062	6,765	7,332	8,193	7,509	8,188	7,771	7,903
Change	-737	545	780	-1,297	567	420	-684	678	-417	132
Percentage	-9.9	8.1	10.7	-16.1	8.4	5.4	-8.3	9.0	-5.1	1.7
2 Central										
Average	4,233	4,801	4,872	4,277	4,294	4,726	5,174	4,839	4,420	4,453
Change	170	568	71	-595	17	395	447	-335	-419	33
Percentage	4.2	13.4	1.5	-12.2	0.4	9.1	9.5	-6.5	-8.7	0.7
3 Northern										
Average	2,918	3,051	3,302	3,101	2,826	3,127	3,207	3,493	2,951	2,824
Change	-81	132	251	-200	-276	66	80	287	-543	-127
Percentage	-2.7	4.5	8.2	-6.1	-8.9	2.2	2.6	8.9	-15.5	-4.3
4 Northeastern										
Average	2,906	3,112	3,281	3,098	2,915	3,242	3,351	3,557	3,017	3,024
Change	255	206	169	-183	-183	331	109	206	-540	7
Percentage	9.6	7.1	5.4	-5.6	-5.9	11.4	3.4	6.1	-15.2	0.2
5 South										
Average	3,824	3,793	4,279	3,792	3,623	3,911	3,903	4,261	3,713	3,725
Change	540	-31	486	-487	-169	429	-8	358	-548	12
Percentage	16.5	-0.8	12.8	-11.4	-4.5	12.3	-0.2	9.2	-12.9	0.3
Total										
Average	4,130	4,492	4,796	4,313	4,350	4,879	4,895	5,148	4,694	4,667
Change	-1	362	304	-483	37	342	15	253	-454	-27
Percentage	-0.02	8.8	6.8	-10.1	0.9	7.5	0.3	5.2	-8.8	-0.6

Source: Labor Force Survey, National Statistical Office.

Table 20.1 Key indicators of labor markets in Bangkok

Key Indicators : BKK	Dry Season (Round 1)				Wet Season (Round 3)			
	1996	1997	1998	1999	1996	1997	1998	1999
Employed	3,809,506	3,889,053	3,936,537	3,871,972	3,722,825	4,004,204	3,886,652	3,903,650
Unemployed (exclude seasonally unemployed)	48,027	56,015	123,094	210,081	48,043	38,833	189,367	154,807
Seasonally unemployed					1,351			1,057
Total Labor force	3,857,533	3,945,068	4,059,631	4,082,053	3,772,219	4,043,037	4,076,019	4,059,514
Out of labor force	1,862,385	1,931,525	1,978,115	2,103,113	2,014,512	1,917,171	2,035,535	2,196,868
Average real wage (monthly)	7,786	8,646	7,775	8,374	7,975	8,809	8,795	8,772
Total hours worked/ week	197,567,134	200,479,132	165,572,653	198,628,671	191,121,007	178,744,830	192,583,210	197,060,850
Average hours worked/ week	51.9	51.5	42.1	51.3	51.3	44.6	49.5	50.5
Average time looking for work (days)	148.1	68.6	112.0	161.5	63.3	105.8	113.0	146.8
Labor force participation rate	67.4	67.1	67.2	66.0	65.2	67.8	66.7	64.9
Unemployment rate	1.2	1.4	3.0	5.1	1.3	1.0	4.6	3.8
Underemployment rate (<30 hours/week)	1.5	1.6	17.0	2.1	1.3	12.8	2.6	2.9

Source: Labor Force Survey, National Statistical Office.

Table 20.2 Key indicators of labor markets adjustments in other urban areas

Key Indicators : Urban	Dry Season (Round 1)				Wet Season (Round 3)			
	Feb-96	Feb-97	Feb-98	Feb-99	Aug-96	Aug-97	Aug-98	Aug-99
Employed	5,646,708	5,756,021	5,673,299	5,841,924	5,832,729	6,002,938	5,875,751	6,010,496
Unemployed (exclude seasonally unemployed)	90,572	110,945	185,139	238,112	58,535	75,053	222,834	171,331
Seasonally unemployed	80,101	68,764	70,922	79,882	9,233	6,122	5,980	8,003
Total Labor force	5,817,381	5,935,730	5,929,360	6,159,918	5,900,497	6,084,113	6,104,565	6,189,830
Out of labor force	2,869,130	2,916,607	3,104,063	3,073,889	2,851,491	2,827,430	2,999,392	3,116,974
Average real wage (monthly)	6,273	6,384	6,016	5,975	6,534	6,510	6,146	6,084
Total hours worked/ week	289,656,889	294,702,806	276,449,962	292,817,537	299,447,185	295,528,805	297,140,010	301,870,213
Average hours worked/ week	51.3	51.2	48.7	50.1	51.3	49.2	50.6	50.2
Average time looking for work (days)	68.6	56.1	67.5	84.3	63.5	82.9	84.9	81.9
Labor force participation rate	67.0	67.1	65.6	66.7	67.4	68.3	67.1	66.5
Unemployment rate	1.6	1.9	3.1	3.9	1.0	1.2	3.7	2.8
Underemployment rate (< 30 hours/week)	4.6	4.2	7.6	5.4	3.7	10.5	4.5	4.8

Source: Labor Force Survey, National Statistical Office.

Table 20.3 Key indicators of labor markets adjustments in rural areas

Key Indicators : Urban	Dry Season (Round 1)				Wet Season (Round 3)			
	Feb-96	Feb-97	Feb-98	Feb-99	Aug-96	Aug-97	Aug-98	Aug-99
Employed	20,530,423	20,526,361	19,745,692	20,232,503	22,678,711	22,955,459	22,438,103	22,209,858
Unemployed (exclude seasonally unemployed)	502,125	530,632	1,171,034	1,266,527	246,592	179,344	725,725	685,090
Seasonally unemployed	1,074,681	964,709	1,179,393	990,758	152,752	99,213	71,264	128,413
Total Labor force	22,107,229	22,021,702	22,096,119	22,489,788	23,078,055	23,234,016	23,235,092	22,996,361
Out of labor force	8,847,588	9,321,226	9,641,287	9,589,711	8,076,480	8,296,240	8,719,151	9,279,481
Average real wage (monthly)	3,924	4,071	3,939	3,854	4,379	4,413	4,121	3,989
Total hours worked/ week	1,052,649,981	1,049,384,154	977,276,717	996,962,593	1,166,732,338	1,178,866,163	1,151,013,412	1,111,717,268
Average hours worked/ week	51.3	51.1	49.5	49.3	51.4	51.4	51.3	50
Average time looking for work (days)	58.1	58.9	58.2	63.2	73.8	53.0	71.6	62.3
Labor force participation rate	71.4	70.3	69.6	70.1	74.1	73.7	72.7	71.2
Unemployment rate	2.3	2.4	5.3	5.6	1.1	0.8	3.1	2.9
Underemployment rate (< 30 hours/week)	7.0	6.5	9.4	9.2	6.4	8.1	7.9	9.6

Source: Labor Force Survey, National Statistical Office.

Other urban areas

The labor market in urban areas excluding Bangkok was less affected than Bangkok and the rural areas (Table 19.2). Unemployment, underemployment and changes in total and average hours worked were the smallest in other urban areas. Real wage adjustments were more severe than the unemployment indicators in 1998. Even in early 1999, the average wage continued to decline, although the number of hours worked increased. The average time spent looking for work was much less in other urban labor markets than in Bangkok, probably due to the less rigid nature of these markets.

Although data in August 1999 shows that the unemployment rate declined to only 2.8 percent, the underemployment rate increased to 4.8 percent (Table 20.2). This reflects that workers are not fully utilized, although opportunities to work became easier, probably as a result of a number of temporary public spending programs under Government economic stimulus schemes.

Rural areas

From Table 20.3, rural areas had the highest unemployment rate in the dry season of both 1998 and 1999 (5.3 percent and 5.6 percent, respectively). Rural unemployment apparently dropped in the wet season due to a reduction in seasonal unemployment; for example, in 1998 seasonal unemployment in the wet season was 71,264, having dropped from 1,179,393 in the dry season. Seasonal unemployment in rural areas in the dry season of 1999 was high, almost reaching one million. Even in the wet season of 1999, the number of seasonally unemployed was 128,413.

The Thai rural economy seems to have lagged behind other areas in making gains from the rebounding economy. Rural underemployment rates in 1999, 9.2 percent in the dry season and 9.6 percent in the wet season, are still the highest of all areas. The total and average working hours also show no improvement, in contrast to the trends in other areas, even in 1999. Average wage earnings continued to decline in 1999. The only good sign has been a small reduction in unemployment, 2.9 percent in August 1999 (compared to 3.1 percent in the previous year), probably due to a number of Government-run temporary job creation programs in rural areas.

The data thus reflects that the employment situation in rural areas saw little improvement in 1999, and average real wages continued to decrease. However, the rural labor market seems to be the most flexible of all areas, as the average time spent seeking work is the lowest. This is because by nature rural employment is more informal and easy to enter, but average wages are the lowest in comparison to the labor markets in the other two areas. Thus, the most severe problem in the rural labor market is that rural workers have the lowest earnings and underemployment (or disguised unemployment).

In summary, Bangkok appears to have been both the first hit and the first to begin to recover of the three areas. In the first year of the crisis, Bangkok experienced serious underemployment and sharp drops in hours worked and real average wages. The negative impacts spread from Bangkok to other urban areas and then reached rural areas. In the second year of the crisis, when the economy stabilized and started to bottom out, Bangkok appears to have been the first to benefit from the changed economic situation, reflected in declining underemployment rates, rising total and average working hours and rising real average wages in early 1999—at a time when the worst was still far from over for the rural economy.

Although unemployment rates in all areas continued to increase from 1997 to early 1999, underemployment in all areas reached the highest rates in the dry season of 1998.

Bangkok had the highest underemployment rate of 17.0 percent in 1998 (perhaps because of the increase in underemployment in the informal sectors), but dropped to 2.1 percent in 1999—the lowest rate of the three areas (Table 20.1). This reflects an increase in the total working hours in Bangkok in early 1999 when the economy began to recover. Although the underemployment rate increased slightly in August 1999, total and average hours worked in Bangkok increased while the unemployment rate dropped in the same period. As prospects of employment in Bangkok and urban areas had improved by February 1999, in comparison to 1998, there was an increase in rural-urban migration.

Changes in Bangkok's labor market indicators are much more obvious than in the other areas. The fact that it was more difficult to get work in 1999 even though other indicators were improving likely stems from Bangkok's segmented labor market in comparison to the other two areas.

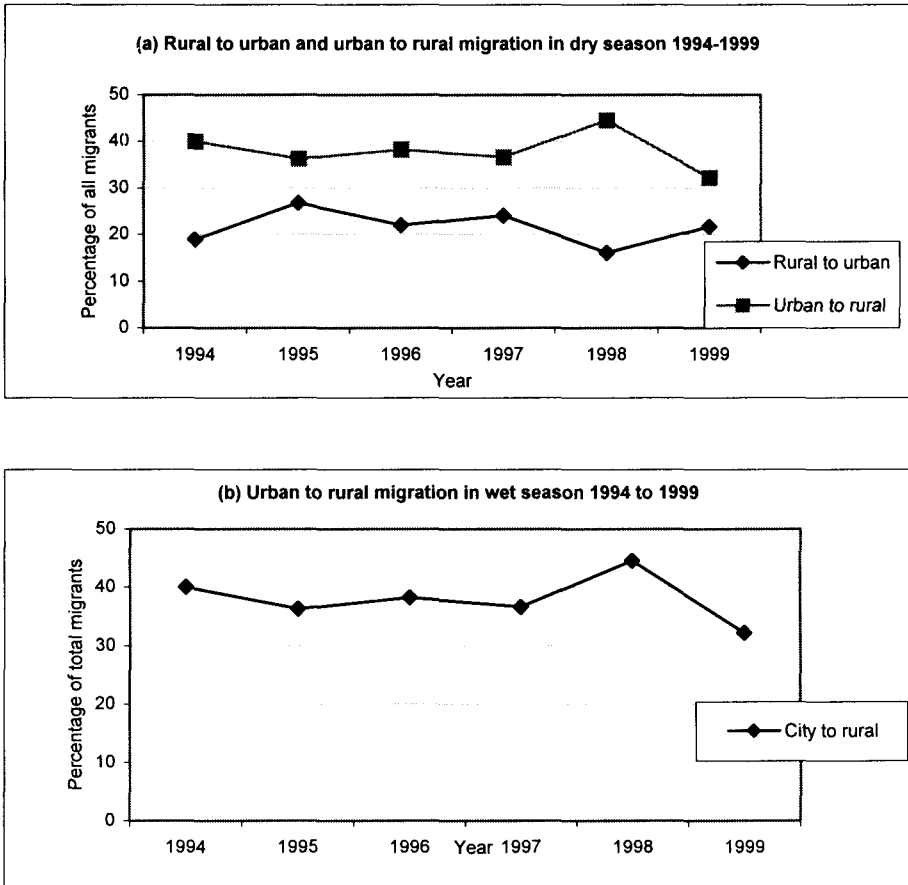
The overall trends of declining unemployment rates and increasing underemployment rates in all areas in August 1998 may have been a result of increases in the number of temporary Government public work projects and fiscal stimulus programs aimed at job creation (but which may not have efficiently utilized labor). Since such measures may skew the real picture, caution should be exercised when interpreting the above trends since the changes in mid-1999 may not necessarily represent long term trends or prospects.

2.4.2 Migration

Because the impacts of an economic crisis on labor markets are felt in different areas at different times and at varying degrees, labor mobility can clearly be seen, with the directions changing as the economic situation in each area changes. The crisis in Thailand resulted in an unusual phenomenon of reverse migration from urban to rural areas during the first year. However, migration trends returned to the usual rural-urban pattern in the second year of the crisis.

Reverse migration (urban-rural) in 1998 increased in both the dry and wet seasons. This was likely the result of negative economic prospects in Bangkok at that time, and insufficient social safety nets to cushion the impacts of the crisis. The unemployed returned to their rural homes even though there were few job opportunities there. This cannot be explained only in terms of economic incentives. Harris-Todaro interprets this phenomenon of reverse migration as “disappointed urban job seekers returning home in despair, and mostly because of social factors” (Gillis et al. 1992). In 1998, the share of urban-rural migration increased from 38 percent to 45 percent in the dry season and 40.2 percent to 41.4 percent in the wet season over the previous year. Figure 3 shows changing migration trends.

The situation in 1999 (both the dry and wet seasons) started to reverse the 1998 trend. Although rural-urban migration dropped from approximately 23 percent to 16 percent during the dry season of 1997-1998, when the urban economy was in severe recession, the trend rose to approximately 21 percent in the dry season of 1999. Urban to rural migration trends significantly declined, even in the wet season of 1999, as shown in Figure 3(b). This tends to imply that labor returned to find jobs in urban labor markets (including Bangkok's) when economic prospects there started to improve. Consequently, employment opportunities for urban-rural migrants in the dry season of 1999 increased, although such opportunities had dropped from 1996 to 1998.

Figure 3 Migration trends

The question then is whether the rural labor market can actually absorb returned migrants. From Table 20.3, considering the labor market in the dry season, the rural market generally had the highest unemployment and underemployment rates in comparison to urban and Bangkok areas during 1997-1999. The only exception was that Bangkok had the highest underemployment rate in 1998. This implies that job opportunities in rural areas were relatively lower than urban areas and Bangkok.

Labor force participation in rural areas in early 1999, in particular, increased by about 400,000 persons, mainly females, while the number of employed people, rose by about 500,000, mainly females. In the same period, agricultural employment increased about 900,000, mostly informal self-employed, own account and unpaid family workers.

Considering the labor market in wet seasons, it is found that the rural labor force in 1998 stayed at almost the same level as that in 1997. However, withdrawals from the labor force in rural areas increased by about 423,000 persons in 1998. This indicates that even in the wet season, rural areas experienced the largest withdrawal of people from the labor market. The major reason was for study purposes, especially males.

2.5 Vulnerable and disadvantaged groups

This section describes the characteristics of the vulnerable and disadvantaged groups affected by the crisis.

2.5.1 *The vulnerable*

In considering vulnerable groups in the labor market, the focus is on those exiting the labor force, the unemployed (including the laid-off), the long-term unemployed, the underemployed, and migrants.

Out of labor force

Data from the Labor Force Survey indicates that a decline in Thai labor force participation rates was evident for both males and females in 1998 and 1999, except for a slight increase in female participation in the dry-season of 1998. Although participation rates for females have been significantly lower than those of males, females had slightly higher percentages of declines during the crisis period, indicating that a larger percentage of female workers were out of the labor force.

Because the number of people out of the labor force has increased significantly since 1997, it is important to consider the reasons for exiting the labor force. Study has been the main reason, outweighing all other reasons, since the late 1980s, and especially so for male leavers. Since the onset of the crisis in 1997, males in Bangkok and other urban areas have increasingly left work in order to study. For females, housework dominated other reasons. However, exit for this reason has declined since the onset of the crisis and an increasing number of women, especially in Bangkok, are exiting for study.

Considering the disaggregated by education levels, it is found that those with secondary and higher-level education (the educated groups) have increasingly left the labor market since 1997. Broken down by age groups, the young (13-19 years old) and the senior (over 60 years), were found to have a higher possibility of being out of labor force in 1998 and 1999.

Unemployment

Considering unemployment by education levels, although the largest number of unemployed are those with primary or lower education, it was the educated groups (secondary and university-level) that had the highest unemployment rates (ranging from about 6 percent to 7 percent during periods of 1998 and early 1999). Teenagers had the highest unemployment rates (12-14 percent in the dry seasons of 1998 and 1999 and 7.5 percent in the wet season of 1998). There is only a slight difference in unemployment rates between genders.

Underemployment

The group with less than primary education has the highest under-employment rate among all education levels. While higher-educated groups seem to have a greater unemployment rate, low-educated groups (unskilled labor) have greater under-employment rates. The rates fell between 5 percent and 7 percent during periods in 1998 and early 1999. The vulnerable are mostly found in other urban (ex-Bangkok) and rural areas. Among age groups, child labor (defined as aged 13-15 years) have the highest under-employment rate,

ranging from 23 percent to 37 percent during periods in 1998 and 1999. Under-employed child labor is mostly found in other urban and rural areas. The second group with the highest under-employment rate is the teens (16-20 years old). In terms of gender, under-employment rates are higher among women than men (5.6 percent versus 3.9 percent in February 1998 and 3.1 percent versus 2.3 percent in February 1999).

Migrants

Urban-rural migrants in the dry season of 1998: The majority of these were those with primary education (70 percent). Most of them had become unemployed from the construction and manufacturing sectors. Of these, many were re-absorbed in the rural labor market, mainly in agriculture (46 percent), followed by manufacturing (16 percent) and services (15 percent).

Rural-urban migrants in the dry season of 1999: The majority in this group were those with primary and secondary level education (48 percent and 31 percent, respectively). Most of them had worked in the manufacturing and construction sectors and were re-absorbed into the services (45 percent) and manufacturing sectors (30 percent) in urban areas.

Long-term unemployment

Besides unemployment and underemployment, another important indicator of vulnerability is long-term unemployment. This group should be of serious concern because long-term unemployment will cause problems for themselves and for their families. Labor force data in August 1998 provides information on those unemployed for longer than one year (which is defined here as long-term unemployment) and Table 21 shows long-term unemployment numbers and rates disaggregated by area, education level, age, and sex.

Table 21 shows that overall long-term unemployment is 0.6 percent of the total labor force. Bangkok has the highest rate of long-term unemployment (0.9 percent), followed by other urban areas (0.6 percent) and rural areas (0.5 percent). The relative severity of the problem in Bangkok is consistent with the average time spent seeking work, which was also the highest for Bangkok. Compared with the other two areas, the labor market in Bangkok seems to be more rigid and highly segmented, making job searching more difficult. In contrast, the rural labor market seems to be more flexible and it enables easier informal entry. The problem of long-term unemployment is not as serious in rural areas because of disguised unemployment and a tendency to migrate elsewhere in search of employment.

Table 21 also reveals that long-term unemployment is relatively high among the educated groups (secondary to university-level education), and the highest for the vocational education category (1.4 percent). This confirms that unemployment among the educated was striking during the crisis, both in terms of unemployment and long-term unemployment. Fresh graduates have had difficulty in finding jobs during the crisis. However, they are possibly more selective and can afford to wait for a more suitable job than the low educated. The high rate of educated long-term unemployment is consistent with the high rate of unemployment in the young age group, as described earlier. The 16-24 years age groups have the highest rates of long-term unemployment (1.15-1.16 percent). Compared by gender, the rate of long-term unemployment is slightly higher in males than in females (0.6 percent versus 0.5 percent).

Table 21 Long term unemployment (>1 year) as of August 1998: breakdown by area, education, age, sex

	Number of long – term unemployed (person)	% of labor force
Total	206,491	0.62
Area		
Bangkok	37,449	0.92
Urban (exclude Bangkok)	41,064	0.67
Rural (exclude Bangkok)	127,979	0.55
Education		
Less than Primary school	8,597	0.44
Primary	97,231	0.45
Secondary	58,343	1.06
Vocational	15,398	1.45
University	25,741	1.05
Teacher training	1,181	0.17
Age		
13 to 15 years	314	0.07
16 to 20 years	30,517	1.15
21 to 24 years	42,320	1.16
25 to 29 years	38,377	0.78
30 to 39 years	46,999	0.52
40 to 49 years	32,941	0.48
50-59 years	11,228	0.28
60 and over	3,795	0.21
Sex		
Male	118,483	0.65
Female	88,008	0.58

Source: Labor Force Survey, National Statistical Office.

2.5.2 Disadvantaged groups

Discussion of the disadvantaged groups in this section is focused on women and children.

Women

Women were harder hit by underemployment than by unemployment. The underemployment rates for women were 5.6 percent, 3.1 percent and 3.1 percent in February and August 1998, and February 1999, respectively, compared to rates for men over the same period of 3.9 percent, 2.6 percent and 2.3 percent, respectively.

Although the unemployment effects on women are slightly different from men, women were more vulnerable to the impact of lay-offs. Field surveys conducted by the Arom Pongpa-ngan Foundation (1999) found that the most vulnerable group among the laid-off was elderly and relatively unskilled women. Most of them were engaged in some sort of routine work. When they were laid off they had limited choices, and whatever choices they had, they had to work harder for reduced income. Many of these laid-off women were their family's main income earners, and therefore they had to accept unfavorable choices.

The study reveals that about 50 percent of the laid-off women workers admitted sub-contracting work in small-scale operations with no welfare and less negotiating power. The relatively young and educated, who represented only about 5 to 10 percent of the laid-off women, may have a better chance to work in large enterprises. About 15-25 percent were self-employed and another 15 percent returned to their rural homes, while the remainder became the urban unemployed.

The impacts of real wage changes on women were different in 1998 and 1999. In terms of overall wage reduction of private employees, women suffered a larger negative impact than men (-12.7 percent versus -8.2 percent in the dry season, and -9.4 percent versus -8 percent in the wet season of 1998). This was mostly due to large reductions in the formal sector (-18.24 percent versus -11.6 percent in the dry season and -9 percent versus -6.4 percent in the wet season of 1998). The reverse trend is found in the informal sector where men suffered a larger wage reduction and wages continued to fall in the dry-season of 1999. A positive wage change for women was found in the dry season of 1999 (5.3 percent overall and 9 percent for the formal sector).

Children

The child labor force was the most adversely affected by underemployment. The Labor Force Survey during two years of the crisis (from mid-1997 to mid-1999) shows that child labor (age 13-15) had the highest underemployment rate of all age groups. Total underemployment rates of this age group rose sharply in February 1998 (27.4 percent) and 1999 (23.4 percent), compared to the 1997 rate of 16 percent. Although the trend was consistent in the other urban and rural areas, the latter had the highest rate. Underemployment among working rural children was 30 percent in 1998 and 26 percent in 1999, compared to 17.6 percent in 1997.

It is also interesting to note that even in the wet seasons, underemployment rates for this group were high (25 percent in August 1997 and 37 percent in 1998), and especially so in rural areas (28.3 percent and 40.5 percent in August 1997 and 1998 respectively). Within this group, female underemployment rates were higher than male rates.

3. Impact on Income, Poverty and Income Distribution

The impacts of this crisis changed rapidly during different short periods, especially during the first year of the crisis (from mid-1997 to mid-1998). Socio-economic survey data of 1996 and 1998 show that changes in aggregated poverty and income distribution between the two years were minor. This section shows changes in average real income by work status and income components, poverty incidences, and focuses on poverty profiles by different classification of households. It also examines changes in income share by decile and income distribution.

3.1 Income

Table 22 shows that, among all work statuses, Government employees had the largest average real income levels, followed by employers, private employees, and own account workers respectively. However, Government employees and the unemployed experienced the greatest reduction in average income levels.

Table 22 Average real income by work status, 1996 and 1998

	1996	1998	Change 98-96
	Average Income (baht/person)	Average Income (baht/person)	(Baht)
Employer	6,098.12	6,183.85	85.73
Own Account Worker	6,055.92	4,737.25	-1,318.67
Private Employees	2,850.46	5,058.88	2,208.42
Government Employees	20,233.84	10,426.36	-9,807.47
Unpaid Family Worker	2,522.50	306.87	-2,215.63
Unemploy	10,436.18	770.80	-9,665.38
Economically Inactive	9.26	745.18	735.92
No Occupation	1,074.19	453.27	-620.92
Total	7.57	3,341.44	3,333.87

Source: Socio-economic Survey 1996, 1998.

Considering sources of income, wages have made up the main portion, followed by non-farm and farm income (as shown in Table 23). The table indicates that shares of wage income and transfer income increased, while shares of other non-farm income and farm income declined in the crisis period from 1996-1998.

Table 23 Share of real income by sources, 1996 and 1998

	1996		1998	
	Total (baht)	%	Total (baht)	%
Wage income	73,159,378,264	50.40	78,190,697,208	51.46
Non farmer income	33,408,698,332	23.01	33,696,436,971	22.18
Farmer income	20,992,598,285	14.46	19,635,265,772	12.92
Transfer income	11,745,758,206	8.09	13,815,847,577	9.09
Property income	3,543,721,563	2.44	3,681,892,499	2.42
Other income	2,315,026,125	1.59	2,925,994,098	1.93
Total	145,165,180,775	100.00	151,946,134,125	100.00

Source: Socio-economic Survey 1996, 1998.

3.2 Impacts on poverty and poverty profiles

Poverty incidence (by head count index) for the whole country experienced a minor change, i.e., from 14 percent in 1996 to 14.29 percent in 1998.¹⁸ The number of the population under the poverty line increased from 8.42 to 9.12 million (during 1996-1998). However, crisis impacts on different groups within the society were different. Therefore, it is necessary to examine changes in poverty incidences between 1996 to 1998 by different groups.

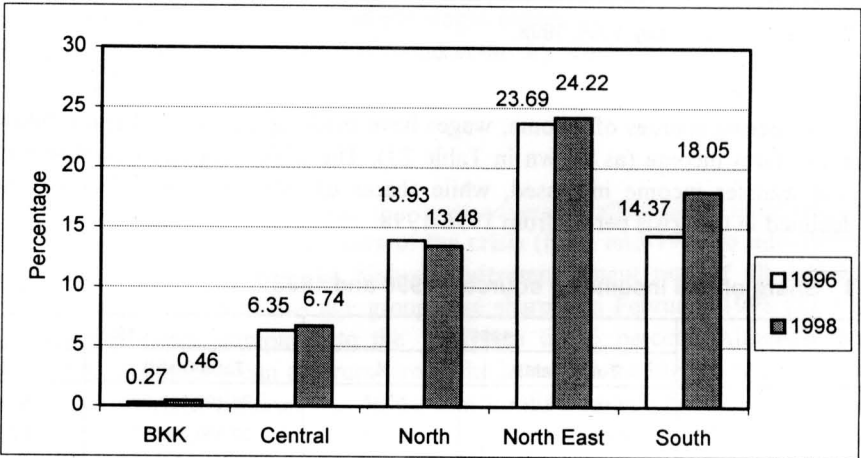
To further examine the impact of the crisis on poverty, we explore the contribution to total poverty of the different sub-groups, which are disaggregated by many categories, such as regions, locations, occupations, education, gender and household sizes.

¹⁸ According to the TDRI's new poverty measurement (Somchai 2000), based on the weighted calculation of calorie requirements, consumption basket and spatial price indices, poverty lines in 1996 were 8,878 and 10,924 baht for rural and urban areas respectively, and poverty lines in 1998 were 10,383 and 12,350 baht for rural and urban areas respectively. Poverty incidences are calculated from the number of the people under those poverty lines.

Poverty profiles by regions and areas

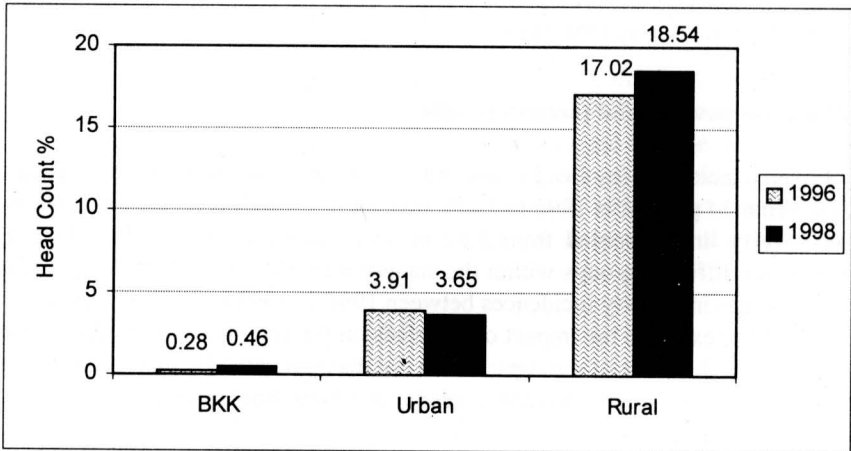
Figures 4 and 5 show poverty profiles by regions and locations. Figure 4 shows that during 1996 and 1998, poverty incidences in Bangkok, the Central, the Northeast, and the South regions increased. Only the North experienced a slight drop in poverty. Figure 5 highlights locational impacts, showing that the poverty incidence indexes in Bangkok and rural areas had increased, while urban poverty incidence slightly decreased. This reflects the severity of the crisis in Bangkok and the rural areas, to where the adverse impacts later spread due to labor movement and resource limitation.

Figure 4 Head count index to total poverty, by regions 1996 and 1998



Source: Socio-economic survey 1996, 1998, NSO.

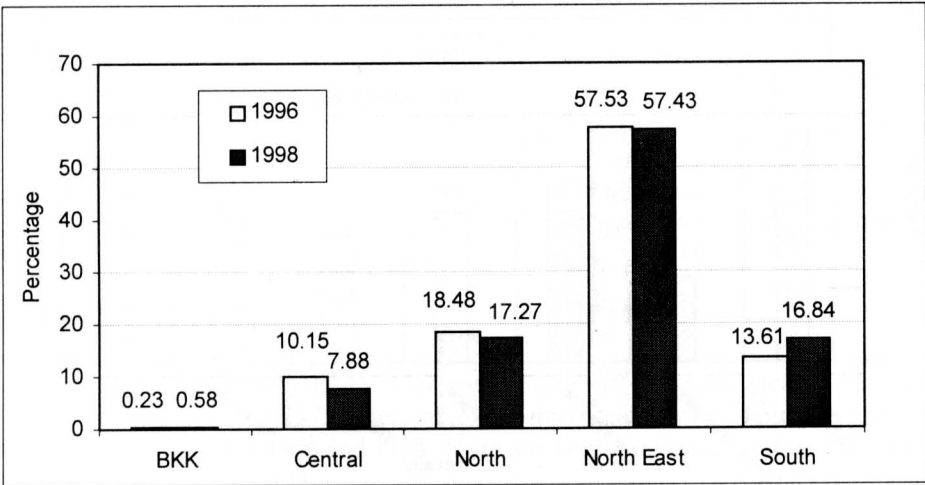
Figure 5 Head count index by areas 1996 and 1998



Source: Socio-economic survey 1996, 1998, NSO.

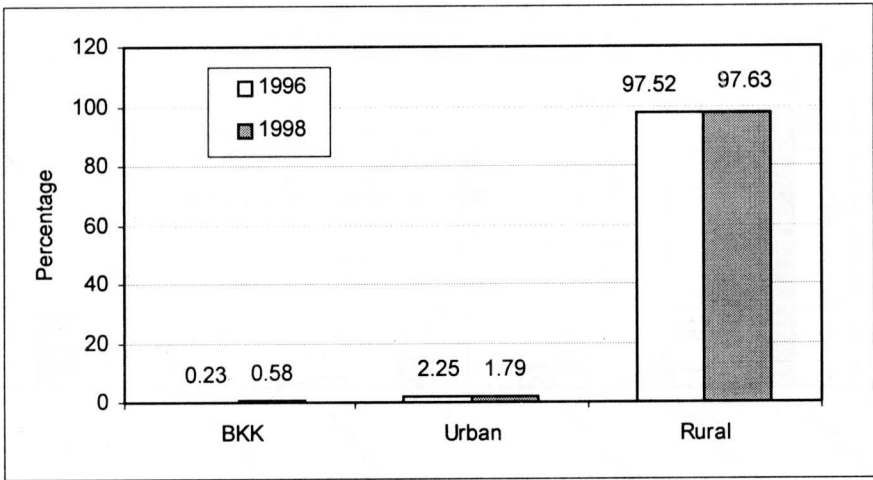
In terms of contribution to poverty, Figure 6 shows that, among regions, the Northeast contributed the highest proportion of poverty both before and after the crisis (57.53 percent in 1996 and 57.43 percent in 1998). This reflects the fact that more than half of the poor in Thailand live in the Northeast. When broken down by areas, Figure 7 shows that rural areas mainly contributed to total poverty, 97.52 percent in 1996 and 97.63 percent in 1998, reflecting that the majority of the poor (about 98 percent) live in rural areas. Bangkok contributes the least in total poverty; however, its share increased from 0.23 percent in 1996 to 0.58 percent in 1998. This is because Bangkok was seriously hit by the crisis.

Figure 6 Contribution of regions to total poverty by regions 1996 and 1998



Source: Socio-economic survey 1996, 1998, NSO.

Figure 7 Contribution of areas to total poverty by areas 1996 and 1998



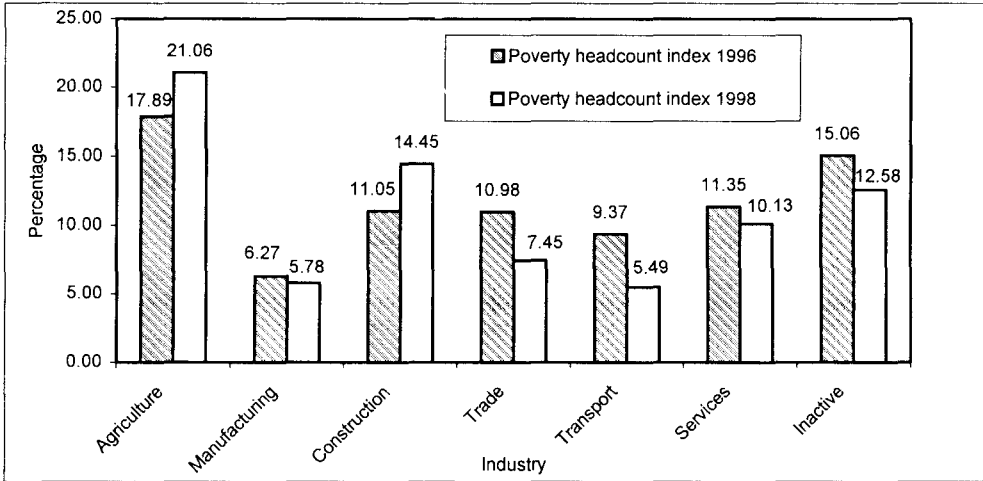
Source: Socio-economic survey 1996, 1998, NSO.

These Figures show that the increase in poverty was most likely to take place in Bangkok and the rural areas (and especially the Northeast). This confirms that the adverse income impacts of the crisis were uneven in terms of regions and locations.

Poverty profiles by employment sectors

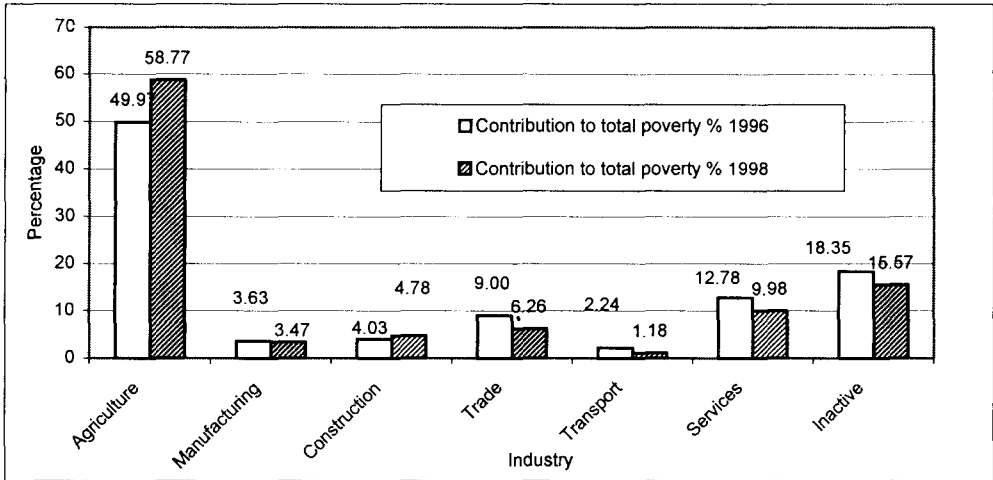
Figure 8 shows poverty incidence by employment sectors and Figure 9 shows shares of their contributions to total poverty during 1996 and 1998.

Figure 8 Poverty by industry of employment of head of household, 1996 and 1998



Source: Socio-economic survey 1996, 1998, NSO.

Figure 9 Contribution to total poverty by industry of employment of head of household, 1996 and 1998



Source: Socio-economic survey 1996, 1998, NSO.

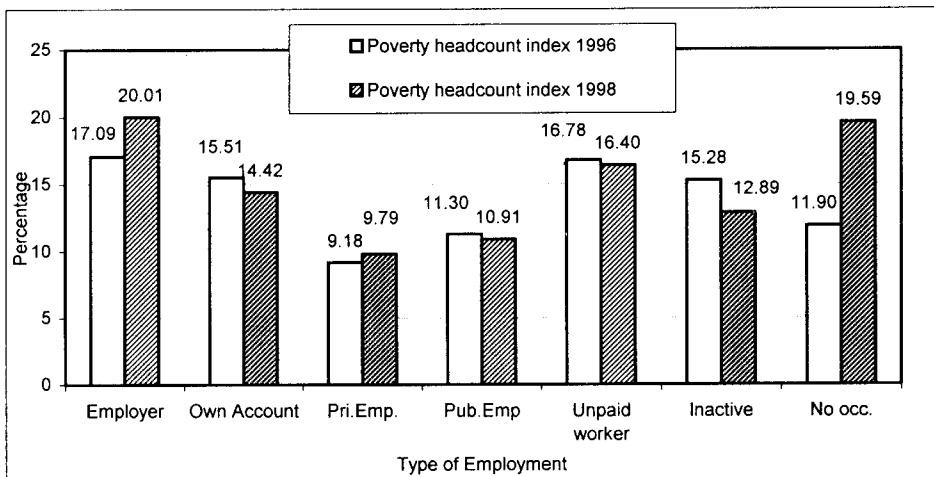
Figures 8 and 9 show that increased poverty was found among those in agriculture and construction, but others were better off in 1998. Those engaged agriculture had an increase in poverty incidence from 17.89 percent to 21.06 percent. The sector's contribution to poverty also increased sharply from 49.97 percent to 58.77 percent (from 1996 to 1998). Those in construction also experienced an increase in poverty incidence from 11.05 percent to 14.45 percent, and the sector's contribution to poverty increased from 4.03 percent to 4.78 percent (from 1996 to 1998). This is because the construction industry virtually collapsed in 1997-1998. Increased poverty in agriculture in 1998 is consistent with the survey results of the Office of Agricultural Economics (1999),¹⁹ reporting that the net income of agricultural households dropped in 1998 due to the rising costs of imported production inputs, although they reaped some benefit from higher export values due to the depreciated baht. Agricultural commodity prices also declined in 1998. The survey also found that the debt of agricultural households also increased, and the share of loans from the informal sector increased from about 9 percent in 1995/96 to 17 percent in 1997/98.

In contrast, households engaging in manufacturing, trade, transport, services, and also inactive groups, experienced a considerable drop in poverty. As a result, the shares of these sectors to poverty also dropped. The highest reductions in poverty incidence were found in the transport sector, from 9.37 percent to 5.49 percent, and trade, from 10.98 percent to 7.45 percent.

Poverty profiles by work status

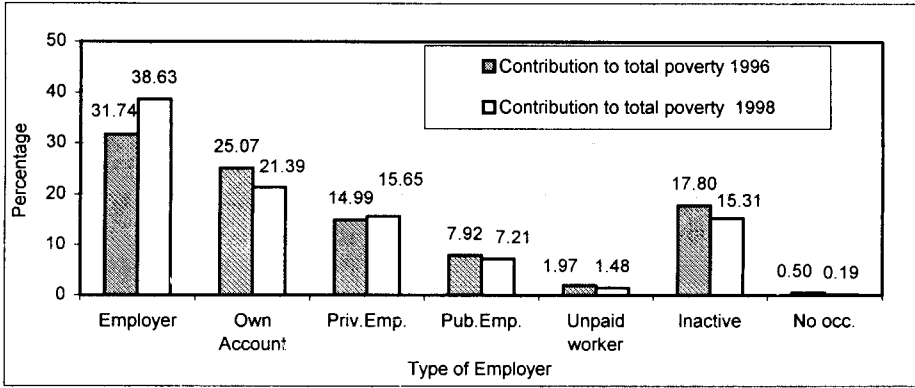
Considering poverty profiles by work status, Figure 10 shows the increase in poverty incidence among employers from 17.09 percent to 20 percent and private employees from 9.18 percent to 9.79 percent during 1996 and 1998. There are similar increases in their contribution to poverty (as shown in Figure 11).

Figure 10 Poverty by employment of head of household 1996 and 1998



Source: Socio-economic survey 1996, 1998.

¹⁹ These surveys were conducted during the 1995/96 and 1997/98 agricultural years to compare the impact of the crisis on income, expenditure, productivity, debts, and labor movement.

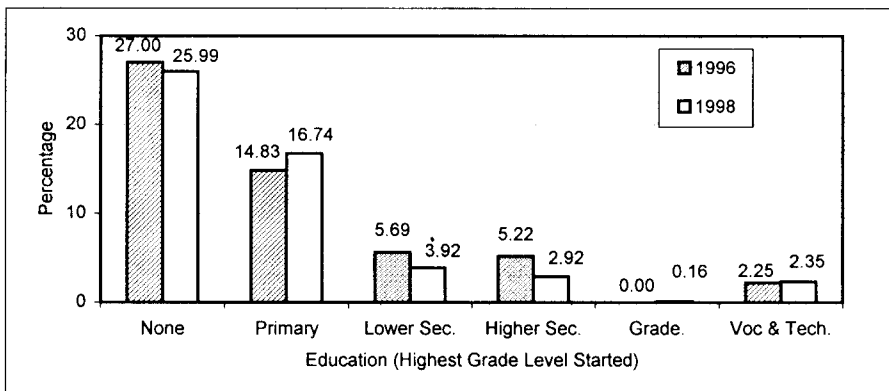
Figure 11 Contribution to poverty by work status of head of household, 1996 and 1998

Source: Socio-economic survey 1996, 1998.

In fact, both employers and employees were adversely affected by business collapses and operations' declining benefits. Those with no occupation had the highest increase in poverty incidence, from 11.9 percent to 19.6 percent. This is understandable because the group faced difficulties in job opportunities and earnings. The others, i.e., own account workers, public employees, unpaid family workers, and also inactive households, experienced a decline in poverty incidences in 1998. As a result, contributions to poverty from these households dropped accordingly.

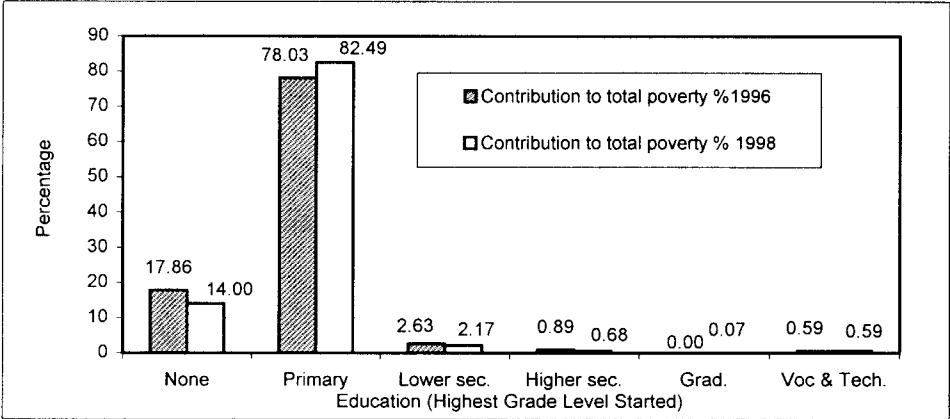
Poverty profiles by education levels

Considering changes in poverty profiles by households' education levels, Figure 12 shows that households with primary education had the highest increase in poverty incidences, from 14.83 percent in 1996 to 16.74 percent in 1998, thus, there was an increase in the contribution to poverty from 78 percent to 82.5 percent (Figure 13). Those households with university graduate and vocational and technical education also experienced a slight increase in poverty. The rest, i.e., those with lower and higher secondary education and even no education, dropped in poverty incidence, so did their contributions to poverty in 1998.

Figure 12 Poverty by education of head of household 1996 and 1998

Source: Socio-economic survey 1996, 1998.

Figure 13 Contribution to total poverty by education of head of household 1996 and 1998

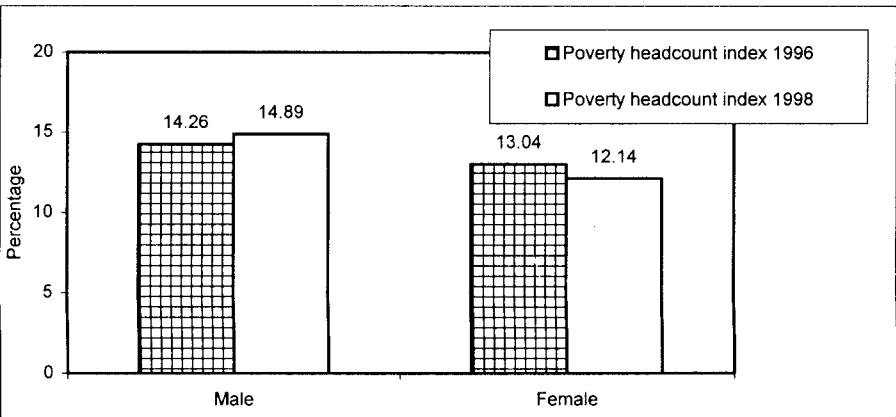


Source: Socio-economic survey 1996, 1998.

Poverty profiles by household size and gender of the head of household

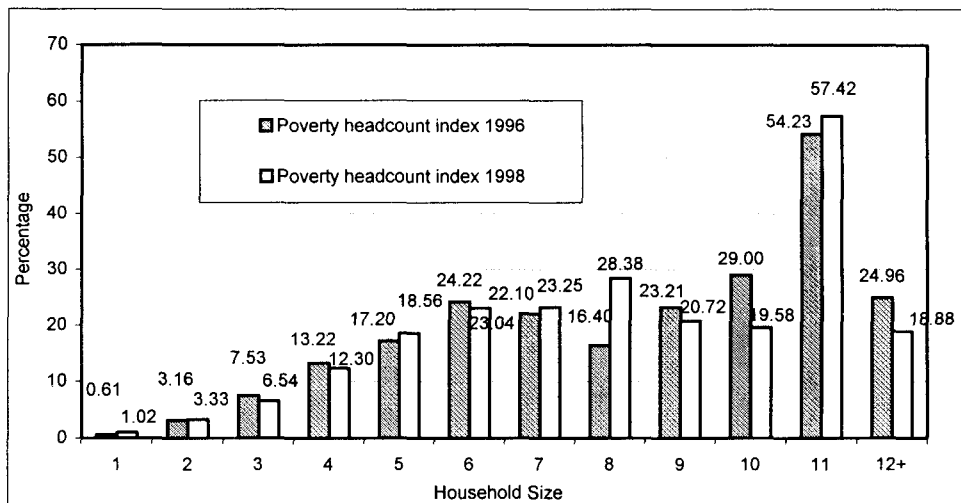
Figure 14 shows poverty incidences by gender. It shows that the poverty incidence of males increased from 14.26 percent to 14.89 percent (from 1996 to 1998), while that of females decreased from 13.04 percent to 12.14 percent during the same period.

Figure 14 Poverty by gender of head of household 1996 and 1998



Source: Socio-economic survey 1996, 1998.

Figure 15 shows poverty incidences by household size. Increases in poverty incidences in 1998 were likely to occur in large households (i.e., 7, 8 and 11). Larger households were likely to have a higher poverty incidence because more family members had to share limited household resources or income. An expansion in the average household size may have resulted from vulnerable people having to return to live or depend on their extended families.

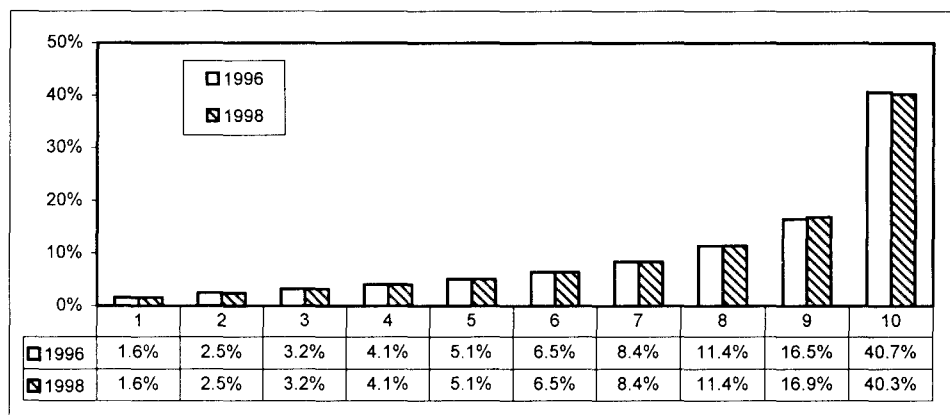
Figure 15 Poverty by household size, 1996 and 1998

Source: Socio-economic survey 1996, 1998.

These poverty profiles reflect that the crisis had a deeper impact on certain groups of people. Although aggregate data shows that overall poverty incidence increased, disaggregated data shows that the adverse impact was highly concentrated on specific groups. The most affected were likely to be in Bangkok and Northeast (rural) areas; agriculture and construction; private employees and employers; extremely high and low educated groups (both unskilled workers and tertiary graduated).

3.3 Impacts on income distribution

The Gini coefficient decreased slightly from 0.5976 in 1996 to 0.5656 in 1998, which reflects that income inequality slightly improved because the rich were more affected and lost greater income share than the poor. Figure 16 shows that income shares were almost unchanged in the 1st to 8th deciles. However, the 9th decile apparently gained more income share, 0.4 percent, while the 10th decile lost income share, 0.4 percent. This implies that the second richest group gained more income share while the richest group lost income share. However, these aggregate changes indicated by this secondary data source between the two-year period appear minor, although people experienced strong impacts at micro levels or in specific instances at different shorter periods. As a result, the Gini coefficient from SES data in 1998 slightly improved from that of 1996. In fact, the poor and the middle class had a smaller amount of income change relative to the rich. The conclusion tends to support the argument that the crisis had a greater effect on the upper class.

Figure 16 Distribution of income by deciles (%)

Source: Socio-economic survey 1996, 1998.

4. Impacts on Social Sectors

The crisis has affected long-term human resource development mainly through its impact on education, health, and family and community problems.

4.1 Education: school dropouts and child labor

Human resource development is of increasing concern as there is evidence of a number of students dropping out of schools and universities since the onset of the crisis. Data from the Ministry of Education indicates that in 1997 the school dropout rate for grade 6 to lower-secondary level was 7.64 percent, and for lower-secondary to higher-secondary levels it was 13.17 percent, both of which increased over the previous years. As a result of family income loss, poor parents could no longer afford to send their children to higher education. The Ministry of Education and the National Economic Council (NEC) estimated the number of school dropouts for 1998. Their estimates show that some 126,000 students dropped out due to the crisis, another 276,000 left school early (after primary or secondary schooling), and others moved to lower-priced schools or shifted from urban to less expensive rural schools. Boys had a better chance of continuing education by becoming Buddhist novices. Generally, school enrollments dropped 7.2 percent for private schools and 1.8 percent for public schools.²⁰

The TDRI conducted a survey in 1998 to examine how urban unemployed families managed the problems of their children's education. It was found that about 32 percent of the children suffered cuts in expenditure on education, especially for high school education. About 10 percent were moved to public schools, particularly those in primary and high schools. About 9 percent said they might not be able to pay tuition fees for the next semester, and about 5.6 percent asked others to take care of their burden, and about 3.6 percent of the children had already dropped out of school.

²⁰ Quarterly Newsletter: ADB's Social Sector Program Loan (SSPL), January, 1999.

Increases in the number of school dropouts leads to an increase in child labor and lower human capital. Child labor, however, does not receive proper returns, and consequently raises the risk of poverty. A study by the Primary Education Commission indicates that 3.7 million out of 6.3 million children suffered from hunger.²¹ A National Economic and Social Development Board (NESDB) study estimated that almost 40 percent of the 7.9 million poor in early 1998 were children (NESDB 1998). Estimates by Kakwani (1998) reveal that the crisis led to a significant increase of up to 0.35 million in child labor; this will have a serious long-term impact on Thailand's human resource development.

Of particular concern are children from disadvantaged households. A survey conducted in late 1997 by the Foundation for Children Development (1998) found that about 45 percent of the disadvantaged children reduced school lunch expenditure. A survey of child labor in disadvantaged households also found that about 60 percent of working children in the survey tended to look for a job in urban areas rather than study or live in rural areas. The possibility of a reduction in lunch expenditure as well as increases in child labor will inevitably affect long-term human capital.

Education at higher levels was also affected. For example, the budget of the Department of Vocational Education (DOVE) was cut by 21 percent for the fiscal year 1998, and that for research for higher education by 18 percent. While students have a limited number of scholarships for higher education, their opportunities in labor markets also deteriorated. Data in Table 24 shows unemployment rates by education levels. Although skilled workers with primary or lower education were the largest group of unemployed (about one million in February 1998), workers with upper-secondary level had the highest unemployment rate, 6.03 percent, in the same period (with the fastest growth rate during 1997-98).

More disaggregated data reflects that the problem of educated unemployment was especially strong in Bangkok, with 7.82 percent for the vocational and 7.35 percent for the university levels. Urban areas had less disparity in unemployment rates among different levels, and had the lowest educated unemployment rate, with 5.21 percent for vocational and 5.33 percent for university levels. The highest university educated unemployment was found in rural areas, with 8.99 percent, which may be due to the fact that rural markets had low job opportunities for university graduates.

4.2 Health and environment deterioration

The crisis is expected to have negative impacts on health, both physical and psychological. In 1998, the budget of the Ministry of Public Health was down 9 percent from the previous year. This would adversely affect the provision of public health services in the period that people, especially the vulnerable groups, may increasingly need them. In addition, the costs of drugs increased after the floating of the baht and the costs of pharmaceutical production increased by about 21 percent (Preeda 1999). A study by Rapeepan and Charasporn (1998) comparing percentage changes in the cost of drugs per unit change in baht at the Banpong Hospital in Ratchaburi province after the baht's floatation found that the costs of essential, non-essential and original drugs increased significantly. This would further increase the burden of essential expenditures on the poor and worsen their health care. As a result, drug consumption decreased. There has also been a shift from using the medical services of private hospitals to clinics in order to reduce health care expenditure.

²¹ *Bangkok Post*, April 16, 1999.

Table 24 Unemployment rate by education: round 1, 1994-1998

	1994		1995		1996		1997		1998	
	Unemployed	Total labor force	Unemployed	Total labor force	Unemployed	Total labor force	Unemployed	Total labor force	Unemployed	Total labor force
Primary and lower %	1,010,214 4.06	24,892,951	559,477 2.31	24,238,544	485,255 1.98	24,509,724	484,396 2.02	23,974,463	1,029,001 4.46	23,071,788
Lower secondary %	90,481 3.85	2,347,737	68,209 2.46	2,768,645	77,877 2.57	3,029,801	99,182 3.13	3,167,750	214,224 5.83	3,676,227
Upper secondary %	29,373 3.35	877,865	32,962 3.03	1,087,725	21,639 2.10	1,031,834	26,785 2.23	1,201,093	85,288 6.03	1,413,407
Vocational and others %	38,487 2.49	1,542,768	39,813 2.63	1,511,491	24,310 1.61	1,507,168	43,544 2.75	1,582,407	59,657 3.58	1,664,144
University %	34,695 2.29	1,515,980	21,970 1.35	1,630,654	31,644 1.86	1,703,619	43,684 2.21	1,976,788	91,099 4.03	2,259,548
Total %	1,203,250 3.86	31,177,301	722,431 2.31	31,237,059	640,725 2.02	31,782,146	697,591 2.19	31,902,501	1,479,269 4.61	32,085,114

Source: Labor Force Survey, National Statistical Office.

Psychological problems have become critical. From the records of 15 psychiatric hospitals, there was an increase in the number of out-patients from 778,457 in 1997 to 804,906 in 1998.²²

Another rising concern is the impact of the crisis on children as malnutrition and abandonment have increased. A survey compiled by the Health Intelligence Unit²³ indicated that the percentage of underweight children had increased from 7.9 percent in 1996 to 11.84 percent in 1997 and 12.29 percent in 1998. Malnutrition is more severe in poorer regions; the Northeast accounted for 25.5 percent of the total malnourished children while Bangkok accounted for 8.4 percent in 1997.

The Ministry of Public Health and the Health Systems Research Institute both estimated that underweight children below five years of age in rural areas outnumbered those in urban areas by more than double. These agencies urged authorities to pay more attention to worsening areas, such as the rural Northeast. The poor had the lowest rate of access to pre-natal and child delivery care. Their infants had the highest rate of low birth weight. Only 15 percent of the poor using the services were covered by the low income card scheme, 25 percent were self-paying and 50 percent were covered by prepaid health cards (Preeda 1999). Health expenditure declined in all income groups, and private hospitals were affected by a drop in the number of patients.

The growth in the number of abandoned children, particularly in Bangkok, is also worrisome as it reflects the weakening of family institutions. The number of unwanted children being cared for at the Rajvithi Welfare Home, about 500 children, has risen by 40 percent since the economic slump. Based on information from 40 state-run hospitals and welfare homes, the survey results showed an increase of 9.7 percent and 34 percent respectively in the number of under-five-year-old and six to 18-year-old children who had been abandoned. The number of infants abandoned by their parents immediately after birth also increased.

The impacts of the crisis on the environment can be viewed from resource uses and conservation budgets. Environmental problems due to the crisis might arise from an increasing number of people sharing limited resources in the same area (i.e., in urban slums or hometowns in rural areas), thus further deteriorating the pre-crisis problems of natural resource mismanagement and deforestation. The increasing reversed migration to rural areas is expected to worsen the rural natural resource use situation. A limited Government budget for environmental infrastructure investment would also limit the capacity for environmental management. For example, the budget for environmental quality control was reduced from 8,311.9 million baht in Fiscal Year 1997 to 7,080.6 million baht in FY 1998 and 5,315.5 million baht in FY 1999, while that for pollution control was cut from 979.7 million baht to 366.5 million baht and 188.4 million baht over the same period.

The deterioration of health and environmental services would lead to a lower quality of life. These phenomena will become serious social problems if not effectively addressed. The increasing cases of suicide and psychological problems among Thai people are obviously linked to the crisis.

4.3 Impacts on community and family

The migration of people back to their hometowns to become unpaid family workers leads to an increase in the average household size, lower household income and increased

²² Data from the Department of Mental Health, Ministry of Public Health.

²³ Results from the surveys are summarized in *Bangkok Post*, April 16, 1999.

indebtedness. A survey by Office of Agricultural Economics (1999) reports that the debt of agricultural households increased and the share of loans from the informal sector increased by 8 percent during 1996-98. This is probably due to increased borrowing by households to make up for declining incomes and to meet the extra expenses of an expanded household.

As many of the returned migrants cannot find work in rural areas, where agricultural unemployment is already high, they have to wait for employment opportunities in non-agricultural labor markets. Limited job and income opportunities may increase social and economic pressures on the unemployed, affecting relations within the family and community.

While there have been a number of negative impacts, the crisis has also generated some positive impacts. For example, the TDRI/WB study (2000) found that there has been an increasing trend of women taking up a greater role in community development, politics, and other activities.

As a variety of the social impacts of the crisis, particularly on the community and family institutions, have already occurred or are likely to occur, the crisis is likely have impacts both positive and negative on the social capital.²⁴ For instance, limited income and employment opportunities may weaken the network of relationships among community members in the long run as they will have less ability to support each other. As people begin to be concerned more with their individual problems, the contribution to social activities/institutions would decline. The weakening of social capital can be caused by a number of factors: a breakdown in community trust; increased competition for employment among members who once cooperated; increased incidence of theft, violence, crime and drug dealing; and higher dropout rates among schoolchildren. Frustration and psychological stress can lead to heightened household and community tension. Crime rates are rising and the crisis has reinforced the drug trade as an easy way to earn money (World Bank 1999). This is consistent with the survey by the Social Research Institute (1999) which indicated that the problems of drugs, robbery and gambling had increased in communities, especially in Bangkok and other urban areas. In many communities, unemployment is the main problem, and has contributed to increased frustration among fresh graduates with no previous work experience.

Nevertheless, the crisis may also hold potential opportunities to increase social capital, the relationship of trust and cooperation within a society. If networks of individuals in society can be strengthened, this would imply an increase in cooperative behavior and in social capital. During the heat of the crisis, supporting networks in families and communities helped absorb the vulnerable groups, particularly those returning to their rural homelands. Thus, supporting networks of family and community members can be strengthened as members come back and share ideas on how to cope with the crisis. The youth (with more exposure to the economy and society outside the rural areas), particularly, return home more frequently and can become a valuable human resource for their communities, and contribute to the increase in social capital.

Moreover, the crisis may also produce some spill-over benefits that may help toward rebuilding social capital. For instance, the crisis forced a number of families to become more disciplined and resilient. Many Thai communities have been stimulated to increase cooperation and mutual support during the crisis. Increasing social activities through community-based institutions during the crisis may provide a promising avenue for social interaction and protection of social values, and such activities merit additional Government

²⁴ Social capital can be defined as an accumulated stock of cooperation-facilitating social arrangements, which, with a relative dearth of sociability, can foster cooperation (Unger 1998: p 15).

support (World Bank 1999). Thus, family and community-based institutions remain effective entities for strengthening the social fabric during the crisis.

5. Policy Responses to Address the Impacts on Social Sectors

The consideration of policies to mitigate adverse social impacts is a priority of crisis management. As overall economic policies also affect the real sector and the development of social sectors, this section discusses overall economic policy responses affecting social development as well as policy responses directly aimed at reducing social problems.

5.1 Overall economic policies

Tight monetary and fiscal policies were implemented in the early period of the IMF assistance. Currency stabilization became the first priority before providing economic stimulus for recovery. Following the IMF-imposed conditions in the earlier Letters of Intent, the Government adopted strict monetary and fiscal policies, such as increasing the VAT (value added tax) (from 7 percent to 10 percent in August 1997), decreasing Government budgets, and maintaining high interest rates. High interest rates were adopted to stabilize the exchange rate. However, the tight fiscal and monetary policies during a severe recession turned out to be damaging to the whole economy. High interest rates exacerbated the illiquidity situation by raising the interest costs of private firms and limiting their access to credit. As a result, export-oriented production firms that were likely to benefit from the baht's depreciation were unable to expand their businesses. This limitation from the tight measures is one of the reasons why the baht's flotation in 1997 did not bring the benefits to the export sector as it did in 1984.

Since the Asian crisis also stems from fundamental problems in economic structure, strict fiscal and monetary discipline obviously resulted in adverse effects on the real sector. After the first year under the IMF program, it was time for the Government to change course. Following a Keynesian-type approach, the Government eased fiscal and monetary measures and adopted a more relaxed macro-policy regime. Since then, interest rates have dropped rapidly and fiscal stimulus programs have been reshaped to meet domestic needs. However, it seems that the adoption of this approach was rather untimely, since the real sector had already been crippled.

The Government has adopted a significantly higher fiscal deficit budget—5 percent of GDP—since the Sixth Letter of Intent (LOI 6). To speed economic expansion, the Government used both taxation and budgetary measures at the same time. LOI 7 further expanded the fiscal deficit, to 6 percent, in order to stimulate domestic demand. The Government has also attempted to disburse more funds to stimulate demand and mitigate the adverse impacts on the poor, mainly through job creation programs.

When economic stabilization started to look satisfactory, the Government decided that it no longer needed IMF funding support; thus it stopped drawing IMF funds after LOI 8 in May 1999. Total IMF loans received until LOI 8 (August 1997 to May 1999) totaled US\$14 billion.

- *1999 Economic stimulus programs*

This economic stimulus package announced on March 30, 1999, aimed at boosting economic recovery. It consisted of expenditure measures, tax reductions and measures to

lower energy prices, and focused on creating employment and increasing incomes for rural and urban people affected by the crisis.

- Tax measures under the package aimed at stimulating investment and consumption. These included: a reduction in VAT from 10 percent to 7 percent from April 1, 1999 to March 31, 2001; elimination of VAT for small enterprises (i.e., those with annual revenue below 600,000 baht); and tax waivers (from the existing 5 percent personal income tax) on the first 50,000 baht net personal income and a tax reduction of 2,500 baht per year on income above 50,000 baht.
- Energy price reduction aimed at reducing costs for producers (industries) and thus on consumers.
- Public expenditure measures, carried out through the fiscal budget and loans, aimed to create domestic employment and productive investment as well as alleviating social impacts.

In addition to the annual Government budget plan, loans totaling US\$1.45 billion (53 billion baht) financed by the World Bank (US\$600 million), Japan's Ex-Im bank (\$600 million), and Japan's OECF (\$250 million) are being speedily used to create more employment and spur domestic demand.

To further promote economic recovery, the Cabinet announced another stimulus package on August 10, 1999. The package aimed to support the economic restructuring process and enhance the long-run competitiveness of the private sector. The package consisted of 1) tax and tariff measures; 2) equity investment measures; 3) measures to promote the recovery of the real estate sector; and 4) measures to improve the financing of small and medium enterprises (SMEs).

As international loans are being used for the economic stimulus packages, the concern is how effectively these loans will be utilized in a way that actually generates benefit to the target groups. In addition, the data on loan allocation, classified by detailed expenditure categories, is ambiguous. This data ambiguity poses an obstacle in monitoring the progress of the target groups *vis-à-vis* the loans they received.

• *Budgeting*

Changes in the priority of Government programs can be assessed from changes in budget allocation patterns. Table 25 shows the change during the crisis period 1997-2000. Although Government budget cuts in 1998 were made on IMF advice that priority programs such as education, health and social services should be protected from the cuts, the percentage cuts in the budgets of these programs were significant, particularly for social services, which suffered the highest percentage cut (-35 percent) in fiscal year 1998. The limited supply of social service programs would inevitably affect the welfare of the poor. The agriculture and energy sectors and environmental protection have also been considerably affected as they too have suffered high percentage cuts. Budget constraints will also lead to a delay in many infrastructure projects, such as transportation and telecommunications, commerce and tourism, energy and environment, all of which received trimmed budgets in 1999. However, the percentage of overall budget cuts was smaller in 1999 and were no cuts for 2000. This indicates the Government's direction of fiscal expansion. In contrast to 1999, a number of sectors received budget increases for 2000, with the commerce, tourism, energy and environment sectors gaining the highest percentages of fiscal expansion. However, it is worth noting that the percentage change in the social services has continued to be negative.

Government budget expenditure on the various programs since the crisis is detailed in Table 25.

Table 25 Government expenditure for 1997-2000 (million baht)

Programs	Fiscal Expenditure for 1997	Fiscal Expenditure For 1998	% Difference from		% Difference from		Approximate Fiscal Expenditure for 2000	% Difference from 1999
			1997	Fiscal Expenditure for 1999	1998			
Agriculture	83,964.3	62,475.7	-25.6	61,375.6	-1.8		67,068.1	9.3
Industry and Mining	3,005.5	2,989.5	-0.5	3,206.4	7.3		3,659.0	14.1
Communications and Transport	95,939.5	80,470.7	-16.1	64,890.4	-19.4		60,165.6	-7.3
Commerce and Tourism	6,935.5	6,374.9	-8.1	4,783.2	-25.0		5,490.9	14.8
Science, Technology, Energy and Environment	19,514.5	14,203.1	-27.2	12,624.1	-11.1		15,227.0	20.6
Education	216,278.5	208,274.8	-3.7	208,616.1	0.2		222,416.1	6.6
Public Health	75,023.0	66,455.2	-11.4	62,467.4	-6.0		65,744.0	5.2
Social Services	158,696.4	103,082.2	-35.0	98,501.5	-4.4		92,994.6	-5.6
Defense	119,429.3	92,565.6	-22.5	89,349.7	-3.5		88,690.5	-0.7
Internal Security	44,278.1	43,875.2	-0.9	44,554.6	1.5		50,006.3	12.2
General Administration	114,139.0	104,811.2	-8.2	99,429.4	-5.1		109,531.3	10.2
Debt Servicing	46,796.4	44,421.9	-5.1	75,201.6	69.3		79,006.6	5.1
Total	984,000.0	830,000.0	-15.7	825,000.0	-0.6		860,000.0	4.2

Source: Bureau of the Budget, Thailand's Budget in Brief 1998, and 1999 (in Thai).

5.2 Social policy responses

The Thai Government's direct responses to social policies can be assessed through its budgeting of programs by areas of social development, including social safety net programs. Government cuts in social services, such as social insurance funds, are bound to have negative impacts on public welfare. The decline in supplies of public and social services more adversely affects the poor. In addition, falling private investment in public facilities (i.e., hospitals, schools, and other infrastructure) forces more people to use limited Government services. The poor and under-privileged groups who are less able to access these services are the most affected. The problem is increasingly severe for those vulnerable groups who are not covered by formal social safety nets, which are unlikely to cover the majority.

Social budget programs

Social service programs during the crisis have been greatly affected by budget cuts, as shown in Table 26.

The Table shows that the social service and development budget, particularly rural development, underwent heavy cuts in 1998. Budgets for social and public welfare, particularly social security, as well as urban and environmental development, significantly declined in 1998. On the other hand, the 1999 budget for social welfare was increased—especially for social security; this category tends to expand more in 2000, reflecting the Government's emphasis on the social security scheme. Budgets allocated for the development of special target groups also increased considerably for 1999, especially for labor welfare

administration and development. This is perhaps a response to address the problem of laid-off workers and rising unemployment.

Table 26 Budgets for social services, by sub-sector

(in million baht)

Sector / Sub-Sector / Program		1997	1998	1999	Approximation 2000
Sector: Social Services		148,454.2	103,082.2	98,501.5	92,994.6
Sub-Sector:	Social and Public Welfare	7,862.3	4,817.4	7,436.2	13,018.3
Program:	Social and Public Welfare Administration	337.1	306.9	317.7	302.8
Program:	Social and Public Welfare	3,378.4	3,149.5	3,196.8	4,106.6
Program:	Social Security	4,146.8	1,361.0	3,921.7	8,608.9
Sub-Sector:	Social Service and Development	95,377.5	55,437.9	50,925.4	43,060.6
Program:	Rural Development	94,501.6	54,595.1	50,399.0	42,507.8
Program:	Land Resettlement Development and Occupation Promotion	875.9	842.8	526.4	552.8
Sub-Sector:	Special Target Group Development	7,159.0	7,847.8	10,864.5	6,774.0
Program:	Child and Youth Development	1,686.9	1,625.4	1,353.0	1,437.3
Program:	Women Development	134.5	97.5	47.2	60.7
Program:	Hill Tribes Development	341.4	336.7	340.0	350.0
Program:	Labor Welfare Administration and Development	3,503.2	4,403.8	7,992.2	4,598.4
Program:	Accelerated Development for the Five Southern-most Provinces	1,024.1	1,057.7	797.2	—
Program:	AIDS Prevention and Suppression	468.9	326.7	334.9	327.6
Sub-Sector:	Urban and Environment Development and Basic Service	38,055.4	34,979.1	29,275.4	30,141.7
Program:	Urban Development	21,687.4	20,568.7	19,624.3	20,209.1
Program:	City Planning and Public utilities	11,262.2	8,757.3	7,860.0	7,828.0
Program:	Sports and Recreation Promotion	5,105.8	282.6	233.7	346.2
Program:	Sport Promotion and Development	-	5,370.5	1,557.4	1,758.4

Source: Bureau of the Budget.

5.3. Social safety nets

What kinds of safety nets are available in Thailand? This section discusses information on existing formal safety nets and their limitations, social assistance programs, and informal safety nets.

- *Formal systems*

Current formal safety nets in the labor market are severance payment and social security schemes.

For most laid-off Thai workers, the obvious safety net so far has been severance pay, which works only in the formal sector. Up to August 19, 1998, severance payment amounted to six months of pay for those who had worked for at least three years, but after that date it changed to 10 months.

The employed and their families may be cushioned by social security programs. These previously included pension benefits to workers in the public sector and health benefits of those in the private sector. Current social security programs cover private enterprises employing at least 10 workers and self-employed professionals. The basic insurance²⁵ covers the employed for sickness, pregnancy and childbirth, death and disability; however, it excludes the unemployed. Recently, pension and child-care allowance schemes for private sector employees have been established. As of September 1999, the beneficiaries of the social security program nationwide were 5.53 million workers (roughly 15 percent of the total workforce) in 96,643 business establishments, of which 39 percent were based in Bangkok.²⁶ With massive lay-offs and rising unemployment during the crisis years, a rising number of the unemployed were seriously affected due to the lack of social insurance; therefore, the Government extended social security benefits for the unemployed from six to 12 months and reduced the tripartite contribution rate by one-third. Laid-off employees from the formal sectors can apply for this voluntary insurance²⁷ within six months of being laid off. As a result, an additional 60,000 beneficiaries have applied for the voluntary insurance.

However, similar to other ASEAN countries, these formal systems (severance payment and the social security system) cannot cover the majority of workers who engage in small-scale operations and those in the informal sector. Thus, it is important to have additional social assistance programs, focusing specifically on target groups.

Data in Table 27 suggests that the majority of the vulnerable who lost employment were unlikely to receive any compensation because about 75 percent (in the dry season) and 73 percent (in the wet season) of those who lost jobs in 1998²⁸ due to business closure or lay-offs did not receive any benefit, while only 12-15 percent received one to three months' salary as compensation. Therefore, other coverage for such large groups who did not receive severance payment needs to be considered.

Table 27 Status of compensation payment to those losing employment from business closure or lay-off

a) February 1998	Number	Percentage	b) August 1998	Number	Percentage
Get Nothing	188,232	74.8	Get Nothing	192,427	73.1
Get 1-3 months payment	31,227	12.4	Get 1-3 months payment	39,848	15.1
Get 4-6 months payment	7,226	2.9	Get 4-6 months payment	13,771	5.2
Get >6 months payment	1,978	0.8	Get >6 months payment	2,619	1.0
Get others	3,952	1.6	Get others	5,051	1.9
Unknown	19,087	7.6	Unknown	9,644	3.7
Total	251,742	100.0	Total	263,360	100.0

Source: Labor Force Surveys, National Statistical Office.

²⁵ Employees under this scheme have to pay 1 percent of their salaries, and an additional 1 percent for the coverage of childcare and old-age pensions.

²⁶ Statistical and Planning Office, Social Security Card Division.

²⁷ The laid-off workers have to pay the normal employee portion of 1 percent and an additional 1 percent (normally the employer's portion) for the basic insurance coverage. Thus, the laid-off workers have to contribute a total of 2 percent, while they used to contribute only 1 percent when they were formally employed.

²⁸ The Labor Force Survey in 1998 added more questions about compensation to workers because adverse impacts on workers were very severe in 1998. Unfortunately, the survey does not carry on asking these types of questions in later years; therefore, only 1998 data is available.

- *Government assistance programs to address the impacts on social sectors*

Other safety nets include those that allow access to social infrastructure, such as education, health, and other public infrastructure. Government social assistance and expenditure programs during the crisis were aimed at assisting the crisis-affected disadvantaged or vulnerable groups. These programs aimed to support numerous projects and provide immediate support to the vulnerable.

The Asian Development Bank's (ADB) Social Sector Program Loans (SSPL) worth US\$500 million²⁹ were particularly aimed at supporting social projects via the ministries of education, health, labor and social welfare, and agriculture. The World Bank loans of US\$300 million, disbursed through the Social Investment Program (SIP), aimed for employment creation and capacity building in communities and local governments. These Government programs are discussed in the following paragraphs.

Job creation programs

The World Bank-supported SIP program and the Miyazawa Plan were mainly job creation programs. Of the SIP's total US\$300 million, the Regional Urban Development Fund (RUDF) and the Social Investment Fund (SIF) were allocated US\$150 million for the longer term projects of capacity building among local organizations in urban and rural areas. The RUDF, totaling US\$30 million, was aimed especially for urban development led by municipalities, which were selected for pilot projects.

The SIF projects, totaling about US\$120 million or 4,368 million baht, aimed to strengthen the capacity of local communities. The SIF program fund, created through the World Bank loan, is managed by the Government Saving Bank, and supports projects designed by local communities. As of February 4, 2000³⁰ there were 1,722 supported projects, using a total budget of 1,915 million baht and benefiting about 2.7 million people. Within one year of the launch of the SIF program, some 400 projects, using 602 million baht had already been completed. Projects are concentrated mostly in the upper North and lower Northeast regions. The projects aim to increase social capital, people participation, and environment preservation.

The Miyazawa fund of US\$1.45 billion, which was originally aimed at stimulating domestic demand through job creation, was distributed through various ministries. For example, the Department of Local Administration, Ministry of Interior, received a total of about 7,400 million baht to be allocated as a lump sum of 100,000 baht for each village nationwide; the Ministry of Education received a total of 4,180 million baht for the development of education areas and for supplying materials to poor students, as well as employing the educated unemployed.

However, public employment-creation programs are expected to address only a small proportion of the total unemployment. The International Labor Organization (ILO), for instance, estimates that only 7 percent of the unemployed will be re-employed under these programs (Lee 1998:55). None of the studies on social impacts provide a clear answer to the question of how much impact unemployment has had on the reduction in household income (IMF 1998). Whether these employment creation programs will become proper "safety nets" remains a question, since they provide only a fraction of relief to those who need it (Lee 1998). Given the constraints to the effectiveness of Government expenditure programs, the

²⁹ However, only US\$200 million has been allocated through budget spending programs via various ministries.

³⁰ *Than Sethakit*, February 13-16, 2000, p. 12.

ILO suggests that passive measures (Government assistance programs) should be an alternative as they seem to be more appropriate than the Government expenditure programs. However, the World Bank's comprehensive development framework concerns a policy to maintain full employment as the most effective safety net, as macroeconomic management is always imperfect and may have some fluctuations in output and employment (Wolfensohn 1999). Moreover, policies dealing with strengthening the capacity of individuals must be directed at human aspects, namely education and health, as foundations to effective development.

Education

For education, ADB funds worth US\$25 million (or about 1,000 million baht) were allocated in the first year of the crisis to provide scholarships to about 300,000 primary and secondary school dropouts to resume studies. An additional 525 million baht was allocated to this program in the second year. There is also an additional Government budget, allocated since pre-crisis years, for providing educational loans to needy higher secondary and university students. These assistance programs aim to minimize the incidence of school dropouts and maintain operational budgets for teacher training and instruction materials in science, mathematics, and foreign language education.

Educational aids for primary and lower secondary school dropouts are provided to those students whose families are unable to re-enroll them in school due to the crisis. The assistance provides for a one-year educational program. So far, about 800 million baht³¹ out of the allocated 1,000 million baht has been disbursed under this program. This amount has been allocated to:

1. 29,916 current dropouts who left school during the education year (136 million baht);
2. 43,324 potential dropouts who were intending to leave school due to unemployed parents (390 million baht);
3. 101,700 drop-out students in the previous three years (42 million baht);
4. 21,810 needy students (87 million baht); and,
5. 45,864 Buddhist novices intending to pursue primary and secondary education in temples (229 million baht).

The problem so far has been difficulty in locating the dropout students as they have already left school. Some of them may follow their parents in migrating to different areas; thus, it is hard to get their records. In addition, it has been suggested that this type of assistance be continued on a longer-term basis, since the re-enrolled students may need support to remain in school for longer than one year as currently supported under the aid program. From a survey targeting primary students with current scholarships, conducted by the Ministry of Education (MOE, 1999), it is indicated that without education scholarships for the next year, the possibility to continue their studying is 81.9 percent (versus 96.9 percent if they are granted scholarships). Therefore, about 15 percent of current scholarship students would drop out next year if there were no scholarship support.

The Ministry also received 4,186,30 million baht from the Miyazawa fund³² which was planned for: 1) reducing the adverse impacts on the poor by supplying education materials, clothes, school lunches, etc., to poor students, with total budget of 855.23 million

³¹ Data from the Office of the National Education Commission, Office of the Prime Minister; as of September 1999.

³² Data from the Ministry of Education as of August 1999.

baht; 2) hiring the educated unemployed (4,736 persons as of August 1999), with total budget of 337.02 million baht; 3) developing the quality of student life, such as building recreation and sports areas for students, with total budget of 419.40 million baht; 4) supporting education development, such as primary education (1,988.75 million baht), expanding education opportunities (288.60 million baht), and repairing and upgrading educational areas and offices (297.3 million baht).

Health

As the crisis-related belt-tightening has created increasing demand for public healthcare services from people who previously used private healthcare, the ADB and the World Bank funds have also been allocated to public hospitals, which provide services to the low and middle-income groups. The ADB loan of about 1,200 million baht has been allocated for a voluntary low-cost health card scheme for the marginal poor and the middle-income group. This fund has provided a top-up 500 baht/card directly to public hospitals under the scheme throughout the country. One card can cover up to five family members. So far, about 1.9 million cards have been issued.

Parts of the World Bank's SIP program fund, worth about US\$27.8 million, have also been allocated to provide free health cards to the crisis-affected poor and the vulnerable, including laid-off workers. Under this pilot project, the SIP fund has been distributed directly to hospitals in six provinces, namely, Yasothon, Phayao, Yala, Nakhon Sawan, Pathum Thani, and Samut Sakhon. Currently, about 27 million poor people and 200,000 laid-off workers and their families use this type of health card.³³ However, a number of laid-off workers may be unaware of this scheme, because the Ministry of Labour and Social Welfare still faces difficulties in wider distribution of information about the program. Other assistance programs include, for example, free medical treatment and improvement of rural health-care facilities for an additional three million people, as well as the extension of health, disability, death, and maternity benefits for laid-off workers for one year.

These programs have already allocated budgets; for example, 1,200 million baht for the voluntary health cards, and about 8,000 million baht for the health cards for the poor. The 2000 budget will allocate about 2,400 million baht to be used as a revolving fund for the voluntary health card scheme.

Skill training and assistance to vulnerable workers

A large chunk of the international loans, worth 3,446,679 million baht has been allocated to the Ministry of Labour and Social Welfare to execute programs aimed at skill development and assistance to the vulnerable segments of the workforce. The loan consists of the World Bank's US\$1,105.13 million, the ADB's US\$1,695.2 million, US\$22.37 million from Japan's JBIC (OEFC), and 623.979 million baht from the Miyazawa Plan. These funds are used for skill development and labor welfare (especially for women and children in the families of the laid-off workers), to provide job-searching assistance, computer skill training for newly graduates, support studies on unemployment and employment during the crisis, as well as employment creation for local empowerment in rural areas. Short-term and long-term training programs have also been conducted. In addition, there has also been a policy since the crisis to limit the number of foreign workers in the country and to promote overseas employment.

³³ Information from the Ministry of Public Health, as of February 2000.

Community empowerment

Many community development programs have been launched by Government agencies; for example, the Ministry of Interior (the Community Development Department and the Department of Local Administration), the Office of the Prime Minister, Ministry of Education (Ratchapat Institute). Among many community development programs, the Government's Community Empowerment for Response to Crisis Action Plan (CERCAP) initiative originated during the crisis to take advantage of networks within communities and to build up social capital at the community level. The plan aims to assist communities to analyze crisis-related problems and create skills of problem solving by themselves. This initiative also has the long-term objective to strengthen local empowerment, which is believed to be one way of cushioning the adverse impacts of the crisis by strengthening community structures and encouraging solidarity.

Assistance programs provided by families and communities can serve as the closest informal safety nets for the vulnerable.

Informal safety nets

This crisis has revealed the importance of informal social safety mechanisms, particularly given the drawbacks of the formal ones. As a matter of fact, immediate assistance to the laid-off and the unemployed seems to be coming from their families as many affected Thai workers are in the informal sector which is not covered by the Government safety net systems and programs. In addition, many of them do not know about Government assistance programs. When hit by the crisis during the first year, many chose to return to their home towns to live with their families. A cohesive, supporting family seems to be an effective social protection during economic downturn.

Although Thailand needs further development of its formal social safety nets, such as expansion of the social security scheme with broader coverage for workers in small-scale enterprises in the private sector, Thai society should also strengthen informal social safety nets to strengthen family and community-based institutions. Given the limited capacity of Government assistance, informal safety nets from the private sector and non-Government organizations are also important. Instead of only waiting for assistance to come from the Government or external sources, communities and local organizations should utilize local resources more effectively. Local resources in terms of nature, knowledge, and culture can be used positively to cope with the crisis. Local communities should organize themselves to discuss their problems and try to find alternative ways out of the crisis by the means readily available. Apart from cushioning the immediate impacts of the crisis, this would lead to an increase in social capital—the relationship of trust and cooperation within a society—that will strengthen the development of Thai society.

6. Coping Strategies

A number of strategies to cope with the crisis are apparent and can be grouped into three main types. The first type involves general coping strategies adopted by most worker-households to survive during the crisis. This is a very immediate response. The second type includes strategies to replace the lost earnings or to gain additional income. This can be seen from movement in economic sectors or between locations. The third type includes the use of Government assistance programs or safety nets.

The immediate response to the crisis by those made unemployed seems to have been to look for new employment. At the same time, they also tried to find alternatives. The responses of the interviewed urban unemployed (Table 28) may give some idea about the various immediate responses to the crisis.

Table 28 Responses to the crisis by the unemployed

	Number of Person	Percent
No response	21	4.01
Looking for a new job	409	78.05
Doing family business	48	9.16
Part-time employment	48	9.16
Continuing studies/practice	23	4.39
Supported by family/relatives	4	0.76

Source: TDRI 1998 (interviews with 524 unemployed individuals).

From the Table, seeking new employment appears to be the coping strategy of the majority (78%). Working part-time or helping out in a family business are also important options (9.16% each) for supplementary income. Exiting the labor force in order to continue studies is the option considered by about 4 percent. Those who did not respond or who were being supported by family/relatives are less than 5 percent. This may due to the limitations of family safety nets, which were also affected by the crisis. A TDRI/WB (2000) report shows that not only households/individuals work harder to recoup lost income, but they also adopt various coping strategies: borrowing mostly at high interest rates, taking children out of school, economizing, cutting down expenditures, and tending to be more self-sufficient.

Primary assistance for many vulnerable groups, however, seems to come from their own families/ households. As vulnerable people moved back to stay with their extended families, the average family size increased from 4.39 in 1996 to 4.52 in 1998.³⁴ With the increase in size, households were also expected to re-adjust expenditure. Data from the SES reveals that expenditure levels and patterns indeed changed.

Urban households undertook various strategies to cope with changes in the economic situation. In one study (Pongsapit and Brimble 1999), about 49 percent of the survey responses indicated that household members had to find a new job or have an extra job, or work harder. About 18 percent of responses indicated that household members attempted to invest in a small business. About 56 percent believed their current income was insufficient, and about 24 percent attempted to reduce expenditure by spending only on necessary items. This is consistent with the results indicated in Table 28 above, in which finding new employment, working part-time or doing a family business were the main coping strategies.

In rural areas, where employment and income opportunities are further limited, most households found it very difficult to earn cash income, and therefore their main strategy was to cut down on spending. In the same study (Pongsapit and Brimble 1999), about 35 percent of the households surveyed said that they were spending less on non-essential items to reduce their expenditure. In some rural areas, encroachment of forests and watershed areas, animal hunting/poaching and extraction of forest resources increased. There also has been an increase in bad debts and higher distress. However, many of the crisis-related problems of agricultural households seem to be absorbed by the extended family and other informal safety nets systems (*ibid.*).

³⁴ Data from Socio-economic survey, compared half-year 1996 and 1998 data.

Adjustments in income earning and employment can be viewed from the perspectives of both employers and employees. Adjustments by employers include cutting non-monetary worker benefits or monetary returns as well as working hours. Employees have adjusted by moving to lower-productivity and lower-earning sectors, such as the informal sector. Reverse labor migration to rural areas, discussed earlier, is also one of the adjustments. Some former factory workers have become agriculture-related entrepreneurs. International labor migration (overseas employment) is promoted but the outcome has not been so successful so far.

As there are limitations on the ability of the family to support itself and the newly unemployed members during the crisis, financial support from formal systems (both public and private sectors) is necessary to compensate, at least partly, family income reduction.

In terms of needed assistance from the Government or NGOs, Table 29 shows the types indicated by the unemployed during interviews (TDRI 1998).

These findings indicate that the majority of the unemployed needed assistance in regaining employment rather than welfare for the unemployed. This is also consistent with the responses to the crisis of the urban unemployed discussed earlier (see Table 28). Assistance to receive education or training is the second-largest assistance sought. This is again linked to the need to be employed, since training or education is seen as necessary to upgrade skills and improve the chances of securing employment.

Table 29 Needed assistance for government or NGOs

Type of Assistance	Number of Person	Percent
None (do not need any assistance)	40	5
Vocational training or education	182	22.75
Job creation or employment	323	40.38
Social welfare for the unemployed	59	7.38
Loan	176	22
Improve overall economic situation	20	2.5

Source: TDRI 1998 (interviews with 524 urban unemployed).

7. Economic Prospects Affecting Social Impact

After severe economic contraction in 1998, it is widely believed that the economy has bottomed out. The economy is expected to grow about four to five percent in 2000.³⁵ Private investment, exports, and private consumption indices have begun to rise. The manufacturing sector has begun a gradual recovery, and the worst-hit sectors (i.e., construction and real estate) seem to be bottoming out. However, these trends must be interpreted with caution, since there are a number of uncertainties, both domestically and internationally. Under such uncertain circumstances, it would be premature to assert that the current recovery will lead to a sustainable growth path, and the possibility of another crisis in the near future cannot be easily discounted.

³⁵ The Bank of Thailand (BOT) has upgraded its earlier forecast of our percent growth to 4.5 percent.

The economy will continue facing uncertainty in internal and external factors, for example, public debt management, future fiscal policy direction,³⁶ the situation of the United States economy, changes in interest rates and oil prices, etc. Thus, while it is generally believed that the worst of the crisis is over, it is still highly uncertain.

If the economy continues to perform better, the overall improvement would alleviate the current constraints in the labor market and improve the employment situation, which would help alleviate poverty and social problems. So far, traditional safety nets as well as assistance programs during the crisis have helped cushion the adverse impacts on the vulnerable.

However, the economy has not yet shown significant improvement and many structural problems remain. The financial and banking sectors, in particular, are still riddled with structural problems. Unemployment has not yet shown significant improvement. Public sector reform plans also have to prepare to cushion the adverse impacts on laid-off workers. Public debt management dealing with future tax structures and expenditure affect different groups of taxpayers and income distribution. Therefore, specific Government assistance programs and systems to cushion the adverse impacts on the vulnerable sectors need to be identified and put in place in time. Also, medium as well as long-term structural reforms need to be initiated, as do improvements in social safety nets to protect the vulnerable groups from future crisis-related impacts.

While escaping the crisis remains the top priority, the need to prevent another crisis and be on guard should another crisis strike, must not be overlooked. This is because in a globalized economy, a number of factors are beyond the control of a single country and its government, which the 1997 crisis proved.

8. Conclusion

Economic and social impacts are felt unevenly across sectors, groups, and areas; they also fluctuate from time to time. Thus, the severity of impacts has changed considerably in different periods since the crisis hit in 1997. It was much more severe during the first year of the crisis (mid-1997-1998) than in later years.

Changes in labor market indicators (processed from quarterly labor force surveys) are more apparent than changes in poverty indicators (processed from the two-year socio-economic surveys). As the impacts were more severe during the first year of the crisis, the more frequent labor force survey data reflected those impacts. On the other hand, poverty data aggregated from the socio-economic surveys during the two-year period are less able to reflect the rapid changes in shorter periods. As a result, indexes on poverty and income distribution during 1996-1998 were almost unchanged.

Among labor market indicators, changes in hours worked are more obvious than changes in the unemployment rate. Changes in hours worked are likely to be an early warning signal before changes in unemployment/employment. Thus, underemployment and hours worked should be given more attention than simply considering unemployment rates, which can give an incomplete picture. Another concern should be long-term unemployment. During the crisis period, the 1998 labor force survey showed a high share of long-term unemployed among the labor force in Bangkok, the high-educated and the relatively young labor force.

³⁶ For example, the temporary VAT reduction will be ended in March 2001, and fiscal expenditure cuts are expected for 2001.

Unfortunately, regular labor force surveys do not address questions concerning the long-term unemployed, so that trends cannot be monitored because there is no past data for comparison.

As the crisis began gnawing deeper into the Thai economy, the number of hours worked declined and the underemployment rate rose. This also resulted in a decline in wage earnings. Several means of “operations adjustment” were used, including labor-hoarding at the onset of the crisis when employers hesitated to lay off employees. At that time, there were no perceptible changes in unemployment, but underemployment and wage-earning changes were more obvious. Unemployment began to rise more explicitly in 1998 when the economy deteriorated significantly and its recovery could not readily be foreseen. When the economy started to stabilize and slowly began on its road to recovery in 1999, underemployment rates declined and hours worked increased. Again, the unemployment rate seems to have been less sensible during that period. Thus, considering unemployment impacts alone may underestimate the real impacts, some of which take place implicitly.

The different impacts on employment, unemployment, underemployment, and wage earnings across sectors and areas, and their variability over different periods of time results in labor mobility among sectors and areas, while some people move out of the labor force. During the first year of the crisis when the economy was immediately hit, employment in the construction and financial sectors, and some segments of the capital intensive manufacturing sectors declined significantly, while employment increased in the service and commerce sectors. At the same time, labor movement between areas—from urban to rural that is contrary to normal migration trends was taking place. The reverse migration of labor was caused by the magnitude of the impacts of the crisis in urban areas in the first year. Many people in the sectors mentioned above had to return to their families in rural areas. However, the impacts of the crisis later spread to rural areas, which have become stagnant and which have been slow to respond to the recovery trends of the economy. The second year of the crisis, then, reversed the migration trend as rural to urban migration rose again. The second and third years of the crisis showed gradual improvement in the urban sectors, but not the rural sector.

Another contrary-to-expectation trend in inter-sectoral labor movement during the first year of the crisis was the expansion of formal employment along with a loss in informal employment. This resulted from the fall in the number of small and medium-scale enterprises (SMEs), which, unlike their larger and formal sector counterparts, had few options to keep their businesses going, and thus became early victims of the crisis. However, when the crisis continued in the second year, even the formal sector began to lose its employment share.

Poverty and income distribution are less sensitive than labor market indicators and also suffered from less frequent data collection. Consequently they are unable to reflect rapid changes during shorter periods. Instead what the aggregated data collected at the beginning and the end of the two-year period illustrates is that the impacts were not as severe and the aggregated indicator of poverty incidence was almost unchanged. In fact, the impacts of the crisis have been unevenly spread, concentrating on specific areas and groups, namely, Bangkok and rural areas, particularly the Northeast; the agriculture and construction sectors; private employees and employers; and low-educated unskilled workers and tertiary graduates.

In terms of the income share, as the rich were apparently a little more adversely affected in terms of declining income, the income distribution indicator shows a marginal improvement. However, as the income share lost by the top income bracket was gained by the one immediately below it, there was little consolation for the rest down the income ladder as their income shares remained almost unchanged. For the poor at the lowest end, even losing a small amount of earnings can give rise to a greater sense of deprivation.

Other social indicators such as education and health are even less comprehensively addressed in surveys and less frequently reported. Therefore, available data shows only small quantitative changes. For example, school dropout and enrollment rates have not changed dramatically. Moreover, the reliability of different data sources also poses a problem. Lack of sufficient data on health and the environment is also a constraint in analyzing the impacts. Thus, quantitative data alone may be limited and not be sufficient to reflect comprehensively all the adverse impacts. Indeed, many social impacts are inherently qualitative; mere numbers from aggregated data will not be able to reflect the severity of the feelings of the many people in the various groups at the micro level who continue to suffer as a result of the crisis.

One conclusion that can be drawn from this study is that the magnitude of the social impacts of the crisis was not as great as people had anticipated, especially when compared to the economic impacts. Although the social impacts in terms of quantity measures may not have been as serious as everyone had thought earlier, the social costs of the crisis seem to be implicit rather than explicit and may persist over a very long term. Social impacts such as the deterioration of quality of life and the slow-down in human resource development seem to be implicit problems which would not appear immediately. Problems of school dropouts, child labor and people's health will probably manifest themselves in the long term.

Another possible reason for the apparently limited scope of the social impacts is the lag effect. As many social variables follow economic conditions, changes in them may not be immediately obvious and they may lag behind changes in economic conditions. The labor market and unemployment, for example, show adjustment lags with improving economic conditions and associated changes in economic variables. Likewise, current unsolved problems and mismanagement in the financial and economic sectors would affect various groups of people as well as poverty and income distribution in the future.

Social policy responses during the crisis are unlikely to address the core issues effectively. Concerning the existing formal social safety nets, such as the social security scheme, only a minority in the labor force are eligible for benefits (about 16-17 percent of the total workforce). The increase in severance payments from six to 10 months also tends to benefit those in the formal sector and large-size establishments as the majority of workers are not eligible for severance pay. Disadvantaged groups are still left without a safety net.

A number of programs aimed at assisting the unemployed through job creation were implemented. However, they have been criticized as inefficient and for not using funds in a timely manner. Because of bureaucratic and political hurdles, public work programs in rural areas, for example, could not respond to rapid changes in economic conditions and labor markets. In addition, the original target groups of these funds may be distorted as the money is distributed through many channels via various line ministries' allocation systems instead of going directly to the target groups. Work programs sometimes concern temporary job creation rather than long-term employment and overall effectiveness. Moreover, the funds are frequently used for short-term political objectives.

To provide broad social protection and to alleviate poverty, a more comprehensive development approach is required for broad-based coverage. Promoting the environment for macro-economic growth should be considered a necessary condition for poverty reduction; however, it is not sufficient. Macro-economic management alone may not guarantee a fair distribution of benefits to various groups of people. Therefore, correcting unfair mechanisms in distribution channels (also depending on non-economic factors such as corruption, regulations, etc.) is required. It is necessary to have supporting mechanisms to create opportunities for disadvantaged people to improve their living standards. As human resources are the foundation for development, policies directed toward human aspects, i.e., education and health, have to be given priority.

Informal safety nets have helped cushion the adverse impacts of the crisis and, perhaps, are the reason for the less severe social impacts (even though the economic impacts have been huge). Thus, informal safety nets and local empowerment need to be strengthened.

Furthermore, there have been changes in terms of culture and social relations, which mostly are not addressed in social impact studies and which are difficult to explicitly identify. A positive cultural change is that people have changed their behavior in terms of consumption, thinking, values, and they are constantly trying to devise coping strategies for themselves and their communities, as well as showing more interest in public participation. In this regard, the role of the public and private sectors can move beyond the limited focus of mitigating social impacts to a more holistic objective of encouraging positive social change in attitudes, invoking public participation, and contributing to good governance.

Appendix 1

Computing Real Wages on a Monthly Basis

Different types of wages (daily, weekly, monthly, etc.) are computed on a monthly basis using daily, weekly, monthly rates, and the Consumer Price Index (CPI) to compute real monthly wages. Bonus, overtime and other fringe benefits, if paid in the form of money, are also included. The following are examples of this computation:

- If the wage is paid on an hourly basis,

$$\text{Real monthly wage} = \frac{\{(\text{wage per hour} * \text{hours worked per week} * 30/7) + \text{Bonus} + \text{Overtime} + \text{Other fringe benefits}\}}{\text{CPI}}$$

- If the wage is paid on a daily basis,

$$\text{Real monthly wage} = \frac{\{(\text{daily wage} * \text{days of work per week} * 30/7) + \text{Bonus} + \text{Overtime} + \text{Other fringe benefits}\}}{\text{CPI}}$$

- If the wage is paid on weekly basis,

$$\text{Real weekly wage} = \frac{\{(\text{weekly wage} * 30/7) + \text{Bonus} + \text{Overtime} + \text{Other fringe benefits}\}}{\text{CPI}}$$

Appendix 2

Measurement of Poverty and Inequality

Indicators to measure poverty and income inequality are the Head-Count-Ratio (HCR) and the Gini Index. The HCR measures the proportion of poor in the total population. The higher the HCR value, the higher the poverty incidence. The Gini index measures inequality. The value of the Gini is between 0 and one. Zero means perfect equality, i.e., all people have equal income. One means perfect inequality, i.e., one person has all the income.

Equations (1), (2) define the HCR and the Gini index.

$$\text{HCR} = \frac{N_p}{N} \quad (1)$$

$$\text{Gini} = \frac{2 \text{ Covariance } [Y_i, F(Y_i)]}{M} \quad (2)$$

Where N_p = number of poor, of which income is less than a poverty line

N = total number of population

Y_i = income of the i^{th} poor person

M = the average income

$F(Y_i)$ = cumulative frequency of Y_i and $Y_1 \leq Y_2 \leq Y_3 \dots \leq Y_N$

References

- Agenor, Pierre-Richard, and Montiel. Peter J. 1996. *Development Macroeconomics*, Chapter 17, p. 556-559. Princeton: Princeton University Press.
- Ammar Siamwalla. 1997. Can a Developing Democracy Manage Its Macroeconomy? The Case of Thailand. Lecture delivered at School of Policy Studies, Queen's University, Ontario, Canada.
- Ammar Siamwalla, and Orapin Sopchokchai, 1998. *Responding to the Thai Economic Crisis*. Bangkok: UNDP.
- Arom Pongpa-ngun Foundation. 1999. *The Struggle of Thai Female Workers*. Bangkok. (in Thai)
- Bureau of Budget. 1998-2000. *Thailand's Budget in Brief*. Bangkok: Bureau of Budget.
- Chalongphob Sussangkarn. 1987. *The Thai Labor Market: A Study of Seasonality and Segmentation*. Bangkok: Thailand Development Research Institute.
- Chalongphob Sussangkarn, and Pranee Tinakorn. 1998. "Impact of Tax Measures and Fiscal Expenditure on the Stimulation of the Economy." TDRI press conference 1998. Bangkok: Thailand Development Research Institute. Mimeographed.
- Coxhead, Ian, and Jiraporn Plangpraphan. 1998. "Thailand's Economic Boom and Bust and the Fate of Agriculture." *TDRI Quarterly Review* 13(2): 15-23.
- Dasgupta, Dipak, and Kumiko Imai. 1998. The East Asian Crisis: Understanding the Causes of Export Slowdown, and the Prospects for Recovery. Background Paper for the World Bank, East Asia: the Road to Recovery. Washington, D.C.: The World Bank.
- Foundation for Children Development. 1998. *Voice from the Disadvantages*. Bangkok. (in Thai)
- Gillis et al. 1992. *Economics of Development*. New York: W.W. Norton.
- International Monetary Fund (IMF). 1998. Mitigating the Social Costs of the Economic Crisis and the Reform Programs in Asia. IMF Paper on Policy Analysis and Assessment. Washington, D.C.: IMF.
- Kakwani, N. 1998. Impact of Economic Crisis on Employment, Underemployment and Real Income. Bangkok.
- Krugman, Paul. 1994. "The Myth of Asia's Miracle." *Foreign Affairs* 73: 6 (Nov.-Dec.): 62-78.
- Lee, Eddy. 1998. *The Asian Financial Crisis: The Challenge for Social Policy*. Geneva: International Labor Organization (ILO).
- Manning, Chris. 1999. "Labour Markets in the ASEAN-4 and the NIEs.) *Asian Pacific Economic Literature* 13(1).
- Ministry of Education. 1999. *Helping Students Facing Adversed Impacts of the Crisis*. Bangkok: Ministry of Education. (in Thai)

- Office of Agricultural Economics (OAE), Ministry of Agriculture and Cooperatives. 1999. *Agricultural Households after Economic Crisis and Basic Economic Data of Crop Years 1998/99*. Bangkok: OAE. (in Thai)
- Pakorn Vichyanond. 2000. How to Prevent Another Crisis: Country Report—Thailand. Paper presented at the Asian Development Bank Institute, Tokyo, March 10, 2000.
- Pranee Tinakorn, and Chalongsob Sussangkarn. 1996. *Productivity Growth in Thailand*. Bangkok: Thailand Development Research Institute.
- Preeda Tae-a-rak. 1999. *Impact of Economic Crisis on Health Care of Thai People*. A study under the 'Health Care Service Reform' project, Ministry of Public Health. Bangkok; Komol Keemthong. (in Thai)
- Rapeepan Chalongsuk, and Charasorn Tantichaiyakun. 1998. "Impact on Managed-floated Exchange Rate on Drug Costs." *Health System Research Journal* Vol. 6, No.
- Sauwalak Kittiprapas. 1999. "Social Impacts of Thai Economic Crisis." In *Social Impacts of the Asian Economic Crisis in Thailand, Indonesia, Malaysia and the Philippines*. Bangkok: Thailand Development Research Institute.
- Social Research Institute. 2000. "สรุปผลโครงการสำรวจผลกระทบทางสังคมอันเนื่องมาจากภาวะวิกฤติเศรษฐกิจ." Documents prepared workshop on Economic Crisis Impacts on Social, Culture and Health," January. (mimeograph, in Thai)
- Somchai Jitsuchon. 2000. "Alternative Approach to Poverty Measurement: An Experiment with Thai Data." *TDRI Quarterly Review* 15(1): 18-22.
- Thailand Development Research Institute (TDRI). 1998. "Socioeconomic Recovery in Thailand." Paper prepared for the 1998 TDRI Year-end Conference on From Crisis to Sustainable Development, Chonburi. (in Thai)
- Thailand Development Research Institute (TDRI)/World Bank. 2000. Consultation with the Poor, National Synthesis Report: Thailand. Bangkok: TDRI. (draft) January.
- Unger, Dunny. 1998. *Building Social Capital in Thailand: Fibers, Finance, and Infrastructure*. Cambridge: Cambridge University Press.
- World Bank. 1998. *East Asia: The Road to Recovery*. Washington, D.C.: World Bank.
- World Bank. 1999. Thailand Social Monitor: Social Capital and the Crisis. Bangkok. (draft) November.
- World Bank. 2000. *Thailand Economic Monitor*. Bangkok.
- Wolfensohn, James. 1999. Proposal for a Comprehensive Development Framework. Paper presented to the Board, Management, and Staff of the World Bank Group, January.
- Yongyuth Chalamwong. 1998. "Economic Crisis, International Migration and the Labor Market in Thailand." *TDRI Quarterly Review* 13(1).

The Social Impact of the Indonesian Economic Crisis

by

Tubagus Feridhanusetyawan^{*}

Centre for Strategic and International Studies
Jakarta, INDONESIA

^{*} Senior Economist of the CSIS. Valuable research assistance is provided by Arya B. Gaduh, Medelina Hendityo, Titik Anas and Vidhyandika Moeljarto.

Summary

The Indonesian economic crisis is characterized by massive price adjustment and drastic economic contraction as a result of massive capital outflow and excessive monetary expansion. The biggest contribution to the economic contraction was sharp decrease in investment, while consumer spending has been relatively constant. This fact indicates that people tend to maintain their consumption by consuming their saving during the crisis. The sharp contraction in the real sector of the economy is accompanied by the movement of resources from the non-traded to traded sectors, from the import-dependent to export-oriented industries, and from the modern to traditional sectors.

The social impact of the crisis is serious, but the society has been adjusting well to the crisis, especially to massive price shocks in the economy in 1998. For some extent the flexibility of the economy, especially the labor market, has absorbed the shocks and led to less drastic adjustment in the quantity and quality of life. Various social indicators show that the social economic condition is moving back to early 1990s, and not to early 1980s like what was predicted before. In other words, the impact of the crisis is not even a decade lost. But social adjustment usually comes with some lag, and the long run negative impact of the crisis, such as on education and health, might still take place beyond the economic recovery.

As a reflection of massive price adjustment in the economy, the adjustment in the labor market has been taking place in a large decline in real wages and a small increase in unemployment. Unemployment increased from 4.9 percent in 1997 to 5.4 percent in 1998 and then to 6.4 percent in 1999. The crisis has increased underemployment from 35 percent in 1997 to about 39 percent in 1998, but recent data in 1999 show that underemployment has declined slightly.

Labor force participation increased during the crisis, especially for females working in the informal sector. The crisis has also led to temporary reversal of labor market transformation where labor moved back to agriculture, informal sectors, and rural areas in 1998. But along with the early recovery of the economy, and the limited capacity of agriculture and informal sectors in absorbing employment, labor moved back to urban, formal and manufacturing sectors in 1999.

High inflation and flexibility in the labor market led to more than 30 percent decline in real income but recent data in 1999 indicated that real wages increased by 18 percent mainly because of low inflation. Labor productivity also declined sharply in 1998 and 1999 but the decline is less compared with that of real wages. Recent growth of real wages has outstripped the growth of labor productivity and this might lead to some problems in the labor market in the near future.

The informal sector has served as a buffer during the crisis in absorbing labor displaced from the formal sector. However, the increase in labor supply has increased competition in the informal sector. The downturn of economic activity has also led to the declining demand of goods and services produced by the informal sector. Various studies indicate that the decline in earning in the informal sector was larger than that of the formal sector.

The impact of the crisis is also heterogeneous across regions in Indonesia. The data indicated that Java, especially West Java and Jakarta, have suffered the most due to the collapse of modern formal sectors. In other islands, the effect is mixed. Some regions with

high export revenues in general have survived the crisis. However, other regions have suffered more than Java, even though the negative impact from the crisis has been complicated by El Niño and regional conflicts, such as in Aceh, Maluku, and East Timor.

The crisis immediately hit urban areas more than rural areas, which led to the movement of people to rural areas to work in the agricultural sectors. But recent data also show that people have been moving back to urban formal sectors when the rural area becomes saturated.

Various data show that the impact of the crisis on education is less severe than what was previously expected. Data on the declining enrollment and increasing dropout rate, for example, show a condition similar to that in early 1990s. The impact seems to be more significant for secondary school in rural areas as the direct and opportunity cost of maintaining children in school increased during the crisis.

The impact of the crisis on health is also minimal even though the real impact of the crisis on health might take longer time to observe. Various data suggested that the price of health services and medical supplies increased substantially but there has been no significant impact on the availability of immunization and contraceptives. The use of public health services has declined, but various indicators of nutritional status do not suggest any serious health related problems due to the crisis.

Poverty has increased since the crisis, but the increase was smaller than what was estimated previously. The number of population below the poverty line has been very sensitive to price deflators, methodology, and source of data. Based on various calculation and data, it can be summarized that poverty actually declined from about 11 percent in 1996 to about 7-8 percent in mid of 1997 just before the crisis hit. During the crisis, poverty increased to about 17-18 percent at the peak in August 98, and then declined back to about 11 percent in August 1999. While poverty is still about 50 percent higher than the level in mid 1997, the current level seems to be similar to that in 1996.

The problem of food security emerged in 1998, but similar to the pattern of adjustments in the economy, the problem was merely in the form of sky rocketing food prices rather than food scarcity. In 1999 food prices declined sharply and the problem of food security was no longer a serious threat.

Drastic economic downturn and worse expectation about the social impact of the crisis led to massive development of social safety net program in 1998. But unfortunately the lack of institutional capacity has led to poor targeting, leakage, and missuses. Some social safety net programs directed for education and health turned out to be more effective than others. Resources for social safety net program in 1999 was drastically reduced, massive scale social safety net program has been put off, but the country still needs to develop a basic safety net program beyond the crisis.

The lack of social safety net during the worst time of the crisis was compensated by a remarkable coping strategy within the family. When prices increased sharply in 1998, people adjusted their expenditure by saving less, looked for cheaper and lower quality sources of food, and even borrowed money from relatives. To replace the lost earning people tended to work extra jobs and hours, and even utilized some family member including children to seek additional income.

1. Introduction

Indonesian economy plunged into a deep recession in 1998 and 1999 characterized by sharp economic contraction, high inflation, massive currency depreciation, banking collapse and large debt overhang. The economic crisis has certainly affected both the economic and social aspect of all Indonesian, not only during the worst crisis period in 1998 but also the years to come. Considering the longer-term nature of the social impact, and the fact that the social adjustments usually come with a lag, it is expected that the social impact of the crisis would continue well beyond the crisis.

The social impact of the Indonesian economic crisis has been a controversial issue throughout 1998 and 1999. During the worst crisis period in early and mid 1998, some studies predicted 'the doomsday scenario' that the social impact of the crisis was very bad and the improvement of social welfare for the last three decades would disappear within the first year of the crisis. These reports were cited everywhere to represent the depth of the crisis, the crisis of confidence in the economy, and the political turmoil throughout 1998. For example, the ILO report in mid 1998 predicted that one in every two Indonesian was living below the poverty line. But by the end of 1998 and early 1999, the views related to the social impact of the crisis have been more optimistic. Various studies came up with the 'not-so-bad scenario'. Some other studies sponsored by the World Bank, for example, came up with optimistic figures of poverty, that was estimated to increase from 11 percent in 1996 to around 14 to 18 percent in 1998 depending on the deflators.

Different from the macro-economic and financial data, the social adjustments and the change in the quality of life are more difficult to measure. While some data on inflation, exchange rate depreciation, and even the negative growth of the economy are readily available, the impacts of those changes in overall economy on the increase in unemployment and poverty, for example, would depend on various factors. The impact of economic contraction on employment and wage would depend significantly on the degree of labor market flexibility. The impact of lower real income on poverty would depend on the wealth effect of the crisis and on the changing patterns of household income and expenditure. When people maintain their consumption level by reducing their saving, a sharp economic contraction would not necessarily lead to a sharp reduction in expenditure, and therefore, would lead to small increase in poverty. In other words, the transmission from the economic crisis to the social impact might not be always obvious, and furthermore, could also come with some lag.

While it is realized that the social adjustments might take longer than the course of the crisis itself, it is important to provide an assessment on how much has the crisis affected the welfare of the Indonesian people. Some macro economic indicators, such as the small decline in personal consumption expenditure in the GDP figure in 1998 suggested that the worst impact of the crisis has been in the decline in investment, and that the well being of Indonesians was comparable to that in early 1990s. But how does this change the labor market? How much was the real wages decline due to inflation? What happened with labor productivity due to the economic contraction? How did the crisis led to problems in education and health? These and other various questions call for answers.

This paper explores the social impact of the Indonesian economic crisis based on the results of various data and studies that are available up to early 1999. In terms of approach, this paper cuts wide rather than deep to provide greater coverage of the possible social impact during the crisis. The first section of this chapter presents the transmission from the economic crisis to social problems, through various channels at both the macro level (such as the output

and the labor market) and micro level (adjustment in household income and expenditure). The next section discusses the sources of data that have been used to study the social impact, including the differences in objectives and sampling sizes. The discussion over the social impact itself starts by presenting the adjustments in the labor market, which covers issues related to employment, underemployment, structural changes, labor income and productivity. Following the discussion on the labor market adjustments, the next sections discuss the longer-term impact of the crisis, namely on education and health. This chapter also covers discussions over the distributional impact of the crisis including the controversy surrounding poverty issues, food security, and social safety net programs. The final section of this paper summarizes the major findings and presents the policy implications.

2. From Economic Collapse to Social Problems

This section presents some conceptual thoughts on the transmission from the economic collapse to the social problems during the crisis. The first part of this section below presents some macro-economic indicators in Indonesia to provide some illustrative background about the crisis. The second part discusses the conceptual thoughts of the transmission from the economic collapse to the social problems, both from the macro and micro perspectives. The third part presents some micro-perspective on the possible adjustments in the household income and expenditure during the crisis to provide some background for further analysis.

2.1 Macroeconomic background

In brief, the Indonesian economic collapsed is characterized by the sharp contraction in the real sector of the economy, the movement of resources from the non-traded to traded sectors, from the import-dependent to export-oriented industries, and from the modern to traditional sectors. On the monetary side, it was also a massive monetary and price shocks in 1998. Excessive monetary expansion to bail out banks led to hyperinflation and drastic currency depreciation. With the lack of confidence in the economy, partly because of a non-supportive political climate, and combined with an effort to reduce the currency in circulation, the interest rate was extremely high in 1998.

High interest rate led to further deterioration of the banks' balance sheet, and furthermore led to corporate and economic insolvency. The collapse of the financial system eventually led to the fall in the real sectors leading to the fall in output, the decrease in employment, and a large deficit of the government budget. While Indonesia shares similar problems with other Asian countries in crisis, such as in the problem of credit crunch and huge foreign debt, there are other problems that made the Indonesian case worse. The special Indonesian case—to wit, a combination of a political turmoil, explosive monetary expansion, high inflation, and a massive Rupiah depreciation—have, unfortunately, made the crisis in Indonesia worst among the countries in crisis in Asia.

The economy plunged into a deep recession in 1998 with the overall growth at minus 13.7 percent—very serious compared with less than 5 percent contraction during the difficult times in the 1960s. The worst contraction has been in the construction sector (−39.8 percent), financial sector (−26.7 percent), trade, hotel and restaurant (−18.9 percent). Other sectors, which have large contractions, are manufacturing (−12.9 percent) and transport and communication (−12.8 percent). Mining and other services sectors experienced a contraction by around 4.5 percent. The agricultural and the utility sectors still experienced positive growth

at around 0.2 and 3.7 percent respectively. The more robust performance of resource based sectors will also mean that the share of agriculture in the total GDP will rise for the first time after 30 years from 16.1 percent in 1997 to close to 18 percent in 1998. The share of the mining sector also increased from 9.5 percent in 1997 to 11.4 percent in 1998. The share of industry will continue to rise from 25.6 percent in 1997 to 27 percent in 1998 due to the growth from oil refining (which increases as increased refining is done domestically to save foreign exchange) and LNG.

Table 30 The growth of gross domestic product, 1996-1999

Classification	1996	1997	1998	1999 (est.)
By Sector				
Agriculture, Forestry and Fishery	3.0	0.9	0.2	1.01
Mining and Quarrying	5.8	2.2	-4.2	0.04
Manufacturing Industry	11.6	6.4	-12.9	1.52
Electricity, Gas and Water Supply	12.8	13.6	3.7	7.70
Construction	12.8	6.4	-39.7	1.04
Trade, Hotel and Restaurant	8.0	6.0	-19.0	-0.95
Transport and Communication	8.7	8.3	-12.8	-1.33
Financial, Ownership and Buss. Services	8.8	3.6	-26.7	-8.58
Services	3.4	2.8	-4.7	2.83
By Expenditure				
Private Consumption	10.9	5.5	-2.9	1.55
Government Consumption	2.7	0.1	-14.4	8.40
Gross Domestic Fixed Capital Formation	14.5	8.6	-40.9	-21.24
Change in Stock	-76.1	94.9	-137.1	-27.48
Export of Goods and Services	7.6	7.8	10.6	-32.50
Less : Import of Goods and Services	6.9	14.7	-5.4	-45.31
Gross Domestic Product	8.0	4.7	-13.7	0.12

Source: Central Board of Statistics.

If one looks at the expenditure side of growth, then the contraction has been mostly caused by a severe contraction in investment. It is interesting to note that the decline in private consumption was only around 2.9 percent, smaller than the decrease in government expenditure at more than 14 percent, and investment at around 40 percent. These tend to suggest that people have been smoothing their consumption by consuming or reducing their savings during the crisis. This might also suggest that people think that the crisis is merely a temporary phenomenon, so that they have not reduced their consumption.

The Central Board of Statistics produced an estimate of GDP per-capita during the crisis, which increased in nominal terms from Rp. 3.10 million in 1997, to Rp 4.65 million in 1998, to Rp. 5.42 million in 1999. In term of US\$, it decreased from US\$ 1082.9 in 1997 to US\$ 465.0 in 1998, before it increased to US\$ 691.5 in 1999. The growth of real-per-capita GDP during the crisis was minus 14.3 percent in 1998, and is expected to be around minus 5.5 percent in 1999. The GDP per-capita in US\$ is very sensitive to the exchange rate, and is estimated to be around US\$ 690 in 1999, a decline from US\$ 1083 in 1997.

Table 31 Per-capita GDP during the crisis

	1997	1998	1999 (estimate)
In Rupiah at current price	Rp. 3,100,707	Rp. 4,647,500	Rp. 5,421,600
Growth of Nominal GDP per capita	15.5	50 %	17.1 %
Growth of Real GDP per capita	3.0	- 14.3 %	- 5.5 %
In US\$ at current price	US\$ 1,082.9	US\$ 465.0	US\$ 691.5
Growth of GDP in US\$	-6.0 %	- 57 %	48.7 %

Source: Central Board of Statistics.

Table 32 Selected monetary indicators

	1996	1997	1998	1999
Inflation (percent year-on-year)				
General CPI	5.9	11.6	77.6	2.0
Food	6.1	19.9	118.4	-5.3
Housing	4.8	6.2	47.5	5.2
Clothing	5.9	7.9	98.7	6.5
Interest rate(percent)				
1 Mo.SBI(highest rate)	14.0 (May-Jun)	17.7 (Dec)	69.5 (Aug)	35.8 (Jan)
1 Mo.SBI(lowest rate)	12.3 (Dec)	8.2 (Jun)	15.7 (Jan)	12.3 (Dec)
Growth of money supply (percent year-on-year)				
Mo	33.1	34.0	63.0	17.5*
M1	21.7	22.2	29.2	16.8*
M2	30.5	23.2	62.3	18.2*
Exchange rate (average level) Rp./US\$				
July	2,334	2,506	14,230	6,730
December	2,355	4,628	7,485	7,125

Note: * Money supply data are collected up to October 1999.

Source: Bank of Indonesia, various publications.

The effect of the economic crisis on inflation has been dramatic as inflation reached 77.6 percent in 1998. Prior to the crisis, inflation was maintained below 10 percent and in fact, there were two months in the first half of 1997 when there was a fall in the CPI or deflation. The increases in the prices of traded commodities, especially food, dominated the increase in the Consumer Price Indexes in 1998. The prices of foodstuff, including cereals and roots, preserved fish, bean and nuts, increased by more than 118 percent. Clothing prices increased by 98.7 percent in 1998, followed by health commodities and services that increased by 86.1 percent. Housing prices increased by 47.5 percent, but the housing equipment increased by more than 126 percent. It means that the prices of the non-traded components of house, such as land, have decreased very substantially.

Monetary developments for the last twelve months, however, have been encouraging. The trend of deflation continued from March to September 1999, and the cumulative monthly inflation from January to December 1999 was only 2 percent. So the picture of inflation is exactly like an inverted V curve, sharp increase in 1998 and sharp decrease in 1999. The major source of deflation has been the decline in food prices, while prices of clothing, housing and health continued to increase even though at a smaller rate.

The growth rates of liquidity and money supply increased very dramatically in the first half of 1998. It was precisely during this period that the rush on banks forced Bank Indonesia as the lender of the last resort to inject liquidity support to prevent a collapse in the banking system. As the result, money in circulation increased by around 60 percent in the first six months of 1998 (100 percent growth from November 1997). The growth rate of M1 (currency and demand deposits) also continues to be high at 40 percent and the growth rate of M2 (M1 and time deposits) at around 60 percent. Despite the fact that Indonesia is on an IMF program, reserve money growth continues to be high at 47 percent indicating that there continues to be a lot of liquidity in the economy.

Monetary aggregates seemed to be under control starting in late 1998. After August 1998, the growth of M0 and M1 slowed down, and they have been very much more under

control since then. With the sharp contraction in the base money in March 1999, which led to the downward revision of the IMF's monetary target by about 4 percentage point, the increase in base money was only around 3 percent for the first half of 1999. The IMF and the Central Bank (Bank Indonesia) have been following a classic monetary targeting where the focus of the monetary policy is to control money growth and inflation, and to keep the exchange rate relatively free.

Interest rates started to fall in mid 1999 partly because of the increase in confidence after the general election. Pressure for Rupiah depreciation also eased when the successful general election in May 1999 showed that political reforms seemed to be on the right track. The interest rate (SBI) continued to decrease from the 30 percent level in April and May to 13 percent in August, mainly because of the increasing liquidity in the banking sector and the higher confidence in the economy. From mid 1998 to mid 1999, the deposit rate continued to be above the loan rate and led to the negative spread in the balance sheet of commercial banks. But since May 1999, the deposit rate has been lower than the loan rate (working capital)—which will certainly improve the banks' balance sheets.

While the deposit rate has been reduced by around half since mid 1999, the loan rate continues to be high at around 23-26 percent. Credit growth collapsed in this time, but not because of the high loan rate but mainly by the loss of trustworthy relationships between the commercial banks and the private sectors. Banks basically do not lend to customers in bad shape anymore, but unfortunately most customers are in bad shape at present, especially because debt-restructuring has not been very effective. Therefore there seems to be little incentive for the loan rate to go down because the interest rate is not the major problem of the loan growth recovery. Again, the major problem for loan growth recovery is finding credit-worthy customers who want credit.

The high interest rate environment temporarily killed the stock market by reducing both stock prices and the volume of transactions. The volume of transactions dropped from about US\$ 5 billion in July 1997 to slightly more than US\$ 100 million in August 1998. The Jakarta Composite Stock Price index decreased from 721 in July 1997 to about 350 in August 1998. The stock price index remained at about 400 level in early 1999. The new optimism in 1999 as a result of the favorable political climate, lower interest rates, and some signs of economic recovery led to the resurgence of the stock market. The composite index was up again to around the 600 level at the end of 1999 and the volume of transactions was back to the level prior to the crisis.

The exchange rates depreciated from Rp. 2,400/US\$ before the crisis in July 1997, to Rp. 15,000/US\$ in July 1998, and around Rp. 9,000/US\$ in September 1998. The depreciation of the exchange rates (up to 600 percent at the bottom) was mainly caused by the excessive monetary expansion to save the banking system from collapsing. Up to December 1997, the depreciation of the Rupiah was comparable to the movement of other currencies in Southeast Asia. But because of the excessive printing of money in January and February 1998, and again in May 1998 after the riots, the depreciation of the Rupiah has dramatically deviated from the common patterns of the other Southeast Asian currencies. Monetary stabilization, especially the stable growth of the base money, in the third and fourth quarter of 1998 led to a stronger Rupiah at around Rp. 7,500/US\$. But again, the strengthening of the Rupiah seems to be a temporary phenomenon because of the relatively weak and uncertain economic fundamentals throughout 1998-1999. In 1999, the Rupiah seemed to stabilize at around Rp. 7,500-8,000/US\$.

2.2 The transmission

The transmission from the economic crisis, characterized by the sharp output contraction and currency depreciation, high inflation, and banking system failure, to the social impact of the crisis could be traced from several adjustment mechanisms in the economy. While there are many channels of transmissions that determine the supply and demand of social services, and also affect the quality of life of Indonesian people, they can be categorized into three categories of transmissions. First is the adjustment at the macro level at the output and input markets, especially the labor market. The second category is the adjustment at the micro level, namely the changing patterns of household income and expenditure. Finally, there is the direct transmission through the government expenditure, namely the provision of public social services. Figure 17 presents the transmission mechanism through various channels both at the macro and micro level, as well as other channels through the government expenditure.

The first channel of transmission at the macro-level adjustment is in the output markets where the changing structure in the economy has moved resources from one sector and industry to another. The crisis has shifted resources from the modern, non-traded, and import dependent sector such as construction, and capital intensive manufacturing to traditional, traded, and export oriented sectors such as agriculture, forestry, mining, and labor intensive manufacturing. In the shrinking sectors, market adjustments in the form of declining profit and real income, firm insolvency, company closing, have been more severe compared with the adjustment in the booming sectors. But the fact that not every industry or sector has been suffering from the crisis and even some sectors, such as the export-oriented manufacturing and agriculture, have in fact benefited from the crisis, has led to the complexity in assessing the social impact of the crisis. The recent data suggested that the social impact of the crisis have been heterogeneous across region, gender, income groups, and sectors or industries.

Combined with the flexibility of the labor market, the fact that excessive monetary expansion and high inflation has characterized the Indonesian crisis led to a different kind of adjustment in the labor market compared with that in Thailand or Korea. In those two countries, inflation was still in the single digit and the real wage was relatively stable, which means that the adjustment would be in the form of rising unemployment rates. Unemployment rate increased from 2.6 percent in 1997 to 7.5 percent in 1998 in Korea, and from 2.2 to 4.6 percent in Thailand. In Indonesia, the flexibility of the labor market and high inflation rates led to a drastic fall in real wages and small increase of unemployment rate from 4.7 to 5.5 percent.

The second channel of transmission at the macro-level adjustment is in the labor market, characterized by the fall in employment, real income and labor productivity. As a result of the flexible labor market in the naturally labor surplus economy, the increases in unemployment and underemployment rates have been relatively smaller than previously expected, but the decrease in real wage has been dramatic. Consistent with the changing structure of the economy in general, labor has moved from the formal to informal sectors,³⁷ from modern to traditional sectors, and from urban to rural areas. The discussion over the

³⁷ The definition of formal and informal employment in this paper is based on the employment status classification in the survey of the Central Bureau of Statistics. Employer and employee are generally classified as formal employment, while self-employment with no helper, self-employment with family or temporary workers, and unpaid family worker are classified as informal sector.

adjustment in the labor market will be presented in more detail in the next section of this paper.

The third channel of transmission is at the micro level in the form of changing patterns of household income. Sharp reduction in real income has forced people to work more for relatively less income and to consume their savings or to sell their assets to cope with increasing expenditure. The increase in prices has been three or four times larger than the increase in nominal wages, such that the purchasing power of the family could decline by around half. Sharp reduction in real family income has also forced women and children to work in the labor market to seek additional family income. The increasing number of street children and beggars in urban areas clearly show how the vulnerable groups are the real victims of the crisis.

The fourth channel is also adjustments at the micro-household level in the form of changing patterns in expenditure. The doubling of food prices has forced people to reduce and to substitute their spending on secondary and tertiary needs such as clothing, health services, education, and housing, for more basic needs especially food. For low income families, where food consumption accounts for most of their expenditure, the sharp increase in food prices have significantly reduced their purchasing power, lowered their food consumption, and even led to starvation in some cases. The drastic reduction in food expenditure in real terms would lead to serious health problems both in the short and long run.

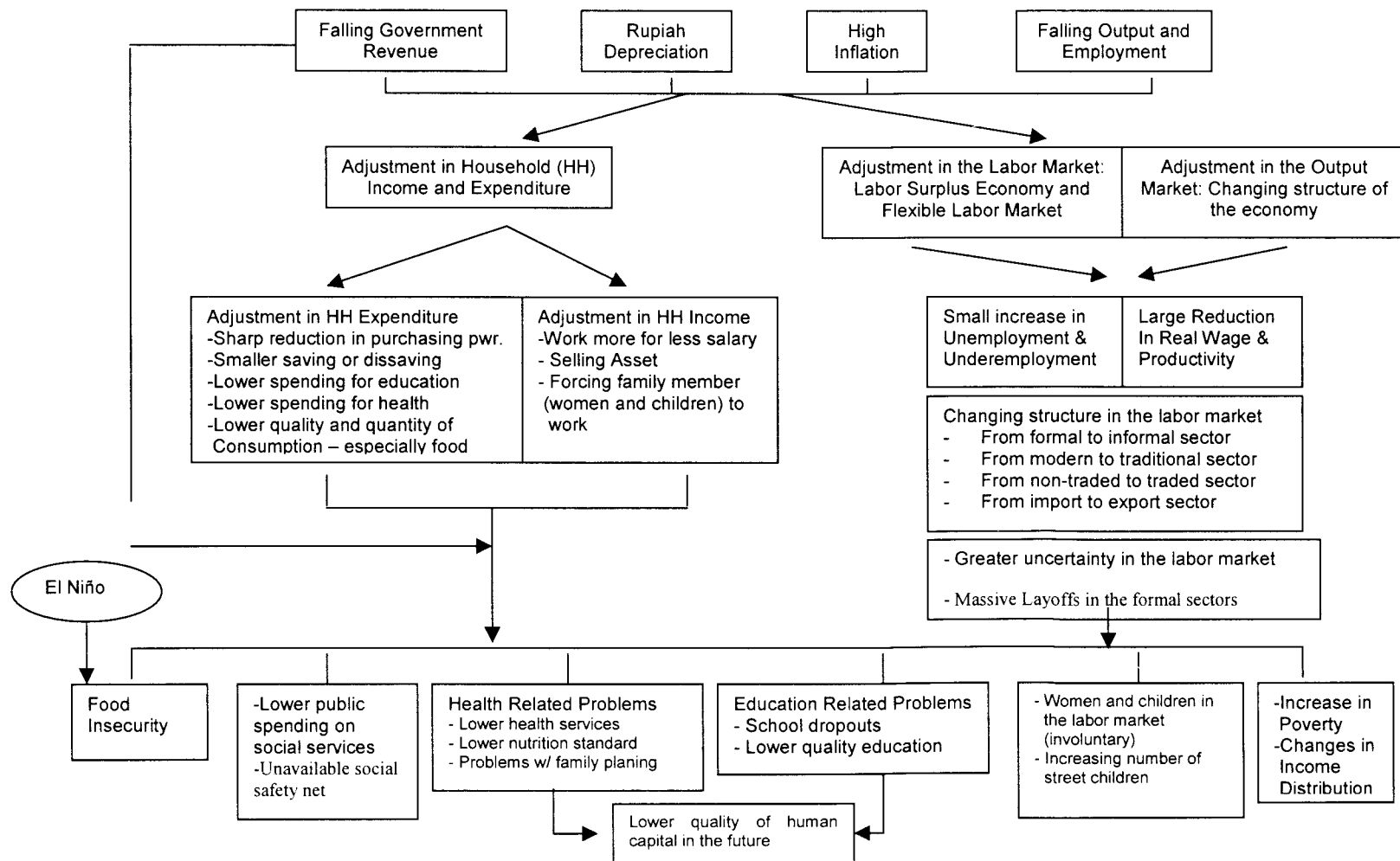
The substitution from secondary or tertiary expenditures to the more basic commodities such as food would lead to serious human capital problems in the longer run. The sharp decline in real income has forced many families to reduce their spending on child education, and even to withdraw their children from school. Both the direct and opportunity cost of keeping the children in school would be high if the children can be utilized to seek additional income for the families. The expenditure in health services, including contraceptives and immunization, would also be reduced.

Another channel of transmission from the collapse of the economy to social problems is through direct government expenditure. The government budgetary constraints during the crisis also led to smaller public spending for education, health, and other social services. Combined with the lack of capacity within the government in dealing with the crisis, the limited government budget has led to ineffective social safety net programs.

One should not underestimate the contribution of the drought or the El Niño effect in 1997 on the social problems in Indonesia during the crisis. In addition to the breakdown of the distribution system after the riots in May, the shortage of domestic food supply due to the drought in 1997 contributed to the high food price inflation. While the supply of food was generally available in the country, the price of food increased by 50 percent higher than the general inflation rate. Especially for the poor, the purchasing power for food commodity drastically declined and potentially led to food security problems.

The problems associated with the social impact of the crisis would be tremendous when all of these social problems are taking place during the difficult political and other reform processes in Indonesia throughout 1998-1999. The combination of the break-down of law and order, the loss of government credibility, the sharp decline in the real income, and the unavailability of some kind of social safety net system, have led to various riots, social unrest, and serious ethnic conflicts in various places in Indonesia.

Figure 17 From economic collapse to social problems



2.3 The changing patterns of expenditure and income

The changing pattern of income and expenditure at the household level is the heart of the analysis on how the crisis has affected the life of the people in Indonesia. The relation between expenditure and income at the household level is not simple, and in fact, it could be very complex and could hide many aspects of income and expenditure adjustment during the crisis. But unfortunately, the data on income are generally not available, even though the data on expenditure has been relatively more reliable and available.

The crisis has clearly changed the composition of expenditure as people try to adjust their patterns of consumption in order to maintain their current level of well being while facing sharp increase in prices, especially food. Food prices increased by 118 percent in 1998, while those of clothing and health services increased by 98.7 and 86.1 percent respectively. It is expected that people would increase their expenditure share on food and other basic items, and decrease their spending on durable goods and secondary needs such as recreation.

The following discussion related the changing expenditure to income, but because the data on income and saving are generally incomplete, the following should be treated as a hypothetical analysis based on the available data. To be more specific, the equation of income and expenditure should be broken down into their detailed components:

$$\text{Income} = \text{Expenditure}$$

$$\text{Salary} + \text{Interest} + \text{Profit or Dividend} = \text{Consumption} + \text{Saving}$$

$$(\text{Wage} \times \text{Hours of work}) + \text{Interest} + \text{Profit or Dividend} = (\text{Prices} \times \text{Quantity}) + \text{Saving}$$

The changing pattern of household expenditure, for example, is clear by looking at the result from the IFLS. For urban household, the share of expenditure for food items increased from 59 percent in 1997 to 64 percent in 1998. For rural household, the increase was from 76 percent to 81 percent. Among the selected food items, the expenditure on basic foods increased while that of non-basic food, such as meat, decreased. Household expenditures for non-food items groups generally decreased, with the exception of alcohol/tobacco and transport in urban areas. For urban household, major expenditure reduction took place in recreation, health and clothing. For rural areas, large reduction took place in health, clothing, and education.

Various indicators suggested that nominal expenditure generally increased during the crisis, while the real value declined due to high inflation. Based on various micro data that are available, it is fair to assume that on average the household nominal expenditure actually increased by around 30 percent in general from 1997 to 1998. Due to almost 80 percent annual inflation in 1998, the real expenditure, however, declined by around 26 percent. Assuming an identity of income and expenditure, the total household income in nominal terms should increase by the similar amount at 30 percent.

From the income side, the total household income can be decomposed into three components: salary, interest income, and profit or dividend. On average, the data from *Sakernas* for example, the nominal monthly earning increased by about 17 percent, which means that in order to meet the 30 percent increase in total income, there should be some contribution from the increase in the interest and dividend income combined. The data show that the interest income in general has increased since the crisis because of the high interest rate environment in the economy.

Table 33 The changing patterns in household expenditure (percent share)

Items	Urban Household			Rural Household		
	1997	1998	Change	1997	1998	Change
Food	59.0	64.0	5.0	76.2	80.8	4.7
Selected Food						
Staples	13.0	20.6	7.6	30.6	39.4	8.8
Meat	12.7	10.4	-2.3	12.5	9.7	-2.7
Dairy	3.7	3.7	0.1	2.7	2.6	0.0
Oil	1.9	2.9	1.0	2.7	2.5	-0.2
Vegetables	8.9	8.5	-0.4	11.5	12.9	1.5
Non-food	41.0	36.1	-5.0	23.8	19.2	-4.7
Alcohol/Tobacco	4.1	5.7	1.7	4.4	4.0	-0.4
Health	1.7	1.5	-0.2	1.2	0.7	-0.5
Education	4.9	4.5	-0.4	2.4	1.8	-0.6
HH goods	8.2	6.8	-1.4	3.6	3.2	-0.4
Transport	3.2	3.2	0.1	1.8	1.5	-0.3
Clothing	2.9	2.5	-0.5	2.2	1.5	-0.7
Housing	10.8	9.1	-1.6	6.1	4.8	-1.3
Recreation	2.6	2.1	-0.5	1.8	1.7	-0.1

Source: Frankenberg, Thomas, Beegle (1999).

The salary component furthermore could be broken down into more detailed components, namely the hourly wages multiply by hours of work. The increase in nominal wages generally less than 17 percent from 1997 to 1998 due to constant minimum wage policy to compensate for distressed private sector, which means that the household or the workers would have to work more hours to meet the 17 percent increase in salary. For some poor households, the increase in numbers of work could mean that more family members, including children, are participating in the labor market.

From the expenditure side, the increase in total expenditure is partly financed by the reduction in savings, or even dissaving or selling assets. The consumption component of expenditure could then be broken down into price multiplied by quantity. The facts that prices generally increased by almost 77 percent, while at the same time expenditure increased by only 30 percent from 1997 to 1998, show that people reduced their quantity and also quality of consumption.

Table 34 The changing structure of household income

Income Group	Salary		Saving Interest	Profit/Dividend	Overall Impact (Magnitude)
	Wages	Hours of Work			
Poor	Decrease in Real Wage	Work more	No saving	No dividend	Real Income Decline (Smallest)
Middle	Decrease in Real Wage	Work more or less depending on interest income	Increase	No dividend	Real income decline (Small)
Rich	Wages and salary are small component of household income		Increase	Large Decrease	Real Income Decline (Largest)

It becomes more complicated when the possible adjustment in the household income is broken down into several income groups as presented in Table 34. For the poor workers, the only source of income would be salary so that all of the required adjustment would be in the

form of working more hours or forcing more member(s) of the family to work in the labor market. This partly explains the fact that unemployment rate is not as high as expected. For the middle income group, the interest income is expected to increase during the crisis so that the total real income decline could be smaller than the reduction in real salary. The increase in interest income created a buffer to reduce the pain of real income decline. For the rich, the largest adjustment took place in the collapse of firms, companies, stock markets, and other forms of declining financial assets in their total real income.

Table 35 The changing structure of household expenditure

Income Group	Consumption		Saving	Overall Impact (Magnitude)
	Basic Needs	Secondary Needs		
Poor	Increase in proportion	Decrease Substituting for basic need	Dissaving or Selling asset	Decrease in Real Expenditure (Smallest)
Middle	Increase in proportion	Consuming lower quality, less imported goods	Saving less or no saving	Decrease in Real expenditure
Rich	Increase (smaller) Or might decrease (quality adjustment)	Large reduction in luxuries	Saving less	Large decrease in real expenditure (Largest in magnitude)

The possible decomposition of household expenditure is presented in Table 35, by separating the consumption into two components: basic items such as food, and secondary items such as clothing, recreation, and others. First, let's take a look at the expenditure side for the poor. When prices went up by almost 80 percent in 1998, and the consumption based expenditure (prices x quantity) increased by less than that (approximately around 35 to 50 percent), there was clearly some adjustments in the quantity or quality of goods purchased by the household. Considering the fact that the share of food expenditure for the poor is generally higher than that of the average consumer, and the fact that the increase in food price was actually 118 percent, the poor consumer might actually face a price increase at more than 80 percent in 1998. With a small amount of or even no household saving, all of the increase in the general expenditure would be financed by selling assets, working more hours, or substituting consumption of secondary items to more basic commodities such as food.

For the richer households, the adjustments might be more complicated because of the existence of the interest income and savings. To compensate for the larger increase in expenditure, compared to that in income, people would consume their savings, especially for those who think that the crisis would only be temporary. From the income side, the existence of interest income from savings might also reduce the chance of working extra hours to balance the increase in expenditure. It means that the richer consumer would have more cushions in the short run, by selling and consuming their assets as well as reducing their savings. But it does not mean that they would smooth their consumption forever. Once they realize that their future real income might decrease because of the high inflation and other causes, they would soon reduce their consumption very sharply and save more. But the fact that the rich have more assets denominated in foreign currency has also provided additional cushion during the crisis. Because of the currency depreciation, the value of these foreign denominated assets even increased sharply during the crisis in terms of Rupiah.

The dynamic adjustment in income for small-scale self-employed individuals in the informal sector is even more complicated considering the facts that profit and return to labor input are often mixed. An increase in price due to inflation would generally increase their

revenue, but it does not mean that the profit has to increase because of the increasing price of purchased inputs. The increasing number of people working in the informal sector would increase competition, which in turn would reduce profit.

The macro data on GDP provided clear picture that people tend to maintain their level of consumption by consuming their saving during the crisis. In fact, early sign of recovery in the economy is well reflected by the surge of consumer confidence in 1999 and 2000. Various data micro data provided some evidence to support the argument that expenditure reduction is larger for the rich and smaller for the poor. The changing patterns of expenditure, spending more on basic items and less tertiary items is also obvious. But this does not suggest that the poor has suffered less than the rich during the crisis because there have been drastic adjustments in the composition of income and expenditure in the family during the crisis which are not captured by the available data. In order to meet the increasing level of expenditure, the wealthy could consume their saving, while the poor have to work longer hours or even have to force other family members to participate in the labor market. Therefore, those who suffered the most from the crisis are the ones with no saving and could not participate in the labor market, particularly the disadvantaged groups such as the elderly, single women with children, people with disabilities, and others.

3. The Sources of Data

In early 1998, when the actual data on social and economic indicators during the crisis were not readily available, there was already a strong pressure to measure the depth of the crisis. As a result, several quick and dirty studies conducted by the ILO, the Central Bureau of Statistics (*Biro Pusat Statistik*, hereafter, BPS), and the World Bank were based on the available data collected before the crisis, and by using certain assumptions on price deflators, expenditure distribution, and others, they predicted the likely social impact of the crisis. Realizing the weaknesses of these studies, various international institutions, in coordination with the BPS, conducted various smaller scale surveys to provide rapid assessments of the social impacts. By the end of 1998 and early 1999, some of the results from these smaller scale surveys were published, but the controversy over the depth of the social impact did not diminish. While in early 1998 the problem was the lack of reliable social indicators, in early 1999 the problem was too many data and too many indicators. Various surveys with various objectives, methodology, and sampling procedures, have produced various social indicators, and some of them have produced conflicting numbers.

Over the years, the BPS has collected a considerable amount of data from various large-scale surveys that produced various social and economic indicators. The largest annual data collection is the *Susenas* (National Socioeconomic Survey), which is usually conducted in the beginning of the year. The sample of the *Susenas* is large, consisting of slightly more than 200 thousand households nationwide. But unfortunately, the *Susenas* lacks detailed consumption and income data for the 1997 and 1998 surveys. The detailed information on consumption and income is part of the data module that collected every three years, in 1996 and then in 1999.³⁸ The second major source of data is the *Sakernas* (National Labor Force Survey), which focuses on employment and income, and conducted annually in August using

³⁸ The variables in the *Susenas* are classified into two categories: the core and modules. The core variables are surveyed annually, while the module variables are collected only once in every three years. The three modules are: consumption and income, for example in 1993, 1996 and 1999, and so on; socio-culture, crime, and domestic travel in 1994 and 1997; health, education, and housing in 1995, 1998, and then 2000.

a smaller sample size. The latest data available is for August 1999, which was publicly available in May 2000, and already captured some impact on the crisis. Since the publication of this most current data on the national labor force, there has been less controversy surrounding the impact of the crisis on the labor market.

Because these large data sample were not readily available during the worst time of the crisis in 1998, the urgency to uncover the social impact of the crisis called for a different type of surveys to complement the large sample data collection that the BPS conducts every year. Both government and international organization have sponsored several smaller scale surveys to collect data during the crisis, or to utilize the currently available smaller scale data to analyze the impact of the crisis. Considering the differences in focus, time of collection, sampling, and methodology of the surveys, any comparative analysis based on various survey results should be treated with caution. Therefore, it is important to understand the nature of each data, including the strength and limitation, before making any conclusion on the social impact of the crisis.

The first survey is the 100 Villages survey, a random, longitudinal survey conducted by the BPS and UNICEF. This survey consists of 12,000 households nationwide, and some of the preliminary tabulation had already been done for the August 1998 data.³⁹ The second survey is the Nationwide *Kecamatan* Survey, conducted by the World Bank and BPS, by interviewing more than 12 thousand government officials (not at the household level), such as agricultural and other development officers in rural and urban areas, the health officers, school supervisors, and others. The survey was conducted in October 1998 and the result was published in late 1998.⁴⁰ The third survey is the Indonesian Family Life Survey, a random, longitudinal survey, conducted by the Rand Corporation and the Demographic Institute of the University of Indonesia. The latest data collection was in August 1998, covering around 1900 households—a smaller sample compared with the original sample of around 7200 household in 13 provinces, conducted in 1993 and 1997—whose result was documented in Frankenberg et al. (1999).⁴¹ The fourth data collection was the On-the-ground monitoring conducted by the BPS and UNDP, which was conducted in July-August 1998. While in general the sampling is random and purposive, this survey consists of five modules with different sampling units and sizes. The modules are: the cost of production in the formal sectors taken from 195 establishment; the informal sector taken from 1673 households; the retail businesses taken from 140 retail businesses; the cost of living taken from 1678 households; and the migration taken from 1662 households. The preliminary results of the survey were published in CBS-UNDP (1999).

³⁹ The 100 village surveys were conducted in 1994, July 1997, August 1998, December 1998, April/May 1999, and then August 1999. While it is a nationwide survey, the sample consists of 120 households in each of 100 village (80 rural, 20 urban) in 10 districts spread across from only 8 provinces. See BPS and UNICEF "Rapid Appraisal." 100 Village Survey results, unpublished draft. December 1998.

⁴⁰ See Sumarto, Sudarno, Anna Wetterberg, and Lant Pritchett. (1988) "The Social Impact of the Crisis in Indonesia: Results from a Nationwide *Kecamatan* Survey." Smeru Report, 1998. This *kecamatan* rapid poverty assessment (RPA) was a subjective, expert respondent survey of three government officials in each of Indonesia's 4025 *Kecamatans* carried out by the Central Bureau of Statistics. The survey selected three respondents with *Kecamatan*-wide responsibilities and asked them a standard set of questions, which try to measure the different kinds of impacts in each of their areas of responsibility

⁴¹ For the complete report see Frankenberg, Elizabeth, Duncan Thomas, Kathleen Beegle. (1999) "The Real Cost of Indonesia's Economic Crisis: Preliminary Findings from the Indonesian Family Life Surveys". Labor and Population Program Working Paper Series 99-04. Rand Corporation. March 1999 (also available in the homepage of the Rand Corporation, <http://www.rand.org>). Even though the sample of the IFLS data is generally small, the data have relatively more complete information on expenditure, education and health. Because of these strengths, the data have been used to predict the poverty level and the changes in income and expenditure during the crisis.

4. The Labor Market

During the crisis, the adjustment in the labor market has been remarkable. The Indonesian labor market from 1990 to 1996 was characterized by its rapid labor market transformation followed by a labor market tightening and increasing real wages. Labor moved from the informal to formal sectors, from rural to urban, from primary sectors such as agriculture to modern sectors such as construction, manufacturing and services. The engine of growth for the labor market tightening was broad based growth in all sectors, especially in the labor intensive manufacturing sector.⁴²

The data during the worst time of the crisis in 1998 suggested that the crisis has reversed the process of formalization into informalization and from urbanization to ruralization. The increase in unemployment was small but the correction of real wage was drastic. There are several contributing factors to the specific nature of the labor market adjustment in Indonesia. The first is the flexible nature of the labor market itself, where labor turnover rate is generally high. Combined with the labor surplus nature of the economy, weak labor union, and low reservation wage, the flexible nature of the labor market led to flexible real wages. The second factor that also played a major role in sharp wage adjustment is the specific overall macroeconomic condition, where excessive monetary expansion led to a high inflation and a sharp depreciation. Because of the labor market flexibility and the absence of any unemployment benefit or other forms of social security, displaced workers would have to find other jobs—mostly with lower wages—to survive the crisis. The data confirms the notion that many people in the formal labor market lost their jobs during the crisis, but soon found another one at a lower wage, or went to the informal sectors for some additional income.

The process of informalization and ruralization in the labor market, however, did not last very long. The data in 1999 indicated a movement out from agriculture going back to manufacturing and more urban based sectors. There was also a movement out from the informal sector recently, but by looking at the data in two years from 1997 to 1999, the pattern of labor market informalization during the crisis is still clear. After sharp real wage contraction in 1998, real wages started to increase in 1999 because of lower inflation. But overall from 1997 to 1999, real wages declined by 18.5 percent while labor productivity in general declined by 14.7 percent. With the movement back to formal-urban sectors, and combined with the increase in real wages, unemployment started to increase more significantly in 1999.

4.1 Labor force and unemployment

The result from the *Sakernas* clearly shows that the crisis has increased labor force participation, especially for females, and particularly in the rural areas. While the growth of the labor force has increased only slightly from 2.6 percent between 1990 and 1996 to 3.5 percent between 1997 and 1998, the growth of the labor force in rural areas increased from around 0.5 percent a year between 1990 and 1996 to 2.9 percent between 1997 and 1998. On the contrary, the growth of the labor force in the urban areas decreased from 7.3 percent a year between 1990 and 1996 to 4.7 percent during the crisis in the 1997-98 period. The crisis has also increased the growth of female labor force and employment. From 1990 to 1996, the size

⁴² The impact of rapid economic growth on labor market is discussed for example in Agrawal, Nisha (1996) "The Benefit of Growth for Indonesian Workers," World Bank Policy Research working Paper, no. 1637. Washington DC. See also Manning, Chris (1998). "Indonesian Labor in Transition: An East Asian Success Story?" Cambridge University Press.

of the female labor force grew at around 2.3 percent annually, and during the crisis in 1997-98 it grew by 4.8 percent. The growth of female employment also increased from 1.8 annually before the crisis to 4.2 percent during 1997-98. The size of the male labor force, however, has been relatively constant before and after the crisis. The fact that the crisis has increased the labor force participation rates for women suggests increasing employment opportunities for women. It could also mean that the crisis has forced women to participate and work in the labor market to provide an additional income for the household.

The picture from the most recent data in 1999 suggests a different pattern. Labor force participation in general increased at a lower rate compared with that in 1998 during the worst time of the crisis. There is also some changing patterns in rural-urban and female-male classifications. After declining from 1997 to 1998, labor force participation in urban areas increased significantly from 1998 to 1999. Classified by gender, the sharp increase in female labor force participation during 1997-98 in fact did not continue and in 1999, male labor force participation increased faster than the female.

Table 36 Labor force in Indonesia, 1990–1999

	Number (million)			Percent			Growth (%)			
	1997	1998	1999	1997	1998	1999	1990-96	1997-98	1998-99	1997-99
General										
Working age population	135.07	138.56	141.09	100.0	100.0	100.0	2.5	2.6	1.8	4.5
Urban	53.35	56.09	58.98	39.5	40.5	41.8	6.0	5.1	5.2	10.5
Rural	81.72	82.47	82.11	60.5	59.5	58.2	0.6	0.9	-0.4	0.5
Labor Force	89.60	92.74	94.84	100.0	100.0	100.0	2.6	3.5	2.3	5.8
Urban	31.92	33.41	36.10	35.6	36.0	38.1	7.4	4.7	8.1	13.1
Rural	57.68	59.33	58.74	64.4	64.0	61.9	0.6	2.9	-1.0	1.8
Male	55.27	56.76	58.43	61.7	61.2	61.6	2.7	2.7	2.9	5.7
Female	34.34	35.97	36.41	38.3	38.8	38.4	2.5	4.8	1.2	6.0
Population employed										
Total	85.41	87.67	88.81	100.0	100.0	100.0	2.2	2.7	1.3	4.0
Urban	29.40	30.30	32.32	34.4	34.6	36.4	—	3.1	6.7	9.9
Rural	56.10	57.40	56.49	65.7	65.5	63.6	—	2.3	-1.6	0.7
Male	53.01	53.90	54.90	62.1	61.5	61.8	2.4	1.7	1.9	3.6
Female	32.40	33.77	33.91	37.9	38.5	38.2	2.0	4.2	0.4	4.7
People looking for work	4.20	5.06	6.03	4.7	5.5	6.4	13.4	20.6	19.1	43.6
Not in the Labor Force	45.47	45.82	46.24	33.7	33.1	32.8	2.2	0.8	0.9	1.7

The crisis has increased the number of unemployment in 1998, but the increase was small. The data from *Sakernas* shows that the total unemployment rate increased from 4.7 percent in 1997 to 5.5 in 1998. The preliminary result of the *Susenas* data shows a similar result—unemployment increased from 5.0 in 1997 to 6.8 in 1998. The government, through the Minister of Manpower, mentioned several times that unemployment was expected to reach around 15 to 20 million people in 1998, but this statement was clearly an overestimate.⁴³ The more reliable official estimates of unemployment in 1998 by the Ministry of Manpower and

⁴³ From February – May 1998, Minister of Manpower, Representatives of Labor Unions, and others observers announced large and overestimated unemployment figures, ranging from 13 to 20 million people unemployed. They might use these large numbers to show the seriousness of employment problems in Indonesia. See for example, *Jakarta Post*, April 14, 1998, *Suara Karya*, May 14, 1998.

Bappenas (the National Planing Agency) put it at around 14.8 percent (13.7 million) and 13.6 percent (12.4 million) respectively. The special task force of the ILO⁴⁴ estimated that open unemployment rate in 1998 would be around 10 percent, or 9.3 million people.

The results from the *Sakernas* show that overall open unemployment rate increased by 16.5 percent, from around 4.7 percent in 1997 to 5.5 percent in 1998. In terms of unemployment, the increase is higher for male compared with female. The unemployment rate among males increased from 4.1 in 1997 to 5.0 percent (23.3 percent increase) while that of females increased from 5.6 to 6.1 (8.4 percent increase). Combined with the results from 1999 data, the increase in unemployment during the crisis is clearly larger among males. Male unemployment rate increased from 4.1 to 6.0 percent (47.5 percent increase), while female unemployment rate increased from 6.1 to 6.9 percent (22.0 percent increase) between 1997 and 1998. This result was previously predicted because the economic sectors that have suffered the most and are among the slowest to recover from the crisis, particularly the construction sector, have a larger number of male workers. On the contrary, labor intensive and export oriented industries that have survived the crisis due to their export orientation employ more female workers.

Table 37 Unemployment rate in Indonesia, 1997–1999

	1997		1998		1999		Growth		
	No. (Mill.)	Rate (%)	No. (Mill.)	Rate (%)	No. (Mill.)	Rate (%)	1997- 98	1998- 99	1997- 99
Total	4.20	4.7	5.06	5.5	6.03	6.4	16.5	19.1	35.7
Urban	2.57	8.0	3.10	9.3	3.77	10.5	15.5	21.6	30.0
Rural	1.63	2.8	1.96	3.3	2.26	3.8	16.9	15.1	35.9
Male	2.26	4.1	2.86	5.0	3.52	6.0	23.3	23.1	47.5
Female	1.94	5.6	2.20	6.1	2.51	6.9	8.4	13.9	22.0
By Education									
No schooling	0.03	0.3	0.03	0.4	0.03	0.4	19.0	26.1	27.7
Elementary Education	0.95	1.9	0.22	2.2	0.25	2.8	-76.4	15.9	43.8
Secondary Education	2.84	10.0	0.91	11.5	1.15	12.4	-67.9	15.0	24.2
Tertiary Education	0.65	10.4	0.87	11.0	1.04	12.7	33.6	5.8	22.2

Source: BPS, *Sakernas* 1997-1999.

The recent data from the *Sakernas* in 1999 shows that unemployment rate continued to increase from 5.4 percent in 1998 to 6.4 percent in 1999, a greater increase compared with that in 1997-98. Open unemployment rate at 6.4 percent is generally small in an international comparative perspective, but the fact that the unemployment rate increased from 4.7 in 1997 to 6.4 in 1999 shows that the crisis has increased the unemployment rate significantly. It is important to note however that this adjustment in the labor market did not take place immediately during the worst time of the crisis, but took place two years later. The data confirms the notion that the adjustment in the first year of the crisis was the adjustment in real wages due to inflation with unemployment rate increased slightly. When inflation decreased in 1999 and therefore real wages sharply increased, employment finally had to adjust, and as a result, unemployment rate was higher in 1999.

⁴⁴ See ILO (1998) "Employment Challenges of the Indonesian Economic Crisis." ILO Report.

In Indonesia's statistics, open unemployment is defined as "working for less than one hour a week and at the same time looking for a job." When the real income is shrinking as a result of stagflation, in a country where there is no unemployment insurance and social security, people cannot afford to be unemployed. So, when some people work for more than an hour a week—let's say, for two hours, either in the formal or informal sectors a week before the survey was conducted—these people were not counted as unemployed. Because of this, unemployment has been generally small in Indonesia. In 1996, open unemployment was almost 5 percent and was dominated by the unemployed young people. The unemployment rate was the highest among those between 15-24 years old (around 13 percent) when secondary school graduates enter the job market. Open unemployment among those who are 30 years or older is generally not significant in Indonesia.

Another characteristic of unemployment in Indonesia in 1990s was urban unemployment. While urban areas accounted for only 30 percent of the total employment, this accounted for almost 60 percent of unemployment.⁴⁵ Manning and Jayasuriya (1996) indicated that urban unemployment among the youth in the 1990s has been increasing. According to Agrawal (1996), however, unemployment in Indonesia is not a serious problem.⁴⁶ First, those unemployed are mainly young people who enter the job market at the first time. Second, the duration of unemployment is usually short—an indication of a relatively flexible labor market in Indonesia.

The results of the *Susenas* data in 1998 show that the majority of the unemployed labor force consists of those who had just recently entered the job market. Around 79 percent of female and 68 percent of male unemployed consisted of those who had never worked before. There was no significant difference between rural and urban areas on this issue, and this data confirms the reality that the young dominated the composition of unemployment in Indonesia. In terms of education, the preliminary *Susenas* data suggests that the increase in unemployment is among those with higher education. The percentage of unemployed people with high school education or above increased from 1997 to 1998, while those with education less than high school in fact decreased at the same period. These results support the notion that only those who have higher income could survive and afford to be unemployed and their unemployment spell could be longer.

4.2 Tracing the patterns of labor displacement

While the additional increase in unemployment is small, it does not mean that there is no serious layoffs or employment reduction in the labor market. The small increases of unemployment rate in 1998 at the aggregate or average level clearly show that those who lost their jobs in one sector have found another job or have been absorbed by other sectors' employment. Economic adjustments caused by the crisis have led to both booming and shrinking sectors and industries. Many displaced workers from the shrinking sectors have been forced to work in other industries, or in the informal sectors. Because the labor market in Indonesia has been flexible, real wage would easily adjust to the changing supply and demand conditions. These smaller-than-expected unemployment figures once again show the flexibility of the Indonesian labor market and the large reduction in real wages that it has to

⁴⁵ See Manning, Chris and Sisira Jayasuriya. (1996) "Survey of Recent Development," *Bulletin of Indonesian Economic Studies*, August., and also Manning, Chris, and P.N.Junankar. "choosy Youth or Unwanted Youth? A survey of Unemployment." *Bulletin of Indonesian Economic Studies*. Vol 34. No. 1 April 1998.

⁴⁶ See Agrawal, Nisha (1996)

bear as a result of the crisis. In other words, the price of this smaller-than-expected unemployment rate in 1998 was a sharp correction in real wages.

This adjustment of the Indonesian labor market can be scrutinized in more detail with the help of several of the added questions in the 1998 *Sakernas* data. Designed to measure the impact of the crisis, the BPS included additional questions looking at labor displacements that happened after July 1997—i.e., the beginning of the crisis. These questions include reasons for displacement, the sectoral classification of the previous job, and the status of the previous job.

The result confirms the notion that the crisis has immediately induced the informalization of the labor force, and also a move from the more modern sectors of manufacturing and services to the more traditional sectors such as agriculture. The result also provides an interesting insight on the gender-differentiated impact of the economic crisis.

Overall, about 4.3 million workers—men and women—were displaced after July 1997. This accounted for roughly 4.9 percent of the 87.5 million workers working in 1997.⁴⁷ From this 4.3 million, one million dropped out of the labor force, while another million is struggling to find work. About 2.2 million or 2.5 percent of the total workers in 1997 managed to find work leaving 2.1 million (2.4 percent) as the real employment reduction occurring after the crisis.

Nevertheless, it is not all that clear that the job displacement that occurred after July 1997 was a *consequence* of the crisis or it was simply a natural phenomenon of turnovers. Since previous years do not include questions on labor displacement, it is difficult to judge the extent of the crisis' impact on these displacements. Hence, the question on reasons for displacement might provide an estimate of the extent of the impacts of the crisis on employment reduction. The survey put five answer categories for the reasons of job displacement: (1) insufficient wages; (2) incompatible working environment; (3) dismissals; (4) going out of business; and (5) others.

Reason (3) and (4) can be grouped together under "involuntary job displacement" while the other three reasons can be grouped as "voluntary job displacement". Hence, about half of the 4.3 million were involuntarily displaced, and the other half quit their jobs voluntarily. More men were forced out of their jobs than women.

Table 38 Reasons for job displacement, 1997/98

Gender	Involuntary	Voluntary.	Total
Male	1,562,874	1,245,388	2,808,262
Female	575,379	895,480	1,470,859
Total	2,138,253	2,140,868	4,279,121

Source: BPS, 1998.

Meanwhile, as mentioned before, the crisis has induced a process of informalization Table 39. illustrates how the crisis shifted work from the formal sector to the informal sector. Of the 4.3 million displaced workers between July 1997 and August 1998, 3.2 million came from the formal sector while around 1.1 million from the informal sector. Meanwhile, among those displaced from the formal sector, only 1.6 million managed to find work and a substantial share of them (59 percent) are working in the informal sector. Among the 1.1

⁴⁷ Note, however, that the data on the displacement is part of the 1998 *Sakernas* Data, while the data on the number of workers in 1997 is part of the 1997 *Sakernas* Data. Even though the two are not perfectly comparable, they are deemed to be precise enough for the purpose of this exercise.

million displaced from the informal sector, about 0.6 million managed to find work. Most of them are returning to the informal sector. Overall, the informal sector absorbed about 63.0 percent (1.4 million) of those who found work after job displacement, while the formal sector only absorbed about 37.0 percent (0.8 million).

Table 39 Labor displacement by formal-informal, 1997/98

August 98 Survey Before July 97	Employment			Looking for	Not in the
	Informal	Formal	Total	Work	Labor Force
Informal	441,469	160,705	602,174	106,341	346,842
Formal	935,384	649,560	1,584,944	979,350	659,470
TOTAL	1,376,853	810,265	2,187,118	1,085,691	1,006,312

Source: BPS, 1998.

The patterns of displacement and adjustment also confirms the notion that the crisis has reversed the trend towards the more modern sectors such as manufacturing and services, and instead moved away from those sectors towards the traditional sector of agriculture. In absolute terms, the sectors that have displaced the most workers are, in order of magnitude: manufacturing, agriculture (probably due to drought and El Niño), services, trade and construction. Even though agriculture displaced a relatively large number of workers, it simultaneously absorbed a substantial number of workers that have recently been displaced (see Table 40).

Table 40 Displacement of workers by sector, 1997/98

Sector	Displaced from Sector		Absorbed by sector in 1998	
	Number	As % of 1997 Emp.	Number	As % of Total Displaced
1. Agriculture	782,603	2.2	859,142	20.1
2. Mining	63,833	7.1	45,566	1.1
3. Manufacturing	1,094,249	9.8	264,995	6.2
4. Utilities	24,144	10.4	2,221	0.1
5. Construction	562,736	13.4	208,092	4.9
6. Trade	676,113	3.9	420,511	9.8
7. Transport & Communication etc.	235,071	5.7	165,398	3.9
8. Financial Services	61,757	9.4	9,348	0.2
9. Services	778,615	6.2	211,845	5.0
TOTAL	4,279,121	4.9	2,187,118	51.1

Source: BPS, *Sakernas*, 1998.

A high proportion of those who lost their jobs found work in agriculture (39.3 percent). A smaller proportion found work in trade (19.2 percent) and manufacturing (12.1 percent). This movement out of the modern sectors into agriculture—agriculture absorbs the largest number of displaced workers coming from every major industry in the economy, except for trade (see Table 40)—signaled an important trend of going back to agriculture and, consequently, a move back to the rural areas.

In terms of gender, the *Sakernas* data shows that the crisis has reduced employment opportunities in the formal sector for male workers relative to female. Total employment in the formal sector decreased from 30.3 million in 1997 to 28.8 million in 1998. Male accounts

for 1.4 million or 98 percent of this reduction of employment in the formal sector. This is not surprising given the fact that the economic sector that suffered the most—and will be the slowest to recover—is the male-workers dominated construction sector. Meanwhile, the sectors that have survived well during the crisis have been the female-dominated labor-intensive export-oriented sectors such as textile, garment and footwear industries.

Nevertheless, a more detailed observation on the displacement data offers an interesting insight on the process of labor market adjustment. The fact that female contributes only 2 percent to the total employment reduction does not imply that they did not experienced labor displacements. In fact, the number of females being displaced from their work is comparable to that of males. Females account for about a third of those displaced between July 1997 and August 1998 (see Table 41). Compared as a percentage of total employment in 1997 by gender, the difference between male and female was less than a percentage point (5.2 and 4.4 percent respectively). This implies that the effects of these displacements were quite substantial for female as much as it was for male. The majority of males who were displaced came from the manufacturing (22.6 percent of total displaced), construction sector (18.9 percent) and services (17.3 percent). A majority of females were displaced from the manufacturing sector (31.2 percent) and trade (22.0 percent).

Table 41 Displacement by gender, 1997/98

Gender	Displaced			1997 Total Employment
	Number	As % of Total Disp.	As % of 1997 Total Emp	
Male	2,808,262	65.6	5.3	53,005,502
Female	1,470,859	34.4	4.5	32,400,027
TOTAL	4,279,121	100.0	5.0	85,405,529

If women accounted for a third of those displaced, yet contributed a relatively miniscule share of employment reduction, does it mean that the labor market absorbed the majority of these female workers? Interestingly enough, that is not really the case. As a matter of fact, a majority of women (about 69 percent) who were displaced in 1997 were not working at the time of the August 1998 labor survey. In fact, a significant number of them was “discouraged” and left the labor force as a result of the crisis—the number is much higher for women compared to men in both absolute and relative terms. Most of those that drops out of the labor force returned to their domestic role in housekeeping.

Again, even though the number of displaced female workers who leave the labor force was much higher than male workers, overall, there is actually a decrease of the number of women **not** in the labor force, while there is an increase of the number of men **not** in the labor force. The number of women in not in the labor force decreased from 34.44 million to 34.35 million—a decrease of 0.3 percent—while the number of male increased from 11.03 million to 11.47 million—an increase of 4 percent.

This seemingly contradictory numbers show that the workers being absorbed into the labor force are, often times, not the same workers leaving the labor force. Even though the exit of women from the labor market was balanced by a significant number of women entering the labor force, the crisis has caused many of previously working women to get out of the labor force and return to their domestic role. This implied that the crisis caused a significant, albeit unknown, negative effects towards previously working women.

Table 42 Labor displacement for male and female**Male**

Status on Aug 98 Status on Jul 97	Labor Force			Not in the Labor Force				Total Displaced after July 97
	Working	Looking for work	Total	Going to School	House- keeping	Others	Total	
Informal	459,809	76,706	536,515	2,696	11,690	94,966	109,352	645,867
Formal	1,264,326	643,672	1,907,998	4,676	29,884	219,837	254,397	2,162,395
TOTAL	1,724,135	720,378	2,444,513	7,372	41,574	314,803	363,749	2,808,262

Female

Status on Aug 98 Status on Jul 97	Labor Force			Not in the Labor Force				Total Displaced after July 97
	Working	Looking for work	Total	Going to School	House- keeping	Others	Total	
Informal	142,365	29,635	172,000	3,418	205,939	28,133	237,490	409,490
Formal	320,618	335,678	656,296	6,891	329,587	68,595	405,073	1,061,369
TOTAL	462,983	365,313	828,296	10,309	535,526	96,728	642,563	1,470,859

4.3 Underemployment

While unemployment rate remained small during the crisis, underemployment in Indonesia has been generally severe, and the crisis has increased the number of underemployment. But the increase in underemployment was, once again, small. Underemployment is generally defined as workers who work for less than 35 hours a week, and under this definition, 35 percent of workers in Indonesia were underemployed in 1996 before the crisis hit. The results from the *Sakernas* data in 1998 show that the number of underemployment increased from 21 percent to 24 percent in urban areas and from 44 percent to 47 percent in rural areas. In 1999, the number of underemployment decreased slightly to 23.5 percent in urban areas and 45 percent in rural areas.

Compared with the number of underemployment before the crisis, the larger increase in the urban areas (20 percent) compared with that in the rural areas (10 percent) reflects the fact that the urban areas have been hit harder during the crisis. But this is also due to the fact that the formal employment is much larger in the urban areas, and the decrease in formal employment would force those who lost their jobs to work less than 35 hours a week in the informal sectors. The increasing number of underemployment during the crisis appeared for both male and female workers.

It is important to note that similar to other countries, the Indonesian labor market is characterized by high underemployment rate even during the economic boom period in early 1990s. During the last decade of the economic boom period, the relation between economic growth and underemployment was not really clear. While high economic growth in 1990-96 significantly reduced unemployment, especially in the formal sector, underemployment rate was always high. Therefore, the increase in underemployment from around 35 percent before the crisis to around 39 percent overall during the crisis cannot be seen as large adjustment.

Because of the seasonal nature of agricultural work, underemployment in rural areas is generally much larger than in urban areas. Around 45 percent of worker in rural areas work

less than 35 hours a week, compared with around 21 percent in urban areas in 1996. After the crisis, the reduction in employment opportunity might reduce the number of working hours and increase underemployment. However, on the contrary, sharp reduction in real wages and income might force people to work more hours, and therefore could even reduce the number of underemployment.

4.4 The changing structure of the labor market

Formal-informal. The crisis has reversed the formalization of the labor market before the crisis into the process of informalization during the crisis period from 1997 to 1998. The formalization of the labor market—characterized by the increasing size of the formal sector in the economy—was rapid during the boom years of the early 1990s. The share of informal sector employment decreased from 71.4 percent in 1990 to 65 percent in 1996, while that of the formal sector grew from 28.6 percent in 1990 to 36.8 percent in 1996. This formalization of the labor market was more rapid in the urban areas and, naturally, was accompanied with a strong urbanization process. During the crisis, the share of the informal sector in general increased from 63.3 percent to 65.4 percent. This 6.9 percent annual increase during the crisis was much larger than the annual growth of the informal sector at around half a percent for the last decade. At the same time, the growth of formal sector employment declined by minus 4.4 percent. The fact that total employment grew by 2.7 percent from 1997-98, higher than the annual rate at around 2.0 percent before the crisis, was in fact due to the sharp increase in the informal employment.

The informalization has been stronger in rural areas, especially during the crisis. Prior to the crisis, during 1990-1996, people were leaving the informal sectors at the rate of 0.6 percent in the rural areas. The trend shifted sharply during 1997-1998, where there was a substantial growth of 5.8 percent going into the informal sectors. A similar trend happen in the urban areas—not as salient, but nevertheless, quite significant. During 1990-1996, informal sector employment grew by 6.3 percent annually. Following the crisis, the growth increases to 10.3 percent. Meanwhile, formal sector employment in both rural and urban areas contracted by 7.2 percent and 2.0 percent respectively.

By looking at the employment status within the informal sector, the crisis has increased the share of family workers. The increasing number of employment in the informal sectors is expected, but the fact that the number of family workers increased significantly during the crisis suggests that people look for jobs within their family unit as part of the coping mechanism to survive the crisis. The number of women working as family workers increased more significantly than that of the men during the crisis. From 1986 to 1996 before the crisis, the number of female family workers decreased by 1.8 percent annually. But from 1997 to 1998, the number of female family workers increased by 6.5 percent.

But the most recent data in 1999 suggested a sign of reversal of this pattern. With early signs of economic recovery, labor moved back to the formal sector. After declining by more than 4 percent from 1997 to 1998, the number of workers in the formal sector increased by 5.3 percent in 1998-99. But in two years from 1997 to 1999, informal sector employment increased by 5.7 percent while that of formal sector increased by 0.6 percent. This means that additional employment during that period was created in the informal sector. The recent movement back to the formal sector, however, also suggests that labor absorption in the informal sectors is limited. In fact the recent move to the formal sectors took place both for the male and female workers and also for urban and rural categories.

Table 43 Employment status of Indonesian workers, 1990 – 1999

	Number (million)			Percent			Growth (% p.a.)			
	1997	1998	1999	1997	1998	1999	90-96	97-98	98-99	97-99
Total	85.41	87.67	88.81	100.0	100.0	100.0	2.2	2.7	1.3	3.8
Formal	31.74	30.33	31.93	37.2	34.6	36.0	5.6	-4.4	5.3	0.6
Employer with permanent employee	1.47	1.53	2.55	1.7	1.7	2.9	11.7	4.1	67.2	42.5
Employee	30.28	28.81	29.38	35.5	32.9	33.1	5.3	-4.9	2.0	-3.0
Informal	53.66	57.34	56.88	62.8	65.4	64.0	0.6	6.9	-0.8	5.7
Self-employed with no employee	19.86	20.52	21.71	23.3	23.4	24.4	3.5	3.3	5.8	8.5
Self-employed with temp/family worker	17.98	19.69	18.91	21.1	22.5	21.3	2.8	9.5	-3.9	4.9
Family worker	15.81	17.13	16.26	18.5	19.5	18.3	-4.6	8.3	-5.1	2.7
Female	32.40	33.77	33.91	100.0	100.0	100.0	1.9	4.2	0.4	4.4
Formal	9.66	9.62	10.18	29.8	28.5	30.0	5.2	-0.4	5.8	5.1
Informal	22.74	24.16	23.73	70.2	71.5	70.0	0.8	6.2	-1.8	4.2
Male	53.01	53.90	54.90	100.0	100.0	100.0	2.4	1.7	1.9	3.5
Formal	22.09	20.71	21.76	41.7	38.4	39.6	5.7	-6.2	5.0	-1.5
Informal	30.92	33.18	33.15	58.3	61.6	60.4	0.5	7.3	-0.1	6.7
Rural	56.05	57.37	56.49	100.0	100.0	100.0	0.3	2.3	-1.5	0.8
Formal	14.95	13.88	14.40	26.7	24.2	25.5	3.7	-7.2	3.8	-3.8
Informal	41.10	43.49	42.09	73.3	75.8	74.5	-0.6	5.8	-3.2	2.3
Urban	29.35	30.30	32.32	100.0	100.0	100.0	6.9	3.2	6.7	9.2
Formal	16.80	16.45	17.53	57.2	54.3	54.2	7.4	-2.0	6.6	4.2
Informal	12.56	13.85	14.79	42.8	45.7	45.8	6.3	10.3	6.8	15.1

Source: BPS, Sakernas, Various Years.

Sectoral Impact. There was a rapid movement of labor out of the agricultural sector for the last seven years from 1990 to 1996 before the crisis hit. Agricultural employment declined rapidly from 56 percent of total employment in 1990 to around 44 percent in 1996. The number of employment in the manufacturing sector increased from around 8 percent in 1990 to almost 13 percent in 1996. The construction sector has absorbed a large proportion of unskilled labor moving out from the agricultural sector as employment in the construction sector grew by almost 11 percent a year from 1990 to 1996. The share of trade, restaurant, and hotel sectors increased sharply from almost 15 percent in 1990 to almost 19 percent in 1996, and became the second largest sector (after agriculture) in absorbing labor.

The economic crisis has seriously affected the non-tradable sectors especially construction, the inefficient financial sector, and the highly import-dependent manufacturing sectors. Labor from these sectors have been laid off and moved to other sectors – especially the surviving agricultural sector. Through the terms of trade effects, sharp currency depreciation led to the collapse of highly import dependent sectors. In contrast, some export oriented manufacturing such as textile, shoes, and garment, have largely benefited from the crisis. The result from the *Sakernas* data showed that during the crisis in 1998, employment in the utility (electricity, gas and water) sector decreased by 37 percent, followed by mining (23 percent), construction (15.9 percent), and manufacturing (10 percent). These reductions were drastic changes from, for example, 10.7 percent annual growth of employment in the construction sector and 6.6 percent annual growth in the manufacturing sector from 1990 to

1996. The collapse of the financial sector during the crisis also created employment reduction by minus 5.8 percent in 1997-98. Again, during the economic slowdown, agriculture turned out to be the savior of the economy in labor absorption with an increase of 13.3 percent employment during the crisis period. After decreasing from 56 percent in 1990 to 41 percent in 1997, the share of employment in the agricultural sector increased to 45 percent in 1998.

Table 44 The changing pattern of sectoral employment, 1990–1999

Sector	Number (million)			Percent			Growth			
	1997	1998	1999	1997	1998	1999	90-96	97-98	98-99	97-99
Total	85.41	87.67	88.81	100.0	100.0	100.0	2.0	2.7	1.3	3.8
1. Agriculture	34.79	39.41	38.38	40.7	45.0	43.2	-1.9	13.3	-2.6	9.3
2. Mining	0.88	0.67	0.73	1.0	0.8	0.8	6.4	-23.0	7.7	-20.6
3. Manufacturing	11.01	9.93	11.52	12.9	11.3	13.0	5.6	-9.8	15.9	4.4
4. Utilities	0.23	0.15	0.19	0.3	0.2	0.2	3.2	-37.0	28.1	-23.9
5. Construction	4.18	3.52	3.42	4.9	4.0	3.8	10.2	-15.9	-3.0	-22.5
6. Trade	16.95	16.81	17.53	19.9	19.2	19.7	6.3	-0.8	4.2	3.3
7. Transport & Comm. Etc.	4.13	4.15	4.20	4.8	4.7	4.7	8.9	0.7	1.3	1.9
8. Financial Services	0.66	0.62	0.63	0.8	0.7	0.7	6.1	-6.0	2.7	-3.6
9. Services	12.57	12.39	12.22	14.7	14.1	13.8	4.3	-1.4	-1.4	-2.9

Source: BPS, Sakernas Data, various years

The movement to the agricultural sectors during the crisis, however, did not last very long and suggested the fact that labor absorption in the agricultural sector is limited. The data in 1999 show that labor started to move out from the agricultural sector and to go back to the other modern sectors, especially manufacturing and public utilities. After growing by almost 10 percent from 1997 to 98 during the worst time of the crisis, employment in agriculture declined by 2.6 percent from 1998 to 99. Employment in other sectors started to increase from 1998 to 99, such as 7.7 percent in mining, 15.9 percent in manufacturing, 28 percent in electricity, gas, and water. Employment in the construction sector still decreased by about 3 percent from 1998 to 99.

Urban-rural. The movement of labor to the informal sector and to the traditional sectors such as agriculture, forestry, and fisheries in 1998, is accompanied by the movement of employment opportunities to the rural areas. The crisis has reduced the growth of urban employment from more than 6 percent per annum during the booming years in 1990-96 to about 3 percent from 1997-98. But the annual growth of rural employment increased from almost 0 percent before the crisis to more than 2 percent after the crisis.

However, the data in 1999 again show a reversal of this urban-rural pattern. From 1998 to 1999 employment in urban areas grew by 6.7 percent while that in rural areas declined by 1.6 percent. In fact this reverse movement was so strong such that within two years after the crisis, employment in urban areas still increased by more than 9 percent compared with less than 1 percent in rural areas. In other words, the movement to rural areas during the crisis was a temporary phenomenon.

4.5 International labor migration

As an immediate reaction to the Asian crisis in 1997-98, the number of Indonesian workers working in other Asian countries declined significantly, even though reliable data on the number of overseas workers are generally hard to obtain. With the recovery of Asian

economies, and continuing surplus of labor in Indonesia's domestic labor market, the number of overseas workers increased significantly from 1998 to 99. When the crisis hit in 1997/98, many Indonesians who worked in Malaysia/Singapore were sent back home, even though the recorded decline from more than 320 thousand workers in 1995/96 to 71 thousand workers in 1997/98 could be an overstatement. The outflow of foreign unskilled workers has created a tightening labor market in Malaysia and many Indonesian workers are allowed to go back working in Malaysia. In 1998/99 the number of Indonesian workers in Singapore and Malaysia increased to 171 thousand workers. Indonesian workers who work in the Middle Eastern countries declined slightly from 1996/97 to 1997/98, but then increased significantly from 1997/98 to 1998/99.

While there are not many available data on illegal migrations, it is generally understood that most of illegal workers from Indonesia choose to go to Malaysia because of the distance and the similarities in language and religion. The Ministry of Manpower in Malaysia estimated that until November 1998 there were 72,191 illegal workers from Indonesia working in Malaysia.⁴⁸ It was also reported that in 1997, Malaysia deported 38,153 illegal Indonesian workers, and until October 1998, again Malaysia deported 52,000 workers from Indonesia.⁴⁹ This shows that there has been an increasing numbers of Indonesian crossing the border and working illegally in Malaysia following the crisis. It is estimated that there have been around 1,700 illegal Indonesian workers entering Malaysia from Sarawak (in Kalimantan Island) every month.⁵⁰ The illegal workers crossing the Malacca Straits border by boats (*Pongpong*) is estimated to be around 6,000 people monthly.⁵¹

Table 45 Number of Indonesian overseas workers processed by the Ministry of Manpower, 1995-1999

Year	To Middle East		To Malaysia/ Singapore		To other countries		Total	% Change over Prev year	Sex ratio (Males/100 Females)
	No	%	No	%	No	%			
1995/96	48,298	40	46,891	39	25,707	21	120,896	-31	48
1996/97	135,336	26	328,991	64	52,942	10	517,269	328	79
1997/98	131,734	56	71,735	30	31,806	14	235,275	-55	20
1998/99	179,521	44	173,995	42	58,153	14	411,609	75	28

Source: Ministry of Manpower.

During the boom periods of the early 1990s, the number of foreign workers in Indonesia increased significantly. Most of them are professionals and executives, hired mainly because of the scarcity of skilled labor in the domestic market. The depreciation of the Rupiah has clearly reduced the ability of domestic companies to employ foreign workers. The data from the Department of Manpower shows that during the booming years in 1996, the number of foreign workers in Indonesia was around 48.7 thousand workers. In 1997, the year when the crisis started, the number decreased to 37.2 thousand and in 1998 it decreased further to 33.3 thousand. From 1997 to 1998, the number of foreign professionals declined significantly from around 13 thousand to 7.2 thousand workers.

⁴⁸ *Bisnis Indonesia*, "Calo Puas Memeras, Pekerja Memelas", November 6, 1998.

⁴⁹ *Republika*, "Malaysia Mendeportasi 10.000 TKI Ilegal", March 21 1998.

⁵⁰ *Kompas*, "1700 per bulan, TKI Masuk Sarawak", April 23, 1998.

⁵¹ *The Jakarta Post*, "Steps to protect workers 'slow compared to promotion'," December 18, 1998.

Table 46 The number of foreign workers in Indonesia by main occupation

Classification	1996	1997	1998
Executives	12,663	8,762	9,497
Professionals	11,163	12,969	7,206
Supervisors	8,281	5,409	3,864
Technician/Operators	16,551	10,052	12,864
Total	48,658	37,192	33,325

Source: From the homepage of the Department of Manpower, taken in July 1999.

4.6 Earning and productivity

Accurate data on income is generally hard to obtain in developing countries including Indonesia. But the *Sakernas* reported the total monthly earnings or wages in the formal sectors, which at least present the picture of the monthly wage in the formal sectors before and after the crisis. Nominal and real wages have generally moved along the same pattern for the last ten years before the crisis, with inflation at around 8 to 10 percent. But it is clear that with more than 77 percent inflation in 1998, the economic crisis has sharply reduced real wages from 1997 to 1998.

The 1998 *Sakernas* data shows that nominal monthly wages, measured as the monthly earning⁵² in the formal sector, increased by 16 percent from 1996 to 1997, and by 17 percent from 1997 to 1998. Having been corrected using GDP deflators, real wages still increased by around 4 percent in 1997, but then sharply decreased by 34.2 percent from 1997 to 1998. The new level of real wage in 1998 was comparable to the level in 1989/90, and it means that the increase in real wage during the last seven years before the crisis disappeared only within the first year during the crisis. Compared with the decline in personal consumption in the GDP, that was only around 3 percent, the data again suggest that people have maintained their consumption level by consuming their savings. But the newest earning data from *Sakernas* data 1999 show that low inflation and some increases in nominal wages clearly led to surging real wages in 1999. After declining by more than 30 percent in 1997-98, real wages started to climb back up by 10.5 percent from 1998 to 99, even though within two years from 1997 to 1999, real wages still declined by 27.2 percent overall.

Almost all sectors, except transport and agriculture, experienced real wage declines by above 20 percent between 1997 and 1998. In that period, real wages in the agricultural sector declined by 17.9 percent while that of transport by 14.3 percent. Not unlike the decline in sectoral employment, there are large variations between sectors in the size of the decline in real wages, with construction experiencing the largest shock in real wages early on in the crisis, with a decline of almost 43 percent. Trade, manufacturing and mining also experienced a substantial drop in real wages by 37.2 percent, 34.9 percent and 31.1 percent. By comparing real wages in 1997 and 1999, it is clear that the largest decline took place in construction, manufacturing, and trade with a decline of more than 30 percent. Real wages in services sector in general including trade, transport, and other services, declined by around 13 to 30 percent between the two years. Real wages in the agricultural and transport sectors declined less sharply in 1998, but declined further in 1999, when other sectors were experiencing increases. This indicates that there were some labor surpluses in those two sectors in 1999.

⁵² Monthly earning consists of monthly wage plus other benefits.

Table 47 Growth of real wages, 1997-1999

	1997-98	1998-99	1997-99		1997-98	1998-99	1997-99
All Sector	-34.2	10.5	-27.2	Urban	-36.3	9.3	-30.4
By Sector				Male	-36.3	7.6	-31.4
1. Agriculture	-17.9	-6.8	-23.5	Female	-35.6	13.6	-26.8
2. Mining	-31.1	23.9	-14.7	Rural	-31.5	11.2	-23.8
3. Manufacturing	-34.9	6.0	-31.0	Male	-31.5	12.5	-22.9
4. Utilities	-21.4	16.8	-8.2	Female	-29.6	7.4	-24.4
5. Construction	-42.8	2.8	-41.2	By Education			
6. Trade	-37.2	10.5	-30.6	No schooling	-29.2	12.1	-20.6
7. Transport & Comm. Etc.	-14.3	-8.6	-21.7	Elementary Education	-34.0	5.8	-30.2
8. Financial Services	-21.7	10.7	-13.4	Secondary Education	-36.7	13.2	-28.3
9. Services	-23.6	12.7	-13.9	Tertiary Education	-34.5	5.3	-31.0

Note: Sectoral real wages are deflated by sectoral GDP Price Deflator.

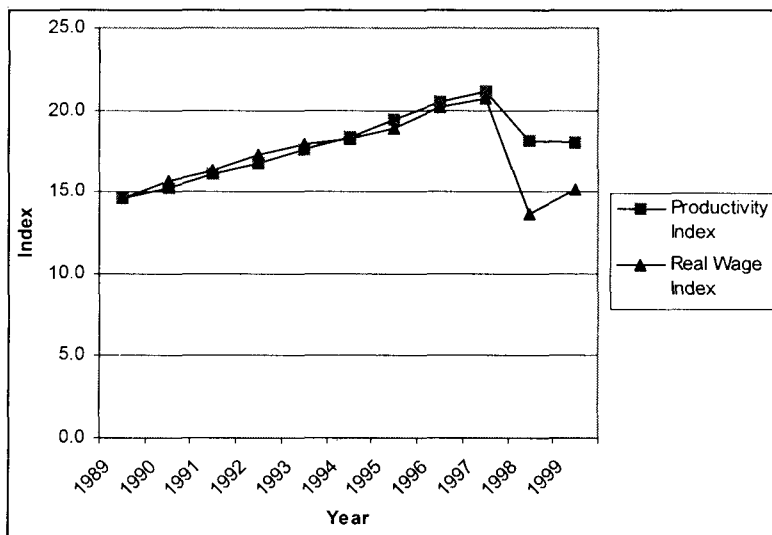
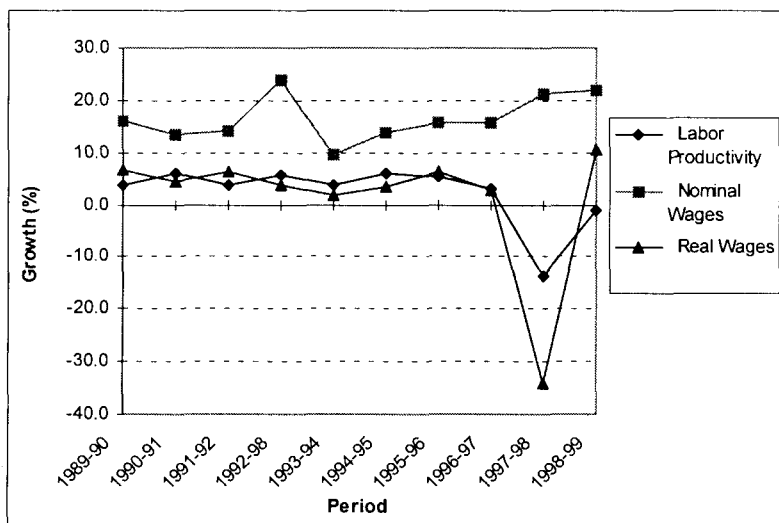
Source: BPS, *Sakernas* Data, various years.

There has not been any real indication on the difference in the real wages decline between the urban and rural areas, even though the earning data in the formal sector from the *Sakernas* tend to suggest that this crisis is a crisis for urban workers. A quick estimate by using similar price deflators shows that the decline in real wages in the urban areas from 1997 to 1998 was around 33 percent compared with around 28 percent in the rural areas. The data also show that the decline in real wages for male workers in urban areas is larger than that of the females. But other data suggest that the decline of real wages in rural areas, represented by the real wages in agriculture, declined by around 40 percent from 1997 to 1998. Similar trend took place in outer islands, such as Sulawesi, Nusa Tenggara and Sumatera (Cameron 1999).

Classified by the level of worker's education, there is a little indication that those with higher education suffered larger real wage decline compared with those with less education in 1998. But the 1999 data tend to show that those with less education (primary school or less) experienced a smaller real wage increases. Small proportion of workers with university degree also experienced a small real wage increase in 1999.

Labor productivity, measured as the real GDP divided by the number of employment, also declined sharply in 1998 due to economic contraction. During the early period of the crisis in 1997, labor productivity still increased by 3.1 percent, but then sharply declined by 13.8 percent in 1998. At the same time, real wages increased by around 3.8 percent in 1997, and then declined sharply by 31.8 percent in 1998. It is interesting to note that while the real wages during the crisis was comparable to that in 1989/90, the level of labor productivity was similar to that in 1993/94. In other words, the real wages declined faster than the labor productivity during the crisis, which opens a possibility of an undershooting wage.

The case of undershooting was confirmed with the newest data from the *Sakernas*. In 1998-99, real wages increased by 19.5 percent while productivity even still declined by 1.1 percent. From 1997 to 1999 overall, real wages declined by 27.2 percent while labor productivity declined by 14.7 percent. When the decline in labor productivity is still below that of the real wage, there seems to be some room for real wages to go up without affecting the competitiveness of the economy. But the fact that real wage growth was higher than labor productivity growth in 1999 provides an indicator that surplus of labor in the labor market was only temporary. The impact of the higher real wage can also be seen in the increase of the unemployment rate in 1999.

Figure 18 Annual productivity and real wage index, 1989-1999**Figure 19 Annual growth of productivity and real wage, 1989-1999**

For some extent, the changes in minimum wage during the crisis contributed to the recent trend in wages. During the worst time of the crisis in 1998, the annual increase in minimum wage was delayed. The annual increase, which is usually due on April 1, was delayed until August 98 when the minimum wage was increased by 15 percent, much smaller than the inflation at 77 percent. This partly explained the sharp decrease in real wages in 1998. But when overall inflation in 1999 was only 2 percent, and the cumulative inflation up to May 2000 was less than 1 percent, the minimum wage was increased twice by 16 percent in April 99 and then by 25 percent in April 2000.

Table 48 Annual growth of wages v. productivity, 1989-1999

Year	89-90	90-91	91-92	92-93	93-94	94-95	95-96	96-97	97-98	98-99	97-99
All Sectors											
Labor Productivity	3.8	6.1	3.6	5.6	3.8	5.9	5.5	3.1	-13.8	-1.1	-14.7
Nominal Wages	16.2	13.4	14.1	23.8	9.7	13.7	15.7	15.8	21.1	21.8	47.6
Real Wages	6.7	4.3	6.3	3.9	1.7	3.5	6.5	2.9	-34.2	10.5	-27.2
Agriculture											
Labor Productivity	-0.6	4.5	4.3	6.7	6.4	4.6	1.9	7.8	-8.3	3.4	-5.2
Nominal Wages	13.5	23.5	2.7	29.2	17.9	12.3	13.8	10.6	47.2	9.9	61.7
Real Wages	8.6	18.3	-3.5	12.7	5.8	-0.6	4.6	-2.5	-17.9	-6.8	-23.5
Manufacturing											
Labor Productivity	7.3	6.6	5.6	2.8	-8.9	11.2	11.3	1.7	-0.5	-11.8	-12.3
Nominal Wages	29.5	4.5	8.4	34.8	4.1	15.2	17.7	18.0	13.5	20.7	37.0
Real Wages	14.5	-6.1	0.2	13.3	-3.5	3.9	7.6	4.0	-34.9	6.0	-31.0
Services											
Labor Productivity	4.6	1.4	3.6	1.0	-0.9	1.4	1.0	-1.8	-14.6	-3.2	-17.3
Nominal Wages	22.1	12.0	8.9	20.1	8.0	15.5	18.1	-1.1	21.5	27.2	54.5
Real Wages	12.0	2.0	-1.2	-2.4	0.7	7.1	9.2	-13.2	-29.1	11.4	-21.0

Source: Own calculation from BPS, *Sakernas* Data, various years.

The loosening labor market weakened the bargaining power of labor in determining wages in 1998. But the bargaining power of labor is expected to increase in the coming years. Political reform and democratization have given more freedom for workers to set up labor movement and trade union for the last two years. As a result the pressure for higher wages, for example in the increase in minimum wages, is expected to be stronger. However, due to the slow process of economic recovery, the increase in productivity and employment could not keep up with the increasing pressure for higher wages. Therefore, it would not be surprising if the incidence of labor disputes, strikes, and other labor problems would increase in the coming years.

There are differences in labor productivity and real wage adjustments across sectors. The data from the *Sakernas* suggests that the adjustment in the manufacturing sectors has been larger or faster than in other sectors, reflected by larger correction in real wages, and no correction in labor productivity in 1998. Real wages in the manufacturing sector declined by 34.9 percent in 1998 compared with 29.1 percent in services, and 17.9 percent in agriculture. Labor productivity in manufacturing declined by a mere 0.5 percent while that in agriculture and services declined by 8.2 and 14.6 percent respectively. Again, sharper reduction in employment and real wages in the manufacturing sectors shows that the biggest labor market adjustment in 1998 took place in the manufacturing sectors. The Indonesian economic crisis started as a financial crisis but the adjustment in the manufacturing sectors has been generally faster than that in the financial sectors.

In 1999, real wages in manufacturing and services started to increase while that in agriculture continued its decline. Real wages in manufacturing and services increased by 6.0 percent and 11.4 percent respectively, while that in agriculture declined 6.8 percent. However, the opposite happened in labor productivity: for both manufacturing and services, labor productivity declined by 11.8 percent and 3.2 percent, while productivity for agriculture increased by 3.4 percent.

What presumably happened was that because of the drastic decline in real wages, people moved out of manufacturing faster than other sectors in 1998. This rapid movement out of the manufacturing sector (compared to other sectors) prevented a drastic decline in

labor productivity per worker in that sector. However, in 1999, real wages in the agriculture sector declined and people again moved out of agriculture. This has created an increase in labor productivity in agriculture. Those leaving agriculture entered the manufacturing sector, causing further decline in the labor productivity of the manufacturing sector.

5. Education and Health

5.1 Education

While the results from various data sources provide mixed evidence of the depth of the social impact in terms of education, there are several general findings. First, the impact seems to be more significant at the secondary school level. The crisis has increased the opportunity cost for putting children to the secondary school because children could work in the labor market and seek additional income for the family during the crisis. But considering the fact that the enrollment rates for secondary school has been generally low at around 60 percent, the decline of enrollment rates by around 5 percent at the most (from IFLS for example) does not show a real and significant impact. The enrollment rates for the secondary school has increased very sharply from just above 50 percent in 1990 to around 65 percent in 1997, and the decline by 5 percent for example, would lead to the condition similar to the early 1990s. The second general fact is that the impact has been more significant impact in the urban areas. This is consistent to the general finding that the urban areas suffer more from the crisis than in the rural areas.

There are several possible reasons for the less dramatic impact of the crisis on education as reported in Manning (1999). The first is the abolition of entry fees. There was a significant increase in the number of schools that charged no entry fees in 1998, in response to a Ministerial instruction that schools should not collect entry fees. Second, the social safety net scholarship turns out to be effective in preventing the drop out rates to increase further. The third factor is parents' unwillingness to take out children from school if their children have not completed their course of study. The fourth is the high value given to formal education, so that parent would not reduce their expenditure on education given the sharp decline in their real incomes.

While the overall figure in early 1999 seemed to be encouraging, the data showing the impact of the crisis on education have been mixed. In mid 1998, the government previous estimated that 2.5 million children are threatened to be taken out from school and 10-15 percent of university students are experiencing difficulties in continuing their education due to financial reasons.⁵³ The World Bank report mentioned estimates by the Ministry of Education showing that the schools' drop out rates in primary school would increase from 2.6 percent in 1997/98 to 5.7 percent in 1998/99, and in junior secondary school, an increase from 5.1 percent to 13.3 percent. According to this report, the government estimated that as many as 1.65 million children would drop out from primary school and 1.11 million from the junior secondary in 1998/99.⁵⁴ The special survey conducted by the Ministry of Education later reported that the enrollment rates in primary and secondary school did fall by less than 2 percent from 1997 to 1998. Enrollment fell more drastically in the private school at both the primary and secondary level. This report also mentioned that the decline of enrollment rates

⁵³ *Bisnis Indonesia*, September 27, 98.

⁵⁴ World Bank (1998). "Addressing the Social Impact of the Crisis in Indonesia: A background Note for the 1998 CGI". Mimeo. Washington (available through the internet).

at lower secondary school in Jakarta was high, at around 8.6 percent, and even higher at the poorer sub-districts at almost 11 percent.

Table 49 Percentage change in school enrollment rates

Source	1997-98
Survey by Ministry of Education*	
Primary School	-1.6
Rural	-1.7
Urban	-1.1
Lower Secondary School	-1.6
Rural	0
Urban	-6.3
100 Village Survey**	
Primary School	3.6
Secondary School	-3.8
IFLS data***	
Age 7-12 (Primary)	
Rural	-3.3
Urban	-0.1
Age 13-19 (Secondary)	
Rural	-2.5
Urban	-5.2

Source: * Manning (1999), ** Sigit (1999), *** Frankenberg et al. (1999).

The result from the *Susenas* 1998 has not been widely published, but the preliminary results did not show any significant changes in the enrollment rates among children. The results from 100 Village survey tell a clear story that the school participation rate for children age 7-12 years are not affected by the crisis. It even increased from 89.8 percent in 1997 to 92.7 percent in 1998. But for those aged 13-15 years, the participation rates decreased from 69 percent to 65.2 percent from 1997 to 1998, with the fall substantially large for girls than boys.

The results from the IFLS data show more significant decreases in enrollment rates, especially at the secondary level in the urban areas. For the 7-12 years old, the percentage of school enrollment decreased slightly by 0.1 percent in rural areas, and 3.3 percent in urban areas. For the 13-19 years old group, the percentage of enrollment rates declined by 5.2 percent in urban areas and 2.5 percent in rural areas. By gender, the percentage of school enrollment declined more for boys in urban areas and more for girls in rural areas. The results from the IFLS data also present the increase in school drop out rates for children. The increases are more pronounced for male than females, for urban residents than rural residents, and from children from the poorest household.⁵⁵ The drop out rates of children between 13 and 19 years of age (secondary school) in urban communities for example, increased from 11.1 percent in 1997 to 17.5 percent in 1998. In rural areas, it increased from 13.5 to 16.8 percent from 1997 to 1998. The report estimates that the size of the gap in enrollment between the top and bottom of per capita expenditure quartiles has widened since the crisis. It is estimated that children from the poorest household are about ten times more likely to be out of school than their counterparts from rich household. Parents pull out their children from school to reduce expenses and to let their children work to collect extra income.

⁵⁵ Frankenberg et al. (1999)

While the drop in enrollment rates and the increase in drop out rates in the secondary school might be serious in the longer run, these changes during the crisis are not alarming considering the fact that the drop out rate in Indonesia has been generally high. While the participation rates in the primary school in Indonesia has been high at more than 85 percent, the drop out rates in the primary has also been also high at around 20 percent. Furthermore, there has been low continuation rates to junior secondary when only around 75 percent of those who completed primary education continued their education to secondary school. In general, therefore, among 100 children who entered the primary school, around 80 children completed the primary school, and only 60 continued to the secondary school. This 40 percent loss in the education system has been a serious phenomenon even before the crisis took place.

While the overall picture on the impact of the crisis on education seems to be encouraging, it might take several years in the future to reveal the real impact of the crisis. First, we have not seen the pictures on the enrollment and drop out rates in 1999 and 2000, and there is still a possibility that the adjustment in education will take place with a lag. Second, the picture on the quantity of education, such as the enrollment rates, tells very little about the quality of education. While the development of primary education in Indonesia has been generally seen as a success story, the quality of education, especially at the higher level, is generally low. In other words, the achievement has been more in quantity rather than quality. Therefore, it needs more research to uncover the impact of the crisis on both the quality and quantity of education.

5.2 Health

By looking at the economic development from the longer time perspective, the impact of economic growth on health can be seen more clearly⁵⁶. But precisely because health related indicators reflect a longer-term dimension of economic development, the immediate impact of the crisis on health is rather difficult to measure. Some indicators such as the provision of public services on health could be presented, but less public spending and lower quality public health services do not necessarily lead to higher number of infant mortality rates and shorter life expectancy. The course of the crisis and the recovery in the next few years also matter in affecting the health condition of the society. Painful adjustment that taking place in the short period of time in the future might lead to a different impact on health compared with a long and less painful adjustment.

While it is realized that it will take longer time to uncover the impact of the crisis on health, this section presents some early findings from several data that are available during the crisis. In general, there has been a slight increase in the number of population with health problems, but the impact of the crisis on nutritional status, and general health condition is not yet clear. What's clear is the decline in the use of public health services, relative to the private ones, even though the reason for this is still subject to further analysis. What's also clear is the shortage and the skyrocketing prices of medicines and health supplies. But the shortage of medicines and health supplies did not seem to affect the immunization program and the use of contraceptives.

⁵⁶ For the last three decades, various indicators show that the health development in Indonesia has been impressive. Infant mortality rates, for example, declined from 145 per 1000 live-birth in 1967 to 51 in 1995, while maternal mortality rate also declined very substantially during the period. Live expectancy increased from 45.7 years in 1967 to 64.4 in 1991 and is expected to become 67 years in 1999.

The number of population with health problems has increased during the crisis, even though the increases might not be significant. The data from *Susenas* recorded responses from household members who were asked whether during one month before the survey they have experienced any symptoms of illnesses. These symptoms is categorized as “serious” when it disturbed the daily activities of the respondents. The *Susenas* data shows that the percentage of population experienced serious health problems increased from 12.8 percent in 1997 to 14.6 percent in 1998 and the percentage of those having the problems persist until the time of the survey also increased from 3.2 percent to 3.6 percent. These changes are perhaps too small to be considered significant. The results from the 100 Village Survey data show a higher increase in the number of persons with health problems, from 19.4 percent in 1997 to 27.5 percent in 1998. In the IFLS data, the percentage of population who reported that they are in poor health increased from 13.6 to 13.8 percent. The *Susenas* and 100 Village data seems to suggest that the health problems seems to be more serious in the rural areas, even though the immediate impact of the crisis has been more prevalent in the urban areas. The preliminary data also suggest that the impact is more severe for female rather than male, even though the differences might not be statistically significant.

There are also several indicators of nutritional status that are available from the IFLS data, such as the children’s height-weight index, Body Mass index, hemoglobin level, and others. But because these physical measurements and indexes are longer-term indicators, any changes of these indexes from 1997-1998 are not good indicators of the impact of the crisis. In fact some of these indicators, such as the hemoglobin level, show some improvement of health condition during the crisis. In other words, one should not put too much emphasis on analyzing these indicators of nutritional status.

Another indicator that might be more relevant is the use of health care facility. The *Susenas* and IFLS data consistently show a decrease in the use of public services. The public service is generally of lower quality and cheaper, but surprisingly, the number of visits to the public health services has declined during the crisis. The IFLS data provide a more convincing evidence that the use of health services in general decline significantly from 1997 to 1998. The IFLS data also show the increase in the use of traditional health services. There is a clear difference in the use of public and private health services in Indonesia. The publicly funded *Puskesmas* and *Posyandu* are generally located in rural areas, in the sub-districts, or in the village, close to and mostly used by low-income people for health treatments. The public and private hospital or polyclinics are mostly located in the bigger cities, and the consumers of private hospitals are mostly the middle and higher income groups. It needs further study to explain the decline in the use of public health services especially the *Puskesmas* and *Posyandu*, but the speculation is that from the demand side, the low income household who usually go to the *Puskesmas* or *Posyandu* switch to the traditional practitioner or private paramedics. From the supply side, the decline in government spending on health services has led to the shortage of medical supplies in the *Puskesmas* and *Posyandu*. The government budget cuts has reduced the subsidy for drugs and medical supplies and eventually led to the increase in costs and prices of health treatments.

The fact that the crisis led to the shortage of drugs and medical supplies is clear. The IFLS data provide information on responses from health providers on the availability, prices and quality of outpatient care at health facilities. And the result show that in general public facilities appear to have been more affected by the availability of drugs and supplies, while private providers have been more affected by changes in the prices of the inputs. This is expected, however, because the government generally determines the prices of health services in the public facilities. While drugs and supplies are limited during the crisis, the IFLS data show no significant evidence of declining immunization uptake for children. The IFLS data

also confirmed that between 1997-1998 there have been no significant changes in contraceptive prevalence, or method mix, or with women's satisfaction with family planning services. In fact the use of contraceptive slightly increased from 1997 to 1998. The *Susenas* data also show no sign of declining use of contraceptives.

6. The Informal Sector

While the increasing role of the informal sector during the crisis is obvious, the depth and the degree of the crisis impact on informal sector are difficult to assess. Part of the problem is the definition of informal sector itself. One definition is based on the classification used by the CBS (Central Board of Statistics) in the *Sakernas*, the informal sector generally consists of self-employed with no workers, temporary or part time workers, and family workers, but unfortunately the data on earning are not recorded. Another definition is small enterprise (generally urban and non-farming) without legal entity, settled premises or official recognition (ILO 1999). But in fact much of the off-farm employment in rural areas could also be included in informal activities. The informal nature of the sectors includes lack of fixed premises, small in size, lack of a legal existence and ambiguity about whether they have met the regulatory requirements that might apply to them.

Recognizing the problem of definition, this section attempts to provide a more tangible picture of the informal sector during the crisis. In general, various studies have shown that the movement of labor to the informal sector has reduced earning in that sector. Other studies also show that the collapse of the formal sector led to the declining demand for goods and services produced by the informal sector. Higher competition and declining real income led to the fact that greater reliance on the informal sector during the crisis is only a temporary phenomenon. Labor market data in 1999 clearly show significant movement out from the informal sector back to the formal sector.

6.1 More competition

The informal sector is sometimes viewed as a substitute for the formal sector in absorbing labor, and therefore depressed formal sector, especially in 1998, led to the movement of labor to the informal sector and created a higher competition there. With an easy entry and relatively little risk and capital, informal sector employment became saturated. One micro study (Hardjono 1999) found that tighter competition took place for laborers in the agricultural, trade, and also transportation activities such as *becak* (rickshaw) driving. People in the informal sector had to work more hours or even more than one job during the crisis to maintain a similar level of earning due to the higher competition and lower demand.

By using in-depth interview, another study (Hendytio 1999) confirmed the saturation of the informal sector. In assessing the coping strategy of retrenched workers during the crisis, the study found that a group of male workers established a cooperative of meatball soup sellers in North Jakarta, which recruited a thousand of laid-off workers. When the number of meatball-sellers in North Jakarta increased by a thousand, the competition among them became tighter. In addition, there was also a tendency of changing value system, in which laid-off workers could now accept any simple informal jobs without being ashamed even though their skills and resources are underutilized. This case is found in North Jakarta where out of 65 laid-off workers who participated in the focus group discussion, 20 people worked as street vendors, self employed construction workers, and *ojek* or *bajay* driver (two or three wheels public transportation)

6.2 Lower demand

While informal sectors is sometimes viewed as an alternative place to work, in many cases the existence of informal sector is in fact to support the activity in the formal sectors nearby. Therefore the demand for goods and services from the informal sector declined with the collapse of the formal sector. Observations from workers living in areas closed to some factories show that the collapse of the factory led to the collapse of the informal sector activities, such as food stalls, kiosks, and beauty parlors around the factory (AKATIGA 1988). Similar picture is also shown by a study on the impact of retrenchment on the local community (SMERU 1999). For example, the report captures a story of a man who initially derived his income by renting of rooms to factory workers. When the crisis erupted and workers were laid-off, his income dropped sharply as many of his rooms left empty. Another example is about a driver of public transportation for workers of a shoe-factory, who lost his job after the closure of the factory when the crisis hit. In those two cases, for example, they lost all of their income.

6.3 Lower income

More competition clearly led to lower income even though the data on income in the informal sector are scattered. Various studies generally confirm the notions that the decline in income was in fact larger than that in the formal sector. One micro study on Cost of Production and Informal Sector (ILO 1999) reveals that average nominal incomes in the informal sector declined from Rp 101,000/month in 1997 to 80.000 in 1998 (more than 20 percent). In real terms, this was devastating (more than 55 percent decrease) because of the high inflation in 1998. Evidence of severity of the crisis impacts on the informal sector is also provided by a Survey of Crisis Impacts on Retail Business (CBS-UNDP 1999) which uses both establishment (retailer) and household approaches. The data from the surveyed area show that nominal income was relatively constant at Rp.543 thousand per month in 1997 and Rp.542 per month in 1998, but with almost 80 percent inflation in 1998, this means 44 percent decline. The survey on retailers reveals the fact that grocery stores and general shops have experienced reduction in profit, number of buyers, sales volume and inventories. The data also show among 140 retailers surveyed, about 78 percent reported declining profit, 78 percent reported declining number of customers, 85 percent reported declining sales, and 88 percent reported declining inventories. (CBS-UNDP 1999).

6.4 Heterogeneous impact

Several studies come to the conclusion that there were some significant variations across types of commodity and market orientation. People who were doing business in essential goods such as selling food have been experiencing less severe impact. Finding from study on retail business suggest that the volume of sales of non-food items such as clothing, electronics, cigarette, and cosmetics decreased sharper than that of food items (ILO 1999). In line with this finding, another study (Hardjono 1999) that particularly looked at occupational changes and mobility of the households along the northern coastal plain of West Java found that during the crisis those who sell basic food items have been suffering less. They are still in business, but their income declined substantially due to higher competition. This fact is expected and consistent with the changing patterns of consumption during the crisis characterized by increasing expenditure on basic items such as food and lower expenditure on non-basic items such as clothing and housing. This survey also identified that some informal

sector activities such as repairing motor cycle, recycling tires, and selling second hand articles have survived the crisis because of substitution effect. By contrast, other activities such as cake production have been greatly affected by the decline in demand and higher input prices.

Market orientation also matters in surviving the crisis. Some informal sector activities that function as supporting activities to export oriented industries have been doing well. Recent study of the wooden furniture industry in Jepara, Central Java illustrates that this industry, that has high percentage of informal activities, is surviving well due to the increase in furniture exports. Other informal industry such as pottery and anything related to exported agricultural commodities such as cocoa and coffee have been generally surviving the crisis. On the other hand informal activities that depend of imported inputs and sell in domestic market, such as photocopy services, film processing, and others have suffered the most.

6.5 Home-based workers

One rapidly growing part of the urban informal sector is the large number of home-based workers who produce items (e.g., garments, crafts) on piece rate basis for merchant or other middlemen. The crisis has provided additional impetus for the growing numbers of home workers from both the supply and demand sides. On the supply side, the growing pool of unemployed workers provides an increasing supply of laborers who are available for home-based work. On the demand side, the pressure to reduce cost of production during the crisis provided an incentive to producers to use relatively low-cost home-based workers as opposed to regular workers working in the factory. In addition, the increase in export due to exchange rate depreciation also stimulated the demand for home-based workers who produced goods for exports (Sigit 1999). However, similar to the other segment of the informal sectors, while the number of home based workers have been increasing, many of them suffered from lower income and higher cost of production.

6.6 Farm workers

During the crisis the agricultural sector in rural areas has absorbed a large number of retrenched workers from other sectors and from urban areas. Those who entered the agricultural sector worked mostly as self-employed and family workers (informal sector). As a result, there was a sharp increase in labor supply in the rural-informal sectors in 1998. Hardjono (1999) show that the crisis has reduced the number of working days for informal farm-workers. Before the crisis, male agricultural workers used to work three days in a week on average. During the crisis, because of larger supply of workers, each male agricultural worker worked only one day a week on average. In terms of income, the study also found real income decline in the agricultural-informal sector. By working for 4-5 hours a day, farm workers used to receive Rp. 5,000/day in 1997. In 1998, the nominal daily wage increased to Rp. 7,000/day, which means about 27 percent decline in real terms.

The decline in wages in the agricultural sector is supported by the *Sakernas* data that show how real wages in agriculture continued to decline by 18 percent in 1998 and further by 7 percent in 1999. In contrast, real wages in other sectors has already started to increase since 1999. The profitability of the agricultural activities has also declined recently with the decline in international prices of rice and the ban of fertilizer subsidies. As a result, labor that moved to the agricultural and rural sector immediately when the crisis hit in 1998 finally had to return back to the urban areas in 1999.

7. Distributional Impact

7.1 Regional distribution

Regional disparity has been a long time phenomenon in the Indonesia economy. Some provinces are very rich while some others are very poor. As the regions differ highly according to their level of income, factor endowments and resource allocation, the regional impact of the crisis is expected to be distributed heterogeneously across regions, which makes the assessment rather complex. The heterogeneity of the impact depends on whether the region rely more on modern sectors or traditional sectors.

One of the popular issues on regional disparity is the economic disparity between the western part of Indonesia (Java, Sumatra and Bali) and the eastern part of Indonesia (Kalimantan, Sulawesi, Nusa Tenggara, Maluku and Irian Jaya). The western part of Indonesia is characterized by a relatively high per capita GRDP while the provinces in the eastern part of Indonesia have among the lowest GRDP—exempting the natural resource abundant provinces, such as East Kalimantan and Irian Jaya. Provinces with large areas, such as the provinces in Kalimantan are among the provinces with the lowest per capita GRDP while the smallest DKI Jakarta was among the richest.

Java and Bali are regions where the modern sectors—such as manufacturing, construction, trade, hotel and restaurant—dominate, while most of Sumatra, Sulawesi, Kalimantan and Nusa Tenggara—excluding Aceh, Riau, South Sumatra, East Kalimantan and Irian Jaya whose oil, gas and other mining dominated—are regions which mainly rely on agriculture. In Java and Bali, agricultural activities are mainly on producing food crops. North Sumatra, Lampung, West Sumatra, North Sulawesi, NTB, South Kalimantan and South Sulawesi are agriculture-dominated regions, in which the economy is dominated by the production of estate commercial crops. Southeast Sulawesi, NTT, East Timor, Bengkulu and Jambi are also agriculture-dominated regions, especially producing food crops. Kalimantan is also based on forestry and fishery.⁵⁷

We argue that some regions with economic activities that are considered as modern sectors that are highly affected by the fluctuation of the exchange rate, e.g., financial services, might be devastated by the crisis. Other regions with economic activities which mainly rely on traditional sectors might benefit from it, especially those producing export-oriented estate crops. Areas with manufacturing activities might also be hurt by the crisis since those activities have high a import intensity. The crisis—which began as a currency crisis and eventually, fed into a financial crisis—is primarily affecting firms that had either some debts denominated in dollars, relied heavily on imports or have linkages with the formal banking sectors. It makes sense that regions more closely tied up with the urban formal economy have been harder hit than those regions which were not as tightly integrated. Those regions with export earnings, had benefited from the collapse of the Rupiah combined with the economic reforms. Some regions experienced natural disasters—such as the prolonged drought due to the El Niño, which hit eastern islands, the western coast of Sumatra and parts of Sulawesi and the forest fires in East Kalimantan. We also argue that the regions which are natural resource abundant, might not be hit hard by the crisis.

A rough estimate of the impact of the crisis might be attained from the GRDP growth in 1997. A recent study⁵⁸ using the 1997 GRDP growth shows that all provinces experienced

⁵⁷ See also Igusa (1992), "Regional Development and Investment Opportunity: An Analysis on the Possibility for Local Industrialization" in *Regional Development and Industrialization of Indonesia*, IDE, Tokyo.

⁵⁸ Brodjonegoro (1999).

declining annual growth quite drastically, while Aceh experienced negative growth. The hardest hit regions, experiencing more than 50 percent reduction in GRDP growth, are Aceh, Jambi, Central Java, Jogyakarta, East Timor and Irian Jaya. The moderately hit regions—i.e., those experiencing around 50 percent reduction in GRDP—are North Sumatra, Riau, South Sumatra, Lampung, Jakarta, West Java, East and Central Kalimantan, South Sulawesi and Maluku. The least hit—to wit, those areas with less than 3 percent growth reduction—are South Sulawesi and West Sumatra. The rest of the provinces experienced less than 50 percent growth reduction.

The GRDP growth presented a rough estimate of the impact of the crisis. In order to have a more accurate measure on the impact of the crisis, at least three major surveys have been undertaken: the *Kecamatan* Rapid Assessment (RPA) Survey, the IFLS2+ and Survey of the 100 Villages.

The *Kecamatan* RPA survey separated urban areas from the rural areas. The result shows for certain provinces, the crisis only hurts the urban areas, while in other provinces, urban as well as rural areas are affected. A report based on the *Kecamatan* Rapid Poverty Assessment survey suggests that the impact of the crisis was severely heterogeneous across regions.⁵⁹ It reveals that Java is hard hit, even in the rural areas (all provinces in Java are among the 20 hard hit by the crisis). Some of other islands, particularly large parts of Sumatra, Sulawesi and Maluku, have experienced minimal negative impact and areas that escaped the drought may actually be booming from export crop earnings. Other areas show negative impact, but it is unclear whether their problems are economic crisis-related or a result from the drought (East Timor and Nusa Tenggara).

The reason that all provinces in Java—even in the rural areas—are among the most seriously affected, might be that the deep integration between urban and rural in Java allowed the crisis—that initially started from modern sector in the urban areas (banking and big companies)—to affect the rural areas. Other areas where the urban as well as the rural are included in the 20 hardest hit areas, are Aceh and East Kalimantan. Comparing 40% regions hardest hit by the crisis with the 40% least hit, showed that the urban areas, on average are severely hit by the crisis. The urban areas that are included in 40 percent of regions that are least affected are in the provinces in which the rural areas are relatively not affected by the crisis, namely, Jambi, South Sumatra, Bali, North Sulawesi, South East Sulawesi, Maluku and Bengkulu.

To see whether some areas are worsened than before, the survey measured the “coping index” as an indicator. The “coping index” which was based on the indicators of the degree to which people were selling assets to meet their basic needs, reducing their participation and contribution to social activities and other indicators of the use of “coping mechanisms”. On average, percentage of *Kecamatan* reporting things are worse than before are highest in Java (77.5%), followed by Kalimantan, Bali, Nusa Tenggara and East Timor (56.7%), Sumatra (42%) and Sulawesi (35%). A disaggregated data shows that regional disparity, not only across regions but also urban/rural criteria, where the percentage of *Kecamatan* reporting things are worst that ever were very high, 93 percent in urban Aceh, 87.5 percent in urban West Java and 82.5% in rural West Java. Regions that reporting the least hard hit based on coping strategy that there was only a little percentage that reporting things are worst than before, rural Bengkulu 16.7%, rural Maluku, 26.1%. It also reported that less than half of *Kecamatan* that reporting selling assets, reported things are worse than before in rural 12 provinces: North Sumatra, West Sumatra, Riau, Jambi, South Sumatra, Bengkulu,

⁵⁹ Sumarto et al. (1998).

Lampung, East Timor, West Kalimantan, North Sulawesi, Central Sulawesi and South Sulawesi.

Is the impact of the crisis worst in the regions previously poor or relatively rich? The report on the *Kecamatan* RPA indicated that there exist low correlation and statistically insignificant between those variables.

Table 50 Differential impacts of the crisis

	Relatively well-off pre-crisis	Relatively poor pre-crisis
Hard-hit	Jabotabek, West Java	NTT, East Kalimantan
Not hard hit	Central Sulawesi, Bali	Maluku, Jambi

Source: Sumarto et al. (1999).

The second qualitative survey is the 100 Villages Survey. It suggested similar regional discrepancies by comparing changes in assets from 1997 to 1998. The analysis is based on an index of asset ownership based on 10 durable goods (e.g., bicycle, radio, etc.) weighted by the relative prices of the goods. The result shows that there has not been a massive sale of assets to cover expenditures, which contradict the *Kecamatan* RPA result. On contrary, there was a rather small increase in assets. The increase in asset acquisition is larger in the western islands as compared to Java; while the eastern islands holding about the same as before. The expenditure data shows a similar regional pattern. Expenditures have increased more in the parts of Sumatra (Riau and Lampung in this survey sample) than in either the village surveyed on Java-Bali or the eastern islands. Interestingly, all islands in the sample are those hard hit among the off Java islands in *Kecamatan* RPA, to wit, East Nusa Tenggara, East Kalimantan and Southeast Sulawesi.

The third data source is the IFLS+2, which shows that urban area suffers the most from the crisis, used estimates of average expenditure in rural and urban areas. The preliminary findings show that the average spending in urban areas decreased by 34 percent compared to only 13 percent in rural areas from 1997-1998. Measured by the median, the level of real expenditure in the urban areas decreased by 5 percent while that in the rural areas fell by 1.6 percent. Looking at the regional data, it shows that Jakarta and West Java, where the financial and corporate modern sectors dominated, experienced a very large per capita household income decrease. Average real per capita household expenditures fell by 30 percent in Jakarta and 42 percent in West Java. In central Java, average expenditures fell by 19 percent. South Kalimantan also experienced a relatively high decrease in real expenditures (-21.7%). On the other hand, South Sumatra, North Sumatra and NTB experience a relatively lower reduction in average real per capita expenditures.

The result of the *Sakernas* 1998 does not significantly show the severity of the impact in Java compared to those in outside Java. In terms of employment reduction, for example, the growth of employment varies greatly across provinces, and does not show any significant differences between Java and off Java. But this is expected considering the difference in employment structure across provinces and islands in Indonesia. The inter-related employment indicators, such as unemployment, underemployment, as well as formal-informal structure of the labor market reflects the degree of economic development in provinces. There are large differences in the proportion of informal sectors across regions in Indonesia. Being more modern than other areas, Java has the smallest proportion of informal sector employment at less than 60 percent, while some provinces in the eastern part Indonesia for example, have informal sector employment up to 80 percent of the total employment. When the proportion of informal sector is high, underemployment rate is generally high but

open unemployment is relatively low. Because of this different structure of the labor market, the comparison of labor market indicators across regions would lead to difficult interpretation. What is clear is that the crisis led to the larger increase in informal sector in outside Java compared with that in Java. In term of real wage decline, the data shows that Java has experienced larger wage reductions, in general at around minus 35 percent. This reduction was larger than the average values of real wage reduction in the outer islands except East Timor.

Table 51 Regional real wage and employment growth, 1997-99

	R. Wage Growth		Employment Growth	
	1997-98	1998-99	1997-98	1998-99
Jawa (Average)	-35.1	7.1	2.2	2.8
DKI Jakarta	-33.3	-2.4	-1.5	6.5
W. Java	-37.2	9.1	2.9	3.6
C. Java	-36.5	12.1	2.1	3.1
Yogya	-39.6	13.6	-1.7	5.1
E. Java	-31.3	7.6	3.0	0.9
Sumatera	-35.2	19.0	4.4	-1.3
Kalimantan	-31.8	16.5	1.3	3.0
Sulawesi	-16.0	10.9	3.9	1.4
Maluku-Irian Jaya	-33.3	21.5	6.7	-1.9
Bali-Nusa Tenggara	-32.9	19.2	-1.2	2.5
E. Timor	-44.8	—	6.0	—

One study⁶⁰ using data on real wages from 14 provinces, suggested that no region is spared. In all 14 provinces, real wages declined by 30 to 40 percent. Both industrial and agricultural wage data shows a substantial decline in the purchasing power of labor in those 14 provinces. The notion that the crisis was a Java problem is contradicted by the data. However, the provinces do vary substantially. Bali and Sumatra, although not Medan, were less badly hurt. Bali benefited from tourism and capital and human resources flight from Java since Bali is considered is relatively safer than Java. While, Sumatra benefited by an increase in exports of natural resources based products.

Farm workers in Java were hard hit by the crisis. The average decline, from peak to trough, in real wages for agricultural labor was over 40 percent for the 3 large provinces of Java—East Java, West Java and Central Java. West Java was worst affected, with a nearly 47 percent decline. Sumatra's farm workers were less badly affected, but the decline from peak to trough still averaged over 30 percent. The agricultural real wage for other provinces had substantially declines of between 36 percent and nearly 45 percent with Bali had the lowest decline. Industrial wages for unskilled workers also declined sharply, but to a lesser extent.⁶¹ Average wages for unskilled workers in industry declined by 35.5 percent. The decline in real wages also differs across regions. Real wages for centers of industry in Java, Jakarta and Surabaya were hard hit (a decline by 44% in Jakarta and 40% for Surabaya) as well as Medan (decline by 46%).

⁶⁰ Papanek and Handoko (1999), "The Impact on The Poor of The Growth and Crisis Evidence from Real Wage Data," paper presented at the Conference on The Economic Issues facing the new Government, Jakarta.

⁶¹ Some impact of the crisis on industrial workers was in the form of loss of jobs, not just a decline in wages.

7.2 Rich and poor

The precise data on income are generally difficult to obtain, so that measuring the distributional impact on the rich and the poor is generally based on expenditure level—with all the weaknesses it might have in the analysis. Preliminary results from the World Bank Report (Poppele, Sumarto, Pritchett 1999) using the IFLS data show that the *average* real expenditure fell more than the *median*, meaning that the distribution of expenditure is more even after the crisis. The data shows that the upper middle class was hit harder during the crisis. Measured in terms of the median value of per-capita expenditure, people in the top quartile of expenditure distribution experienced 41 percent decrease in their nominal expenditure from 1998 to 1999, while those in the lowest quartile of the distribution experienced 49 percent increase. Measured in terms of the mean value of expenditure, those in the top quartile of income distribution experienced 54 percent decline in expenditure, while those in the lowest quartile of the distribution experienced 120 percent increase.

The change on the expenditure level classified by education level of the household also showed a similar pattern. The mean expenditure for those who have no education decreased by 14 percent during the crisis while the mean expenditure for those with tertiary education fell by 23 percent. All of these suggested that the expenditure of those who are rich fell more than that of the poor.

Table 52 Changes in per capita expenditure by initial quartile per capita expenditure

Quartile in 1997	Percentage change in mean	Percentage Change in Median
I (low)	120.0	49.0
II	41.9	11.7
III	-1.6	-18.8
IV	-54.0	-41.4

Source: Poppele, Sumarto, Pritchett (1999).

The IFLS data show that the total household real expenditure on average declined by 11 percent, while the monthly per capita expenditure declined by 24 percent from 1997 to 1998. In terms of distribution, the data indicates that there has been a substantial shift in the structure of the distribution of expenditure with the center of the distribution remaining stable. The right tail being substantially truncated between 1997-1998 and the left tail becoming fatter, shows that the decline of expenditure was sharper for the rich. The fact that the median value is generally more stable than the mean value suggests that the distribution of expenditure is more even after the crisis.

The fact that the expenditure for the rich decreased more than that of the poor, however, does not suggest that the rich suffered more than the poor in terms of the declining quality of life. For the rich, a sharp decline in expenditure, for example, could mean switching from having overseas to domestic vacations, while for the poor, a small decline in expenditure could mean reducing their consumption from eating three times to twice a day during the crisis. The fact that the rich has more assets in foreign currency, such as US\$ saving or time deposit, also provided some cushion during the crisis. In fact, those who had a chance to hedge the value of their assets to US\$ during the early period of the crisis are the one who have gained the most from the crisis.

7.3 The vulnerable groups: women, children, and the elderly

The impact of the crisis on the vulnerable groups, such as the elderly, children, single women with children, and people with disabilities, is serious even though reliable data that specifically focuses on these groups are still limited. From the previous discussion related to income and expenditure adjustments, it is clear that those who have no saving and no interest income, or have no capacity to get additional income are the one who suffered the most from the crisis. It is clear that the children of poor families, or elderly, who live near or below the poverty line, unskilled and single female labor with children, are worst victims. But one should not make generalization with regards to the vulnerable groups, for example based solely on gender and age, especially because of the heterogeneous nature of the social impact itself. For example, those who belonged to the vulnerable group before the crisis could be better off after the crisis if in fact their sources of income depend on export earnings. In other words, there could be a new form of vulnerable groups as a result of the crisis. This section presents some early findings of the impact of the crisis on the vulnerable, focusing on women, children, and the elderly.

7.3.1 *Women*

During the booming years, women in Indonesia shared absolute economic and social gains and even enjoyed some reduction in the relative discrepancy in the labor markets. The crisis has even increased both the labor force participation and employment for women, but it is rather difficult to provide a normative judgment whether this is actually a positive or negative development for women. Increasing participation for women in the labor market during the crisis could also mean that women are bearing the burden by having to contribute to the family income. In fact, more research is needed to better understand the impact of the crisis on the gender dynamics in the society, especially at the micro or household level to uncover the survival strategy of the family during the crisis.

The previous discussion on the adjustment in the labor market has shown the increasing female labor participation rate in the labor market, especially in the informal sector. The sudden increase in the rate and the informal characteristics of the work reflect the involuntary nature of the participation, whereas the declining income of the family has forced women to seek for additional income by working temporarily in the informal sectors. In many developing countries, the reduction in the household income would force the family—especially the poor—to tap into their available labor resources in the family, i.e. women and children. In all countries during the crisis, it is expected that the school drop out rates will increase, especially at the secondary level, as poor households can no longer afford to send their children to school and instead, expect them to work to supplement the household income.

The general division of labor in the family, for example where men are usually responsible for generating family income and women are responsible for managing expenditure and preparing food, could also create greater pressure for women. When food prices doubles at the same time when the family income declines, there is clearly stronger economic pressure for women to maintain the welfare and well being of the family by switching expenditure and adjusting consumption. When the adjustment in quality and quantity is no longer possible due to the sharp increase in prices, women have to seek additional income to maintain the expenditure level.

The crisis has clearly increased the number of female workers working the informal sectors. Despite the formalization of female employment in the last decade, the proportion of female workers in the informal sector is still larger than that of the males. Because of the part-

time and temporary nature of these informal activities, the proportion of under-employment among women is also larger, and therefore their income is also smaller. After the crisis, the proportion of women in the informal sectors increased to more than 70 percent, higher than the overall proportion of the informal sectors at less than 60 percent. The proportion of underemployed female workers also increased to more than 50 percent in 1998 compared with around 40 percent of the national average. It is difficult to measure the real income decline in the informal sectors, but higher competition in the informal sector would certainly drive down their wages. The more serious impact, however, is that the increasing number of women in the informal sector might lead to weaker employment position of women because there is clearly no protection for labor, such as minimum wage, labor standards, employment safety measures, and others, in the informal sector.

In summary, the increasing role of women in the labor market during the crisis is clearly a result of push and pull forces both from the demand and the supply sides. From the demand side, the surviving sector during the crisis turned out to be the labor-intensive export-oriented sectors, which are more 'feminine', and the collapsing sectors turned out to be the 'masculine' such as construction, mining, and utilities. From the supply side, the declining real income of household has forced women in the family to enter the labor market and to seek for additional income for the household, either in the formal or informal sectors.

7.3.2 Children

Considering the massive decline of real income during the crisis, there has been strong concern that the impact of the crisis on children could be serious in the form of the increasing incidence of school drop-outs and the higher number of child labor in the labor market. The reduced income might force the family to pull their children out of school and force them to work on the street or other unacceptable places to seek for additional income for the family. But the previous discussion on the impact of the crisis on education reveals little evidence of declining enrollment rates. There has been some reduction in enrollment rates for those in the secondary school, but considering the fact that the enrollment is generally low, it needs longer time to see the depth of the problem.

The other concern of the possible increase in child labor cannot be fully supported by the *Sakernas* data.⁶² Labor force participation rate for children aged 10-14 years increased from 7.7 to 8.3 percent from 1997 to 1998. The labor force participation rate for those between 15 to 19 years of age declined from 39.2 to 38.5 percent. The unemployment rate remained unchanged at around 4.5 percent for the 10-14 age group, and increased slightly from 16.9 to 17.3 percent for the 15-19 age group. Similar to the general trend in the labor market, child labor also experienced strong informalization of work. Non wage employment increased significantly while wage employment decreased, especially among the 15-19 age groups. During the crisis, a high proportion of all child labor outside agriculture was in self-employed work in trade and services in urban areas.

While the *Susenas* data did not show a convincing evidence on the decreasing enrollment rates among children, and the results from the *Sakernas* did not provide a significant increase in increasing child labor, the increasing number of street children could be clearly seen on the street in major cities in Indonesia, especially Jakarta. While the precise measure on the increasing evidence of child labor is difficult to find, one thing is clear, namely that the crisis has pushed the children of the poor to the streets. These children usually work as beggars or street singers, many of them are trying to help their parents make a living.

⁶² See Manning, Chris (1999) "Krismon and Child Labor." Research paper prepared for ILO. May 1999.

In 1998, according to the Minister of Social Affairs, the incidence of the street children increased by 400 percent.⁶³ According to her, there are 50.000 street children in Indonesia, about 26 percent or 13.000 of them live in Jakarta. Before the crisis, there were estimated 3000 street children in Jakarta. The number quadrupled following the crisis.

7.3.3 *The elderly*

The lack of a national social security system has forced the elderly to depend on either family support or to work for the rest of their lives. There were around 14 million people over 60 years of age in Indonesia in 1998, and most of them (66%) lived in rural areas. Being part of the older generation, their education is generally lower than the average population. More than 94 percent of them have primary school education, while the percentage at the national level was more than 60 percent in 1998. As a result of the lack of the social security system, more than 50 percent of the elderly are still in the labor force, mostly in the informal sectors. Because of their lower education and the informal nature of their work, their income, therefore, is generally lower than the average income of Indonesian workers.

The crisis has unfortunately forced the elderly to work more, as reflected by the proportion of the elderly in the labor market that increased from 50.3 percent in 1997 to 51.8 percent in 1998. It is estimated that the number of population over 60 years of age in the labor market increased from around 7 million in 1997 to 7.4 million in 1998. In other words, the number of the actively working elderly increased by 400 thousand during the crisis.

Similar to the general trend in the labor market, the crisis has also driven the elderly out of the formal sectors. In urban areas, the percentage of the elderly who worked in the formal sectors declined from 24.1 percent in 1997 to 23.5 percent in 1998. In rural areas, the percentages declined from 11.3 percent to 10.3 percent, which means that around 90 percent of the working elderly in rural areas work in the informal sectors in 1998. The increasing participation of the elderly in the informal sector is accompanied by the increase in underemployment among the elderly. From 1997 to 1998, those who worked for less than 35 hours a week increased from 37.1 to 39.4 percent in urban areas and from 55.1 to 58.6 percent in rural areas.

8. Poverty

Early in the crisis, one of the most controversial issues in discussions on the social impact of the crisis concerned the estimate of the poverty figures. Given the need, for policy purposes, to assess the immediate impact of the crisis towards the poor, many conducted projections and rapid assessment exercises to approximate the increase in the number of poor in Indonesia. As its result, various groups gave different results—some being very high, while others, relatively low. These disparities spurred debates on the accuracy of each estimates, until finally, on July 1999, BPS published the official 1998 poverty figure based on the core National Socio-Economic Survey or *Susenas* conducted in December 1998.

This section will discuss some of these early estimates, followed with a discussion on the official BPS figures. Within these discussions, some issues of methodology will be brought up, with a special attention to the BPS methodology for calculating poverty lines. Also, given the debate that surfaced following the announcement of the 1998 poverty figure, it

⁶³ *Kompas*, "Anak Jalanan Meningkat 400 Persen.", September 4, 1998.

is also necessary to have a brief discussion on the comparability of BPS's poverty figures, to wit, between the 1996 and the 1998/1999 figures.

8.1 Early estimates

Many of the earliest poverty estimates in 1998 showed a very grim picture of the impact of the crisis to Indonesia's poor. The ILO, for instance, came up with a prediction that one in every two Indonesians lived below the poverty line in 1998. Another estimate by the BPS put the figure at around 39 percent in mid 1998. Given that the official poverty incidence was only around 11 percent in 1996,⁶⁴ these new estimates at 39-48 percent—a four-fold increase within two years—came as a shock. Furthermore, these numbers were comparable to the poverty rate in the 1970s. Hence, if these numbers were to be believed, they suggested that the fruit of economic development achieved in the last twenty five years disappeared within the first year of the crisis. Journalists, politicians, and many economic commentators quoted these figures everywhere to illustrate the seriousness of the crisis in Indonesia, not realizing that these estimates were quick, dirty—and *wrong*. As more data, collected with a more appropriate procedure by the BPS, became available in the end of 1998, the poverty rate in 1998 turned out to be not as bad as predicted. The availability of this new data did not stop the controversy because by then, the data available prior to the BPS data, had resulted in a number of differing poverty figures.

Perhaps, both the ILO and the BPS had an excuse for their mistakes since the pressure to estimate the number of poverty was very strong during the worst time of the crisis in early 1998. The unavailability of data during the crisis forced them to measure poverty using the expenditure data that were collected before the crisis, and then, projecting its likely distribution during the crisis. ILO estimated that around 48 percent of the population (98 million) lived below poverty line in 1998, even though the report explicitly mentioned different poverty standards between 1996 and 1998⁶⁵. The BPS estimated that around 39 percent of the population (79 million) lived under the poverty line in June 1998.⁶⁶ According to this BPS mid-year estimate the number of people living below the poverty line in the rural areas increased from 12 percent in 1996 to 45 percent in 1998, compared with 10 percent and 28 percent in the urban areas.

Although the lack of data was clearly a problem, it turned out that the bigger problems were actually their assumptions. ILO, for example, assumed that the average wage and household income would not change in nominal terms during the crisis, while various data later showed that the nominal wage increased by around 17 percent, and household nominal expenditure increased by around 30 percent. Another wrong assumption was made by the BPS, which predicted that those at the lower end of the income distribution would be hardest hit by the crisis. These individuals experienced a faster income growth during the boom years before the crisis, and therefore it was assumed that their income reduction would also be faster during the economic contraction. It turned out later that this was not the case. The IFLS data for example clearly show that in terms of magnitude, those with higher than average income had experienced sharper expenditure reductions during the crisis.

⁶⁴ The incidence of poverty in Indonesia had declined significantly from around 40 percent in mid 1970s to around 22 percent in 1984 and just around 11 percent in 1996.

⁶⁵ ILO defined poverty standard in 1998 as the poverty standard in 1996 x 16.5 percent increase in median consumption x 80 percent inflation rate.

⁶⁶ The poverty standard according to BPS is equal to 2100 calorie per day plus other basic needs, which was translated to Rp. 52,470/month/capita in urban areas, and Rp. 41,588/month/capita in rural areas.

While the BPS and the ILO came with the 'doomsday scenario', the World Bank produced a more optimistic poverty figure at around 14 percent. This was similarly calculated based on the expenditure data from *Susenas* 1996, but the measurement was based on the predicted sectoral growth of the economy. The procedure was to categorize households in the *Susenas* data according to the sector in which they derived most of their income, and then applied sectoral growth rates to household incomes. By assuming an overall economic growth at minus 12 percent in 1998 and zero percent in the year after, it estimated that the poverty figure was 14 and 14.5 percent in 1998 and in 1999/2000 (Cameron 1999).⁶⁷ Since the actual economic contraction in 1998 was worse than minus 12 percent, this poverty estimate could have been too optimistic, but this, in fact, was closer to the estimates of poverty in the end of 1998.

By the end of the year, several datasets that were collected during the crisis became available, and with these new datasets, some studies came out with a controversial, but much smaller, figure. Based on the preliminary results of the IFLS data, one study sponsored by the World Bank reported that the number of poverty increased by three percent from 11 percent in 1996 to around 14 to 19 percent in 1998.⁶⁸ While it is tempting to compare these results with those done by the BPS or ILO, and the World Bank, it is important to note that they are based on different data samples and poverty measurements. The poverty measurement by the World Bank was based on the expenditure data of the IFLS with a much smaller sample size compared with other large datasets such as the *Susenas*. Due to this limited sample size, this estimate was heavily criticized for being too optimistic.

Another estimate using the *Susenas* 1998 core data by Sigit (1999) supported the finding from the IFLS data that the poverty incidence in 1998 was estimated, based on the 1996 poverty standard, at around 18 percent.⁶⁹ Using a different methodology and different price deflators, another preliminary estimate by M. Ikhsan (UNSFIR 1999) showed that the poverty incidence increased from around 20 percent in 1996 to 33 percent in 1998.

8.2 The BPS poverty figures

On July 9, 1999 BPS announced the new official poverty figures based on the core *Susenas* taken in December 1998. It came up with 24.2 percent of overall poverty incidence, 21.9 percent in the urban areas, and 25.7 percent in the rural areas. Urban poverty was reported to have increased more rapidly than rural poverty showing that urban areas had been hardest hit by the crisis. This official BPS report also mentioned that poverty increased from 11.3 percent in 1996 to 24.2 percent in 1998. While the figures themselves were not really put in question, this claim of comparability with the 1996 figures was immediately refuted by those familiar with the BPS poverty figure.⁷⁰ The problem with this claim was that the commodity bundles in those two years, 1996 and 1998, were actually different.

⁶⁷ Cameron, Lisa (1999). "Survey of Recent Developments." *Bulletin of the Indonesian Economic Studies* Vol 35, No 1, 1999.

⁶⁸ Poppele, Jessica et al. (1999). "Social Impact of the Indonesian Economic Crisis: New Data and Policy Implication." Smeru Report. February 1999.

⁶⁹ See Sigit (1999).

⁷⁰ In BPS's *Berita Resmi Statistik*, July 9, 1999, the BPS claimed that the methodology used for 1996 and 1998 were exactly the same and hence, the two numbers can be directly compared. According to this reading, poverty in Indonesia jumped from 11.3 percent (22.5 million people) to 24.2 percent (49.5 million people). This claim by the BPS spurred controversies since actually, those numbers have not taken into account the different food and non-food bundles. After adjustments, the increase in the number of poor people after the crisis is much lower. Because of this, some accused BPS of politicizing the poverty figure.

Table 53 The number of population living below the poverty line in Indonesia

Year	As a percent of the population			In million people		
	Urban	Rural	Total	Urban	Rural	Total
1976	38.8	40.4	40.1	10.0	44.2	54.2
1980	29.0	28.4	28.6	9.5	32.8	42.3
1987	20.1	16.1	17.4	9.7	20.3	30.0
1990	16.8	14.3	15.1	9.4	17.8	27.2
1993	13.4	13.8	13.7	8.7	17.2	25.9
1996	9.7	12.3	11.3	7.2	15.3	22.5
BPS Mid-year, based on declining real income 1998	28.8	45.6	39.1	22.6	56.8	79.4
ILO, based on declining real income 1998	39.3	53.2	48.3	28.1	70.7	98.8
Smeru Report (W Bank) IFLS Data, various deflators 1998	12.0 - 15.8	15.2 - 23.0	13.8 - 19.9	9.1 - 12.0	19.3 - 29.3	28.4 - 41.3
Smeru Report (W Bank) 100VillageData, various deflators, 1998			14.4 - 18.6			29.4 - 38.0
BPS <i>Susenas</i> data - CPI deflator 1998	17.2	19.0	18.3	13.1	24.2	37.3
M. Ikhsan* <i>Susenas</i> data - Other methods 1996	10.6	25.7	20.1**	7.9	32.1	40.0
1998	20.3	41.3	33.5**	15.5	52.6	68.1
BPS, new poverty standard 1998 (officially published)	21.9	25.7	24.2	17.6	31.9	49.5

* Estimates by M. Ikhsan, as reported in UNSFIR (1999).

** Calculated based on the number of population in urban and rural areas.

Sources: BPS, various reports, ILO report (1998), Poppele, Sumarto and Pritchett (1999).

To understand this debate, it might be worthwhile to look into the official method for measuring poverty. BPS measures poverty by counting the number of people who fell below a certain poverty line. This poverty line is generally understood as a minimum monthly income per capita needed to satisfy a basic food and non-food necessities. However, given the unreliability of income data in Indonesia, BPS opted for using the expenditure data as a proxy for measuring this ability to satisfy basic necessities.

In deciding what constitutes basic necessities, BPS had adopted various approaches over time.⁷¹ As a general rule, BPS took the recommendation of the National Workshop on Food and Nutrition in 1978 of a minimum daily consumption of 2,100 calories as a benchmark to determine its food poverty line. The food poverty line, then, is defined as the

⁷¹ For a complete description of the official poverty measurement methodologies, see Sutanto et al. (1999), "Poverty Measurement: Problems and Development". A paper presented at the "International Conference on Methodologies of Poverty Calculation in Indonesia", November 30, 1999. The part of this section on the methodologies relies on this paper.

total expenditure needed to satisfy this energy requirement. The dataset used for this exercise is the national socio-economic survey, *Susen*s. However, the methodology used to arrive at the required minimum expenditure from this energy requirement evolved over time. Prior to 1993, BPS used a very simple method of averaging calorie price and deriving the minimum required expenditure for food by multiplying this average to the 2,100 calories requirement. For the non-food items, BPS selected 14 non-food items and arbitrarily decided on the minimum amount required for each of the items.

In 1993, however, BPS began to acknowledge the differences of the commodity bundles consumed by poor and non-poor individuals. As such, it changed the way it determined the food and non-food bundles. Starting from 1993, the food poverty line is not determined by calculating the average calorie price alone, but also by first looking at a "reference population"—people belonging to a class who live just above the expected poverty line—and deriving the commodity bundles from these reference population.⁷² Based on these commodities, the total expenditure to purchase these commodities are calculated, and this become the food poverty line.⁷³ Meanwhile, the non-food poverty standard is no longer determined arbitrarily, but by looking at the lifestyle of the reference population. Based on this, a list of commodities and their amounts are selected as a representation of the common consumption of those people living below the poverty line. Furthermore, both the food and non-food poverty standard are also made to be sensitive to regional and urban-rural differences.

From 1993 onward, there had been little change in the choice of the food commodity bundle. The non-food commodity bundles, however, tend to change significantly because it had to adapt to society's current consumption pattern. In setting the non-food commodity bundle for 1996, BPS, due to comparability consideration, did not make a significant revision to the 1993 bundle. The 1996 bundle was merely an aggregation the 1993 non-food commodity bundle. However, for the 1998 poverty figure, a major revision in the non-food commodities had been performed. This revision had not only included a change in the amount and variety of the commodities, but also in the fractions for each commodity group.⁷⁴

This revision resulted in the significant difference between the 1996 and 1998 non-food minimum standard—hence, a significant difference in the non-food poverty line. The official BPS report failed to acknowledge this difference, and thus, claimed that the unadjusted 1996 and 1998 poverty figures were comparable. This, obviously, was incorrect.

Hence, how to read BPS's 1996 and 1998/1999 figures? In order to be able to compare and interpret the two poverty figures and see the crisis induced poverty, Sutanto (1999) offered three alternative approaches. First, by applying the same non-food bundle and their respective proportions used in the 1996 to estimate the more comparable figure for 1998.

⁷² The three principles for the choice of commodity are: first, it must be commonly consumed; second, it must have a substantial share in the reference population's budget; and third, the commodity must be very strongly viewed as an essential commodity if it does not meet the other two requirements. See *ibid*, p. 4.

⁷³ It might be necessary to note here that even though the choice of the commodity bundles is selected based on the reference population, it does not mean that the calorie intake requirement is being abandoned. Once the food commodity bundle and the amount of each commodity are selected, both the total expenditure to purchase and the total calorie content of these commodities are then calculated. If the total calorie content is below the 2,100 calorie intake requirement, the total expenditure is then marked up to ensure that the food commodities purchased can fulfill this requirement. This marked up expenditure becomes the food poverty line. See *ibid*, p. 4.

⁷⁴ "Fraction" refers to the fraction of each commodity group being consumed by the reference population. This subgroup commodity was selected by looking at "the 1995 Basic Commodity Basket Survey" (*SPKKD*) which collected data on specific commodity groups that were most likely to be consumed by the reference population. Not all commodities in a commodity group are common consumption of the reference group: only a fraction of the commodity group is—hence, the concept of "fraction." For more detail, see *ibid*, p. 5.

Second, by applying the same non-food bundle and their respective proportions as used in the 1998 method to estimate the more comparable 1996 figure. And finally, by holding the 1996 bundle and their respective expenditure values and multiplying them by the rate of inflation.

While even after adjusting the figures using the three aforementioned approaches the results are not exactly comparable⁷⁵, these numbers provide a more accurate depiction of the impact of the crisis compared to the original 1996 and 1998/1999 figures. Without these adjustments, the increase in the number of the poor would be 27 million people or, in percentage change, about 12.9 percent increase. However, after doing the necessary adjustments mentioned above, the percentage increase is actually only between 5–6 percent (from 19.2 to 24.2 percent using the first approach, 11.3 to 16.74 percent using the second method, and 11.3 to 17.2 percent using the third method).⁷⁶

All of these preliminary findings clearly suggested that the crisis had increased the poverty incidence in Indonesia. Different methodologies, price deflators, and sources of data produced different numbers of poverty incidence, and hence the precise measure of the increasing number of population below the poverty line was hard to obtain. When one has to make some conclusion about the number of poverty incidence, based on all the findings, it seems fair to conclude that the number of people living below poverty line, or the incidence of poverty, increased by around 65 percent from 1996 to 1998. For example, the poverty incidence could increase from 11 percent in 1996 to 18 percent in 1998, or, based on different methodology, it could also increase from 20 percent in 1996 to 33 percent in 1998. This being the case, the poverty figure for 1998 should be comparable to that in early 1990s. The fact that the preliminary data of the 1998 GDP shows a decline in personal consumption expenditure of around 3 percent, or similar to that in 1993, seems to support the findings that the poverty went back to the early 1990s level.

This generalization however should be treated with cautions. The measurement of poverty incidence based on expenditure data had several important implications. First, the measurement did not capture the case of consumption smoothing, when people spent their savings or dissaving to maintain their previous level of consumption. Second, the expenditure data did not capture the changes in the quantity and quality of consumption as a result of price changes. The different results from various studies on poverty also shows the sensitivity of poverty incidence on the methodology, price deflators, and source of data used in the survey. In terms of methodology, there are several methods of poverty measurement such as the headcount ratio, food poverty lines, and others. In terms of price deflators, there could be food prices, general prices, wholesale prices, or others. In terms of the data, it could be *Susenas*, *IFLS*, or others. In addition to those, part of the problems is also more purely statistical in nature. Because of a skewed income or expenditure distribution, where the number of people with lower income is large, a small change in poverty line would affect lead to large difference in the of people living below poverty lines. In other words, the increase in poverty line by Rp. 2,000 or US\$ 25 cents for example would lead to additional millions of people living below the poverty lines.

Another point worth mentioning is the limitation of the aggregated poverty number in uncovering the complex regional, sectoral, and other distributional dimensions of poverty. Therefore, the more crucial issue related to the poverty is not the precise aggregate

⁷⁵ They are not exactly comparable—even after adjustments—for two reasons. First, even though the food-bundle remains equivalent to 2100 calorie per capita, the composition of commodity, along with its volumes and quality, changes over time. And second, non-food commodity is not available in volume, and hence, the pure price effect is not measurable. See *ibid*.

⁷⁶ *Ibid*.

measurement of poverty incidence, but more on uncovering whether there is any differences in the nature of the poverty, or the people in the poverty, before and after the crisis. Considering the heterogeneity of the social impact, it might be the case that the population living below the poverty line has changed before and after the crisis. In other words, if the number of poverty increased by say 10 million people, it did not necessarily mean that the number of new poverty was 10 million. It could be the case that in fact 5 million people had exited from the poverty group (no longer lived in poverty) in 1998, while the number of the new people living below the poverty line was in fact 15 million.

8.3 Poverty during the crisis: a summary

Given the different methodologies and sources of data, it is rather difficult to see the evolution of poverty during the crisis. Despite that difficulty, Suryahadi et al. (2000) attempted to construct a picture of the fluctuation of poverty incidences prior to and during the economic crisis. Their methodology in constructing this picture, while is relatively crude, had created some interesting conjectures on what might have happened during the period of February 1996 and August 1999. A summary of their findings are presented below.

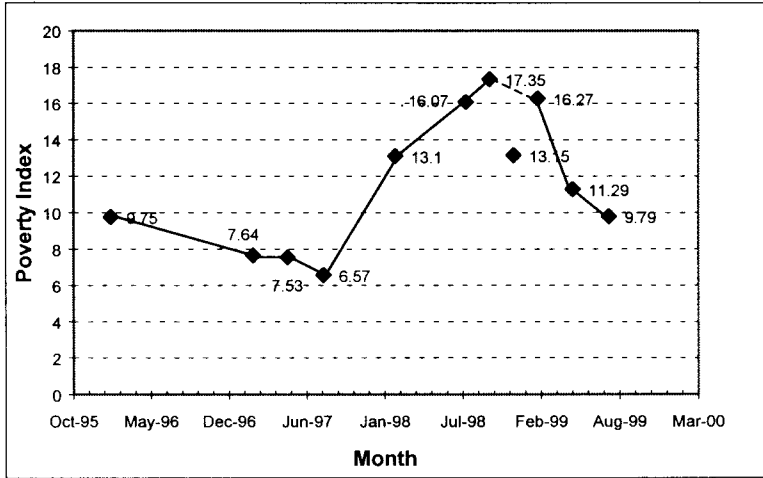
Suryahadi et al. collected poverty estimates from BPS, and from three other sources: first, Gardiner from IHS, which used the core *Susenas* to create estimates for February 1996, February 1997 and February 1998; second, the *100 Villages Survey* conducted by BPS with UNICEF, for May 1997, August 1998 and December 1998; and finally, the IFLS 2+ data, a survey conducted by RAND and *Lembaga Demografi Universitas Indonesia (LDUI)*. For each of the data, the researchers conducted adjustment procedures to make each of the figures relatively consistent with each other.⁷⁷

Table 54 "Consistent" estimates of poverty rate, February 1996–February 1999

Date	Data sources/ Reported by	Actual reported estimates	Adjusted estimates
February 1996	Susenas Core/ Gardiner	11.47	9.75
February 1997	Susenas Core/ Gardiner	9.36	7.64
May 1997	100 Villages/ SMERU	7.53	7.53
Aug-Oct 1997	IFLS 2+/ RAND & LDUI	11.0	6.57
February 1998	Susenas Core/ Gardiner	14.82	13.10
August 1998	100 Villages/ SMERU	16.07	16.07
Sept-Dec 1998	IFLS 2+/ RAND & LDUI	19.9	17.35
December 1998	100 Villages/ SMERU	16.79	13.15
February 1999	Susenas/ SMERU	16.27	16.27
May 1999	100 Villages/ SMERU	11.29	11.29
August 1999	Susenas/ SMERU	9.79	9.79
Percentage Change from lowest point to highest			10.78 (164%)

Source: Suryahadi et. al. (2000)

⁷⁷ For a detailed treatment of the methodologies and data sources used for this exercise, see Suryahadi, Asep et al. (1999). "Poverty Measurement in Indonesia: Comparisons over time (1996 to 1999) and across regions." A paper presented at the International Conference on Methodology of Poverty Calculation in Indonesia, 1999. November 30, 1999.

Figure 20 "Consistent" estimates of poverty rate, February 1996 - August 1999

If the anomalous data from December 1998 is not included in drawing the graph, one can see an interesting progression of the poverty rate in Indonesia.⁷⁸ From these “best-guess” adjusted poverty figures, the highest increase from the lowest point to the highest is 10.8 percentage point or a 164 percent increase from the lowest point to the highest. The poverty seems to have peaked during the second half of 1998, and from then, gradually decreased. By August 1999, poverty rate was close to the level in 1996, although still significantly higher than that just prior to the crisis—almost 50 percent higher than that in August 1997.

9. Food Insecurity

Similar to the security issue in the labor market where price adjustment hurts more than quantity adjustment, the issue of food insecurity is not about the food availability for Indonesia, but more of the skyrocketing food prices and declining workers’ purchasing power of food items. FAO estimated that because of the drought and other factors, rice production was around 45 million tons in 1997-98, so that the demand for rice import was around 5.1 million tons. In fact the rice import for 1998 was actually around 5.9 million tons, higher than the regular annual rice import at around 2-3 million tons. The estimated total basic food availability has been estimated at around 2,100 kcal/day/person, close to the international standard for minimum nutrition intake, even though was lower than the 2,700 kcal/day/person in Indonesian in 1995 (UNSFIR 1999).⁷⁹ It is important to note that Indonesia was considered to be a food secured⁸⁰ nation just before the crisis, so that the United Nation World Food Program (WFP) closed their office in Indonesia in 1996. But due to the economic crisis that led to skyrocketing food inflation, combined with the serious drought in 1997 due to El Niño,

⁷⁸ In December 1998, there was a sudden drop in the poverty rate, presumably due to an increase of expenditure near the month of Ramadan.

⁷⁹ United Nation Support Facility for Indonesian Recovery (UNSFIR). “The social Implications of the Indonesian Economic Crisis: Perception and Policy.” Discussion Paper No. 1. April 1999.

⁸⁰ The food security is generally defined as food availability at an affordable price.

the problem of food security emerged once again in 1998. The WFP reopened its office in April 1998 and continued its program in providing food relieves for Indonesia during the crisis.

In spite of the food supply availability, the concern at the national level is the fiscal burden of the exchange rate subsidy to import rice in 1998. The government provided exchange rate subsidy at around 50 percent of the market rate (or around Rp. 5,000/US\$) for the National Logistic Agency (BULOG) to import rice in late 1997 and early 1998. By assuming that the rice import was around 6 million tons in 1998, the international market price at around US\$ 300/ton, the cost of import could easily reach US\$ 1.8 billion. With the subsidy at around 50 percent, and the exchange rate at Rp 10,000/US\$, the subsidy was estimated at around Rp 9 trillion or around 3.5 percent of the total government budget.

But the more serious concern related to this policy, perhaps, is due to the fact that large exchange rate subsidy has not led to lower domestic price of rice compared with the international market price. The UNSFIR report (1999) indicated that in late 1998 and early 1999, the price of domestic rice in the market was around 20-25 percent higher than the international price. This suggests various problems, ranging from possible serious distortions in the domestic market, to problems related to distribution, or even the possibility that the subsidy went to someone's pocket.

While food availability in terms of quantity has not been a problem at the national level, food security remains a crucial issue at the household level. Food prices have increased by more than 118 percent in 1998, compared with the 78 percent increase in general inflation, and 17 percent increase in nominal wages on average. Data on rice prices is even more shocking. The average price of rice increased from around Rp 1,000/kg just before the crisis in 1997 to around Rp. 2,750 (275 percent increase) in early 1999.⁸¹ The collapse of real earnings and the increase in food prices forced family to consume their savings and switch their expenditure from the luxuries to necessities. For poor families with no savings, where food accounted for most of their expenditure, the increase in rice price by more than 200 percent would create a very serious food security problem in the family. When their income could not keep up with the increasing prices, they have to adjust their expenditure by consuming lower both quality and quantity of food.

This aggregated picture of food security, however, has hidden heterogeneous situation related to food security at regional level, especially the urban and rural division. Some early findings suggest that urban poor community living in slump areas has suffered the most in terms of food security (Sumarto et al. 1998). Those who were laid-off from the collapsing urban and modern sectors such as construction and utilities would be those who suffered the most from the declining purchasing power for food. In fact before the crisis, the urban areas, even the poorest area, were considered as less vulnerable to food insecurity compared with their rural counterparts. During the urban boom years, the growth of their real income was generally higher than the increase in inflation, and certainly much more than the food inflation, making them possible to accumulate some savings. But the fact that they are 100 percent food consumers relying on fixed salary, they become vulnerable to food insecurity once they are unemployed and their savings are depleted.

The fact that urban poor suffered the most, however, did not mean that rural food insecurity has been less serious compared with the urban case. More than 25 percent of rural households in Indonesia are landless, and even in West Java the proportion reaches more than 50 percent. This being the case, the proportion of net consumer of food in rural areas is large, and sooner or later, when coping mechanism in rural areas are exhausted, food insecurity

⁸¹ BULOG (National Logistic Agency), various reports.

becomes a serious issue both in urban and rural areas. Food security problem in urban areas would be soon transmitted to the rural areas along with the reversed movement of migration back to rural areas which would stretch the rural resources and absorptive capacity to produce food. To cope with the skyrocketing food prices, as part of the social safety net program, the government has conducted a special market operation by distributing rice at subsidized price of Rp. 1,000/kg mainly to urban poor since July 1998. From August 1998 to February 1999, around 700 thousand tons of rice has been distributed to around 9 million households or about 40 percent of the 17 million targeted recipients. But poor targeting has made the program less effective in alleviating food insecurity in rural areas. An independent survey carried in the end of 1998 revealed that the household received less than the amount that they supposed to receive, or in other cases, they had to pay the rice at inflated prices (UNSFIR 1999).

10. The Safety Net

10.1 Coping with the crisis: the government social safety nets

The role of the social safety net (SSN) is crucial during the economic crisis to provide some protection for those who have to suffer from painful economic adjustments.⁸² Unfortunately, the SSN programs in Indonesia have not been effective, and this failure has become one major factor contributing to workers' insecurity during the crisis. A successful implementation of the SSN would clearly prevent the crisis induced social and economic problems from becoming a threat, or becoming a security problem, for the society. When public works program were available in the urban areas, for example, displaced construction workers would not have to turn to the informal activities or to go back to the rural areas to survive the crisis. Effective food relief programs could help prevent food insecurity and malnutrition during the crisis.

However, the implementation of the SSN programs has not only been late, but also been in disarrays and full of controversy. To be fair, the failure of the SSN programs was perhaps not surprising. The worsening process of the crisis has been such that there was no warning system that could be developed. Furthermore, the bureaucracy also lacked the capacity to manage the program. The bureaucracy was not only demoralized during the rapid process of economic collapse and political turmoil, but also lacked the experience in designing and implementing the program. The problem was also complicated when the issues were politicized during the year of political turbulence in 1998.

While the need for SSN programs was acknowledged in early 1998, especially when the Indonesian crisis moved to the worsening path compared with other countries in crisis, it was only in June 1998 when the SSN programs were spelled explicitly in the IMF reform package. So to begin with, the plan to have a SSN program was formalized very late—almost one full year since the crisis started in August 1997. The plan to have SSN programs was firstly mentioned in the revised government budget drafted in late June 1998.⁸³ But unfortunately, the social expenditure in the budget plan was heavily allocated for subsidy,

⁸² The general objectives of the social safety net programs are to protect the poor against sharp reduction in consumption and to prevent losses in human capital as a result of the sharp decline in real income. There are several major activities: ensure the affordability and availability of food; maintain the purchasing power among the households; preserve critical social services, especially public health program; and to take special measures to protect women and children.

⁸³ This was released before the final version of government budget announced in July 1998.

especially fuel and electricity. The fact that the majority of the budget was allocated for fuel and electricity subsidy suggested that the SSN program was not reaching the poorest group of the society.

According to the budget plan, around 7.4 percent of GDP or Rp. 70.5 trillion were allocated for the SSN program. This amount was significant compared with the budget deficit that was calculated at around 8.5 percent of the GDP. But out of Rp. 70.5 trillion budget, around 83.5 percent or Rp. 58.8 trillion was allocated for various subsidies. The remainder or 16.5 percent of the total allocated budget, or Rp. 11.7 trillion was planned for employment generation programs, support for education in the form of block grants and scholarship, and other expenditure for health related services. Within the total expenditure for subsidies, 61.2 percent was allocated for fuel and electricity subsidies, while food subsidy was allocated at only around 23.5 percent of total subsidy. The subsidy for medicine, for example, accounted only at around 1.5 percent of total allocated subsidy.

But before any implementation of this plan was reported anywhere, in September 1998, BAPPENAS (the National Planning Board) announced that a nationwide SSN program was being developed. The fact that the BAPPENAS, and not the Ministry of Social affairs, that coordinated the program remains unclear, but it seems that the plan was a response to what was mentioned in the IMF package in July. This announced program consisted of four elements. The first was a food security program to guarantee the availability and affordability of food across society, which includes the promotion of local production of food, as well as the development of a reliable distribution system. The second is a public works program, especially the labor-intensive activity, to absorb employment. The third is a social protection program to protect the health and education facilities, and the fourth is the promotion of small and medium enterprises. The total cost was estimated at around Rp. 17 trillion (6.5 percent of government budget).⁸⁴ But this was clearly smaller compared with the total amount of food subsidy, employment generation programs, supports for health and education services, which amounted to around Rp. 25.5 trillion combined based on the government budget drafted in June 1998.

But three months after the announcement of the SSN program, there was widespread criticism that the safety net was a total failure. It was reported in various media that the program did not work, did not reach the poor, and even the money was corrupted. In fact the World Bank had to delay the disbursement of the loan to Indonesia, partly because of some concern that the fund for the safety net was not properly used. In early 1999 the Bappenas admitted that the disbursement of the SSN fund had been very slow, and that the program had not run smoothly. It was also reported that around 30-40 percent of the fund was actually used. But this problem should have been expected considering the process of how the program was actually designed. The program was not actually planned by Bappenas, but a collection of program was submitted by each department—including some departments that are supposed to have nothing to do with safety nets such as the Department of Justice and the Department of Religious Affairs. So it seems that Bappenas was not the planner; it was just the collector of plans submitted by each of the department. It was not surprising therefore that the government SSN was seen as uncoordinated activities.

Another problem is related to the budgetary constraint. The government budget for 1998/99 was revised several times before the final draft was finally formulated during the worst time of the crisis in July 1998. When the budget was formulated, it was actually unclear how the government would finance its daily operation, not to mention the SSN programs. But soon, various foreign donors pledged their commitments to help. The total amount that

⁸⁴ Kompas, September 20, 1998.

foreign donors have committed to fund the public spending on social sectors was around US\$ 2.78 billion, or more than Rp. 22 trillion at Rp. 8,000/US\$. The biggest contributor was Japan, which pledged about US\$ 1.44 billion. Even though this amount was mainly commitment on papers, and did not specify how the fund was going to be actually disbursed, the total figures was larger than the total budget needed for the safety net. While the money was going to be available from overseas, another problem was due to the fact that Bappenas did not have the full control and authority to channel the fund. Each department received its limited and partial budget from the Ministry of Finance, and there was no guarantee that the fund they received would be spent on SSN activities.

This uncoordinated and badly designed SSN program was just one example of how the government has not been functioning well during the crisis. There have been similar disarrays of uncoordinated programs and policies in other crucial issues, such as trade financing, debt rescheduling and banking restructuring. These bad responses of the government during the crisis have in fact been one major factor that has worsened the crisis.

Table 55 Allocated government expenditure for the social safety net program

	Rp. Billion	Percent
Based on draft budget June 1998*		
All Programs	70.46	100.00
Subsidies	58.81	83.42
Food	13.84	19.63
Fuel	27.53	39.05
Electricity	8.47	12.01
Medicine subsidies	0.88	1.25
Other Subsidies	8.08	11.46
Employment Generation	9.68	13.73
Support for education	0.70	0.99
Support for health services	1.00	1.42
Other programs	0.27	0.39
Based on Bappenas plan September 1998**		
Total fund allocated	17.30	100.00
Agriculture	1.03	6.00
Irrigation	1.02	5.90
Manpower	1.01	5.80
Road Infrastructure	1.17	6.80
Regional Development	2.92	16.90
Education	4.51	26.20
Health	2.00	11.60
Housing/settlement	1.35	7.80
Others	2.25	13.00
Based on Independent Monitoring Task Force**		
(evaluation of the Bappenas plan)		
Total	17.94	100.00
Core SSNet programs (properly allocated)	9.34	52.07
Food Security	0.63	3.53
Social Protection (Health and Education)	4.96	27.64
Employment Creation	3.75	20.90
Non-core SSNet (improperly allocated fund)	8.6	47.94

Source: * World Bank and Bappenas, ** UNSFIR (1999).

An independent committee was finally asked to review and evaluate the SSN program. In February the committee reported that out of the total budget at more than Rp. 17 trillion, the core or the real SSN program was only around Rp. 9.3 trillion, or slightly more than half of the total budget (UNSFIR 1999). The remainder of the budget (48 percent) was allocated for the so called 'supplementary program'. However, it remains unclear how much of the already disbursed fund was actually part of the misallocated budget.

Some government officials blamed on the late result of the social impact assessment. But the lack of indicators should not be blamed for the delay in implementing the SSN programs. Without any sophisticated study or research, it was already clear from the media for example that urban poor have been hit hardest by the crisis. It should be made clear that the establishment of a precise measurement or indicators of the social impact of the crisis and the implementation (designing and monitoring) of SSN programs are two different issues. This former should be a valuable input for the latter. But the lack of coordination between government institutions in implementing the program, for example, clearly shows that the bigger problem is on the latter. While the design was bad and the coordination was worse, the implementation was actually the worst. Concerns over the bad implementation of the program on the field, several NGOs have asked foreign donors to stop their assistance for SSN programs.⁸⁵ In protest of the various leakage and abuses that have been found on the fields, they also requested the World Bank to delay its SSN adjustment loan. Their argument was clear, Indonesian people should not pay the foreign debt that was corrupted by the government.

A study by Suryahadi, Suharso and Sumarto (1999) tried to assess the effectiveness of the SSN using the data collected by the Central Board of Statistics in the 100 Village Survey. In assessing the existing SSN programs—to wit, food security program, employment creation program, subsidized credit program, scholarship program, health programs and the nutrition program—the researchers looked into the coverage and the targeting of those programs. Although results vary between regions, in general the results were not encouraging. In many cases, the coverage was low and resources were not allocated to the right target groups, namely the poor who needed them the most. This indicated that there is a real need to improve these programs and understand why they had relative successes in some regions, while failed in others.

Fortunately, in spite of the problems connected with the government SSN program, there has been a natural safety net for the society. First, extended family is the most important source of the natural safety nets. In addition to that, considering the ruralization and informalization of the labor market, the other forms of natural safety net have been the agricultural sectors and the informal sectors. And considering the fact that the involuntary participation of women in the informal labor market has increased, the female member of the family could also be considered as the provider of natural SSN.

10.2 Coping strategies at the household level

The crisis has depressed the real wage of workers and weakened their purchasing power. Faced with the weakened purchasing power, combined with the lack of public SSN, workers have to devise their own strategy to survive the crisis. This section elaborates these coping strategies, especially in dealing with unemployment, underemployment, inflation or a general decline in income.

⁸⁵ Reported in various newspapers in the second week of February 1999.

A study by the World Bank⁸⁶ shows that workers have a wide range of strategies to cope with the lower income and purchasing power. These strategies include asking for help from families or friends, borrowing money, selling possessions or drawing on savings. A number of respondents look for work in the informal sector to obtain additional income. A little more than a third of the respondents who do not have assets or savings tend to purchase less of everything when their real income declines or tend to reduce their purchases of items whose relative prices have increased. Those who are already married with or without children said that they have reduced their food consumption significantly—not because their income has fallen, but mainly because food prices have risen. Monthly expenditure on food has increased by more than 40%. To cope with the increasing prices, many households substitute cheaper, lower quality sources of calories (cereals, root crops) in place of more expensive higher quality sources (meat, fish, fruit, vegetables). Another strategy is by reducing the numbers of meals per day from three to two or sometimes one. In other words, reduced food intake, fewer meals per day, buying cheaper food seem to be the most common strategies adopted by workers whose incomes have been left behind by inflation and who cannot find any additional income.

The skyrocketing price and the slight increase in most wages, expenditure must be based on giving priority to the essentials. Both male and female respondents in the study ranked food first, followed by toilet articles such as soap and toothpaste. Education and pocket money for children were given a third place. As indicated by Table 57, both males and females drew on their savings to prevent their consumption level from falling below some minimum level.

Saving money by reducing remittances to relatives was also a common coping strategy for respondents. There has been a dominant pattern of income transfer from workers in the urban areas to their relatives in the rural areas, and this income transfer was generally significant source of income in rural areas during the economic boom years in the early 1990s. The World Bank study indicates that remittances are essential for rural relatives if they are to maintain their expenditure on food and education (see Table 56). Given the employment and

Table 56 Most common coping strategies (N = 403)

Additional income		Stop remittances		Family support	
Source	%	Usually spent on	%	Employment Status	%
— sale of assets / property	17.8	— food	50	Employed: — receive support — do not receive support	
— withdrawing savings	6.6	— education	22		6
— borrowing money	10.9	— capital	3		94
— help from others	24.7	— festivities	11		
— additional job	13	— renovating houses	3		
— none	36.5	— other	11		
				Unemployed: — receive support — do not receive support	
					35 65

Source: Hendytio, 1999.

⁸⁶ See Hendytio, Medelina K. (1999) Workers Coping Strategies : Ways to Survive the Crisis in Indonesia,” World Bank, forthcoming. This study conducted in-depth interviews and focus-group discussions involving 181 workers in labor intensive industries, in Greater Jakarta area, Bandung, Surabaya, and Ujung Pandang from October to December 1998.

Table 57 Common and specific strategies by gender and marital status

Common Strategies	Male Strategies	Female Strategies	Married Strategies	Single Strategies
- cut expenses	- become <i>ojek</i> driver	- sell snacks, fruit, vegetables	- rely less on support from extended family	- —rely on support from family or friends
- focus on basic needs	- become fisherman	- become home-based worker	- sell assets, land, jewelry	- go back to their <i>kampung</i> and seek opportunities to work there
- buy lower quality goods	- become home-based worker	- provide washing services	unemployed married female	- wait for new job in factory
- withdraw savings	- sell food, fruit, groceries	- become migrant worker		
- spend severance pay	- raise ducks	- pick cocoa		
- borrow money from money lender	- set up a small business such as raising worms or providing motor cycle repair service	- become a house maid		
- reduce electricity costs.	- become agricultural laborer			
- use washing soap for all purposes	- sell cigarettes		- depend on husband's income	
	- collect cat fish		- do nothing	
	- open barber shop			
	- collect garbage			
	- make bricks			

Source: Hendytio, 1999

income changes that have occurred in the urban areas, it is likely that urban to rural transfers are declining in response to the crisis. Evidence for this was provided by the fact that 60-70 percent workers in the sample who have stopped sending remittances, which may have added as much as Rp. 75,000 – Rp. 100,000 per month to rural family incomes. This means that rural families who have relied on this transfer would soon find themselves in trouble. Therefore, while the urban areas have been the hardest hit by the crisis, the reduction of income transfers from urban to rural areas would transmit the negative impact from urban to rural areas leading to the decline in welfare of people there.

Households are also likely to make significant adjustments in their utilization of social services. People now tend to use traditional health providers rather than government services. Since the government budget for social services is fixed or declining as the result of the fiscal squeeze, services such as health services provided by the government tend to be of reduced quality. Instead of visiting overcrowded centers such as *Puskesmas* (local government clinics), 30 percent of respondents now tend to deal with their health problems by shifting to homeopathic or traditional medicine providers or are attempting to cure themselves by buying medicine from street stalls.

The drastic adjustment in the pattern of expenditure during the crisis, suggested that for the workers reducing their expenditure in real terms was more viable option rather than looking for other jobs with a higher income, which in fact were none or very hard to find. Workers had no choice other than continue working in the same place.

Continuing retrenchments during the crisis have caused a significant increase in the numbers of unemployed workers. For the unemployed, their coping strategies are quite different from those who still have a job. Without a job, workers not only lose their income but also their human dignity. However, at the same time life must go on. Unemployed people who are married may be able to rely on their spouse's income, but in urban areas,

retrenchment became a serious issue where many are living single. In the case of laid-off breadwinners, household survival is seriously endangered. As a consequence, unemployed married workers have become dependent upon local credit from food shops from between one to three months, whilst the less fortunate borrow from money lenders who gouge the interest rates. In one case in order to fulfil his immediate needs, one of the unemployed respondents borrowed money from a private lender at high interest rates.

Single workers who have extended families can survive through family support safety nets and they need not depend on other relatives. The close relations among workers coming from the same area often function as a safety net. Unmarried workers who are laid-off temporarily are supported by those who are still working. The single unemployed move from one friend to another to get shelter and food. This shows a fairly efficient distribution of economic distress so that no one person or family has to suffer devastating effects. People are falling back more than ever on already pressured traditional kinship, neighborhood and religious institutions, in part because of inefficient and unresponsive public institutions. At this point, questions arise on the sustainability of the coping strategies adopted by workers. Dependency on credit, sharing of resources with kin, neighbors, friends, as well as withdrawing savings and borrowing money are only temporary solutions.

Depending upon parents, friends or others can only go on for so long and cannot be a long-term solution to problems created by the crisis. Although household management in response to the financial crisis depends, of course, on the household's economic status and savings, in the longer term savings will be eroded and economic stability will vanish if the situation does not improve as people thought it would. A clear example is provided by those who have borrowed money: this coping strategy can no longer be adopted because workers do not have sufficient, regular income to repay their debts. This implies that some coping strategies that have saved them in the past few months will no longer be valid in the future. If the economic situation does not recover soon, the most affected people will have to adopt other strategies that can be sustained for the longer-term. If these strategies fail, the status of people affected by the crisis will change from new poor into chronic poor. The situation makes the design of poverty and crisis response instruments extremely complicated. In Indonesia today, targeting those people suffering from the impact of the crisis is not the same as targeting those in absolute poverty. However, given that the speed and impact of the collapse was stunning, it is difficult to differentiate between people who are the new poor and those who are the chronic poor.

It is clear that the decrease in real income has played a major role in the deterioration of the standards of living. Replacing lost earnings for the many families who could not afford to be unemployed is the only way to prevent them from the sliding further down the ladder of poverty. At the same time, workers who are suffering from declining real wages need to broaden their income base by seeking additional jobs in order to balance their increased expenditure. As discussed above, in response to their decrease in real incomes, the women usually adopted different strategies to that of men.

It is evident that men have a greater choice of work than women if they lose their primary source of income. Women, by comparison, are more limited in the type of work they can do because of their nurturing roles and gender stereotypes. Unemployed women tend to be tied to activities that are usually not far from their traditional roles such as home-based work, providing washing services, rearing ducks and chickens, and working as peasant laborers.

Compared to men, the coping strategies of women tend to be individual in character. This is mainly because collective strategies require a substantial amount of time and women, who are engaged in the domestic work, find it hard to devote their time to activities outside their homes. For example, to establish a group-based enterprise, several meetings have to be

held, often in the evenings. Meetings are less likely to be attended by women who are expected to be at home at night. Another reason that women tend not to be involved in group-based strategies is because they lack managerial and organizational skills, and tend to have lower education.

11. Final Remarks and Policy Implications

While the social impact of the crisis is expected to continue beyond the crisis, the general indicators suggested that the crisis had brought the social condition back to the situation in early 1990s. From the indicators collected in 1998, it seems that the devastating crisis has not even led to a decade lost, but perhaps more likely a half-decade lost. The data from the labor market shows that the flexibility of the market has absorbed the negative impact of the crisis. While real wages has gone back to the level in late 1980s due to the overshooting inflation, labor market productivity shows that the condition in 1998 looked similar to the market condition in the early 1990s. The structure of the labor market, such as the formal-informal, sectoral, and rural-urban composition resembled the condition in early 1990s. The data related to education and health, even though could be more serious in the longer run, also suggested the similar trends. While it remains controversial, the level of poverty in 1998 was again comparable to that in 1989/1990. The changes in these indicators matched the small decline in the personal consumption expenditure in the GDP figures.

But the half-decade lost should not lead to complacency. It might be true that the monetary or financial impact of the crisis was still be more dominant than the real and social impact in 1998, but the social impact could worsen during the recovery period, especially when the recovery process is slow. The future trend depends on many factors such as political certainty and the overall performance of the economic reforms. But people's confidence also matters in determining the future paths. If the economic recovery is slow, and the impact of the crisis on people's wealth becomes more significant, people start thinking that this crisis is not a temporary phenomenon. When they started reducing their consumption and expenditure, the social impact of the crisis could worsen. The fact that the social adjustments usually come with a lag, so that the indicators collected in 1998 might not show the complete picture, also contributed to the controversy surrounding the social impact.

There are also several other factors that contributed to the controversy surrounding the social impact of the crisis. The fact that the years of 1998 and 1999 are the years of political turbulence has complicated the public discussion over the social impact of the crisis in Indonesia. Much of the discussion over the social impact has been politicized. Throughout 1998 and 1999, many politicians, union leaders, and others commentators, and newspaper economists (widely known as economists only by writing on issues related to economics in the newspaper) came up with a very high unemployment rates, just to illustrate how serious the economic crisis has been. The lack of understanding of the social-economic indicators among reporters in the media, economic commentators, and even some economists, also contributed to the complication and led to public confusion.

But the most important source of controversies surrounding the social impact of the crisis is, perhaps, the heterogenous nature of the impact itself. As such, it is difficult for anyone to make any generalization basically on anything. In terms of region, there have been rural-urban and Java-Off-Java differences. And within Java itself, the impact varies across regions. In terms of sector, there has been a heterogeneous impact between the traded and non-traded, agriculture and non-agriculture, export oriented and import substitution, and traditional and modern sectors. Even within the export-oriented sectors, the impact varies

depending on whether the industries are more import dependent or less. The impact of the El Niño in 1997 has also complicated the situation so that it is rather difficult, for example, to separate the impact of the crisis and the El Niño when it comes to food security. The heterogeneity of the social impact means that aggregate figures or indicators might hide a large variation across regions, sectors, age groups, and other dimensions. Further research is needed to uncover the dynamic and the heterogeneity of the social impact, especially the micro level adjustment in the economy, to be able to see the complete picture of the social impact of the crisis.

11.1 Policy implications

The study shows that the overall macro characteristics of the Indonesian economic crisis matters in determining the social impact of the crisis, and therefore broad based economic development policy that focuses on overall poverty reduction would be the best strategy in dealing with the social impact of the crisis. Price shocks played a major role in reducing welfare during the crisis, therefore any macro policy that minimize inflation would be crucial in minimizing the social impact of the crisis. Trade policies that led to higher domestic prices, such as border tariff on food commodities including rice, should also be abolished to provide food for the poor at affordable prices. On the other hand, special market operations to stabilize domestic food prices and to provide cheap food for the selected poorest group of people are encouraged.

Broad based economic development that foster economic growth, especially the labor-intensive sectors, would be crucial in the near future. It is realized that the economic recovery seems to be slow due to the slow progress of banking and corporate debt restructuring, but any effort that provides new employment opportunity is crucial. Employment creation program should be the top priority for the government during the current period of economic recovery, especially when many indicators show that rural and informal sector could no longer serve as employment buffer zones.

The process of democratization has led to higher bargaining power of labor in determining wages and demanding more labor rights. The government has to be able to accommodate this new phenomenon while at the same time has to be able to maintain the flexibility of the labor market. The increases in minimum wages for the last two years has outstripped the increase in labor productivity and further increases in minimum wage should be conducted very carefully.

With some early signs of economic recovery, the social impact of the crisis started to lessen, and the development of massive scale SSN would not be a crucial priority in the near future. But the country still needs to develop some basic form of safety net, especially for the vulnerable groups such as poor children, the elderly, and others. On the one hand, the heterogeneous impact of the crisis requires a carefully designed and targeted safety net program. But on the other hand, the lack of institutional capacity and legal framework in the country led to poor targeting results. Therefore, basic SSN program should be made simple and transparent, and also open for participation of non-governmental organization in the implementation. There is clearly a need to develop a standard early warning system or social indicators to monitor the progress of the socio-economic well being for better targeting in the future.

Assess to critical social services has to be preserved, particularly in education and health. The impact of the crisis on education and health is long term in nature so that the current data might not reveal the future problems. Therefore, any public investment in education and health services should be maintained, if not increased, in order to prevent the

deterioration of education and health quality especially among the poor. The government should continue the programs to subsidize education in order to maintain the enrollment rate and the quality of basic education. The government should also maintain the provision of free immunization and supplementary food for young children and pregnant women in rural and poor areas.

Finally, the progress towards more decentralized Indonesia should not lead to a lower supply of social services for the people. The path of decentralization is unfortunately unclear at the moment, and there is still confusion on who (local vs. central government) should be responsible for the provision of social services in the region. It is unavoidable that local government would play bigger role in providing the SSN, and therefore the development of locally coordinated SSN program should be intensified.

References

- Agrawal, Nisha. 1996. "The Benefit of Growth for Indonesian Workers." World Bank Policy Research working paper, no. 1637. Washington, D.C.
- Brodjonegoro. 1999. "The impact of current Asian Economic Crisis to Regional Development Pattern in Indonesia." Paper presented at the Conference on The Economic Issues Facing the New Government, Jakarta
- CBS [Central Board of Statistics] and UNDP [United Nations Development Program]. *Impacts on Retail Business, and Household's Socio-Economic Condition*. Survey Report.
- Cameron, Lisa. 1999. "Survey of Recent Developments." *Bulletin of the Indonesian Economic Studies* Vol. 35, No. 1.
- Frankenberg, Elizabeth, Duncan Thomas, Kathleen Beegle. 1999. "The Real Cost of Indonesia's Economic Crisis: Preliminary Findings from the Indonesian Family Life Surveys." Labor and Population Program Working Paper Series 99-04. Rand Corporation. March 1999 (also available in the homepage of the Rand Corporation, <http://www.rand.org>).
- Hardjono, Joan. 1999. "The Micro Data Picture: Results of a SMERU Social Impact Survey in the Purwakarta-Cirebon Corridor." SMERU Report (July). Jakarta.
- Hendytio, Medelina K. 1999. Workers Coping Strategies: Ways to Survive the Crisis in Indonesia." World Bank, forthcoming. This study conducted in-depth interviews and focus-group discussions involving 181 workers in labor intensive industries, in Greater Jakarta area, Bandung, Surabaya, and Ujung Pandang from October to December 1998.
- Igusa. 1992. "Regional Development and Investment Opportunity: An Analysis on the Possibility for Local Industrialization." In *Regional Development and Industrialization of Indonesia*, IDE, Tokyo.
- ILO. 1998. "Employment Challenges of the Indonesian Economic Crisis." ILO Report.
- ILO. 1999. "Indonesia: Strategies for Employment-Led Recovery and Reconstruction." ILO, Jakarta.
- Manning, Chris. 1999. "Krismon and Child Labor." Research paper prepared for ILO. May.

- Manning, Chris. 1998. "Indonesian Labor in Transition: An East Asian Success Story?" Cambridge University Press.
- Manning, Chris, and P.N.Junankar. 1998. "Choosy Youth or Unwanted Youth? A survey of Unemployment." *Bulletin of Indonesian Economic Studies* Vol. 34. No.1 (April).
- Manning, Chris, and Sisira Jayasuriya. 1996. "Survey of Recent Development." *Bulletin of Indonesian Economic Studies*, August.
- Papanek, Gustav, and Handoko. 1999. "The Impact on The Poor of The Growth and Crisis Evidence from Real Wage Data." Paper presented at the Conference on The Economic Issues Facing the New Government, Jakarta.
- Poppele, Jessica, Sudarno Sumarto, and Lant Pritchett. 1999. "Social Impact of the Indonesian Economic Crisis: New Data and Policy Implication." SMERU Report. February.
- Sigit, Hananto. 1999. "Social Impacts of the Indonesian Economic Crisis." Unpublished report for the Asian Development Bank, June.
- SMERU. 1999. "Coping with Adversity." In *Monitoring the Social Crisis in Indonesia*, No. 08/September-November.
- Suryahadi, Asep, Sudarno Sumarto, Yusuf Suharso, Menno Pradhan, and Lant Pritchett. 1999. "The Evolution of Poverty during the Crisis in Indonesia, 1996 to 1999." A paper presented at the International Conference on Poverty Measurement in Indonesia, 1999 in Jakarta, May 16, 2000.
- Suryahadi, Asep, Yusuf Suharso, and Sudarno Sumarto. 1999. Coverage and Targeting in the Indonesian Social Safety Net Programs: Evidence from 100 Village Survey. SMERU Report.
- Sumarto, Sudarno, Anna Wetterberg, and Lant Pritchett. 1998. "The Social Impact of the Crisis in Indonesia: Results from a Nationwide *Kecamatan* Survey." SMERU Report.
- Sutanto, Agus, Pugu B. Irawan, and Ali Said. 1999. "Poverty Measurement: Problems and Development." A paper presented at the "International Conference on Methodologies of Poverty Calculation in Indonesia," November 30, 1999. The part of this section on the methodologies relies on this paper.
- UNSFIR [United Nation Support Facility for Indonesian Recovery]. 1999. "The social Implications of the Indonesian Economic Crisis: Perception and Policy." Discussion Paper No. 1 (April).
- World Bank. 1998. "Addressing the Social Impact of the Crisis in Indonesia: A background Note for the 1998 CGI." Mimeo. Washington (available through the internet).

Some Social Consequences of the 1997-8 Economic Crisis in Malaysia

by

**Jomo K. S.
and
Lee Hwok Aun**

Faculty of Economics and Administration
University of Malaysia

Introduction

The currency and financial crises, triggered by the collapse of the Thai baht in July 1997, led Malaysia and its Southeast Asian neighbors to economic recession. Several factors associated with the financial crisis—e.g., loss of investor confidence, sudden and massive capital outflows, credit crunch—had various adverse effects on the real economy and on social welfare. Like the early debate on the origins of the financial crisis, initial discussion on the social impacts of the recession tended toward extremes of either denial or alarm.

There is no denying that the Malaysian economy experienced a severe downturn from late 1997, with economic contraction through 1998, as the currency crisis developed into a financial crisis, and then, economic recession. However, it is now generally agreed that the Malaysian economy and population were not as adversely affected as its counterparts in Thailand, South Korea and Indonesia. While this is not the place to engage in a comparative analysis of the nature and impact of the crisis in the region, it has to be noted that the financial crisis was not as severe in Malaysia (Jomo 2000). While the pre-crisis level of indebtedness in Malaysia was very high, the level of foreign exposure was less - as a share of GDP, and especially, as a share of export earnings. Unlike the others, the level of foreign liabilities did not exceed Malaysia's foreign exchange reserves. After the severe banking crisis of the late 1980s, Malaysian prudential regulation was improved and had not been as badly undermined by liberalization pressures as in the other three economies. There is an ongoing debate about the actual effects of the unusual policy responses associated with capital controls from September 1998 (Jomo 2000).

This study of the main social consequences of the 1997-8 economic crisis in Malaysia can only briefly consider the origins and nature of the currency and financial crises from mid-1997. The 1997-8 crisis reversed the preceding decade-long boom, taking the economy into its most severe recession of the post-war era. More consideration is given to the macroeconomic impacts of the crisis, particularly for employment, prices and earnings. Other social consequences will also be given due attention. Limited mention is made of various official policy responses—much discussed by other studies (Ishak *et al.* 1999; Haflah *et al.* 1999)—because of the uncertain social impacts of most of these policy initiatives thus far. Instead, this study considers some other social implications of the recent crisis which have not received much attention in the literature so far.

This study therefore begins with a brief survey of the background to, causes and unfolding of the Malaysian currency and financial crises. This is considered necessary for the subsequent assessment of their impacts for the Malaysian banking system and macro-economy. Some consideration is given to the duration of the recession and the nature of the recovery. We next look at how incomes, employment and wages fared. Other factors affecting economic welfare, as well as government expenditures and social transfers during this period are considered next. Lastly, several conclusions are drawn, giving some consideration to the uneven impact of the crisis as well as of official policy responses.

This study is constrained by many factors, including the paucity of reliable data and the Malaysian authorities' general reluctance to release socioeconomic statistics it deems sensitive. In some respects also, the apparent confusion over the social impacts of the recession mirrors the difficulty and complexity of such inquiry. The actual impact of the economic recession on society—individuals, households and communities—is difficult to empirically measure and assess with accuracy and objectivity. At another level, the causes of recession are also difficult to identify, because the links between cause and effect are not always direct or obvious, and also subject to consider theoretical dispute.

There is also a need to distinguish other economic trends from the direct social impacts of the crisis even though they might occur simultaneously. For this study, it is difficult to separate out the adverse impacts of international price movements or other non-economic changes (e.g., weather) on the Malaysian economy during the period of the crisis.

From Miracle To Debacle

Labor shortages and the 1988 withdrawal of privileges under the General System of Preferences (GSP) from the first-tier East Asian newly industrialized economies (NIEs) of South Korea, Taiwan, Hong Kong and Singapore encouraged relocation abroad of production facilities from these NIEs. Meanwhile, reforms, selective deregulation as well as new incentives made relocation in Southeast (SE) Asia as well as China more attractive. Malaysia's resource wealth and relatively cheap labor have also sustained production for export of agricultural, forest, mineral and, more recently, manufactured products.

Much of the wealth generated was captured by the business cronies of those in power, who in turn contributed to growth by re-investing in the 'protected' domestic economy, mainly in import-substituting industries, commerce, services, real estate, privatized utilities and infrastructure. Thus, the export-led growth from the late 1980s was soon accompanied by a construction and property boom, fuelled by financial interests favoring such 'short-termist' investments—involving loans with tangible asset collateral, which bankers like—over more productive, but also seemingly more risky investments in manufacturing and agriculture. The exaggerated expansion of investment in such 'non-tradables' also exacerbated current account trade deficits.

Although high growth was sustained for a decade, with modest fiscal surpluses in the nineties, monetary expansion was not excessive and inflation was generally under control. Nevertheless, some other indices have been awry. Foreign savings supplemented the already high domestic savings rates in the country to further accelerate the rate of capital accumulation. Sadly, the additional funds probably encouraged greater investment in activities such as property and share purchases, which do not add to productive capacity. With the heavy foreign domination of most internationally competitive industries in the country (more so than in most countries in the world except neighboring Singapore), Malaysian investments tended to dominate domestic and primary production.

Thus, the current account deficit, which exceeded RM12 billion during 1994-96, was financed by net capital inflows or foreign savings; meanwhile, Malaysia's savings-investment gap was 5 percent of GNP in 1997. Before the nineties, the gap had been partially bridged by foreign direct investment (FDI), though high levels of FDI and foreign debt had both caused growing investment income outflows abroad. In the nineties, especially in mid-decade, the current account deficit was increasingly covered by short-term capital inflows. Much of these inflows consisted of portfolio investment in the stock market, with financed surges in 1993 and again from 1995 until mid-1997, and with serious adverse consequences following their hasty exit, first in early 1994 and especially in the latter half of 1997.

As noted earlier, capital inflows—into the stock market as well as through bank borrowings—helped bridge current account deficits. These current account imbalances were mainly due to the growing proportion of non-tradables being produced in Malaysia with imported inputs and equipment. Much of this economic activity involved infrastructure as well as property construction. The authorities seemed lulled into a false sense of complacency by their successful efforts to 'sterilize' such inflows in order to minimize excessive growth in money supply and consequent consumer price inflation. However, the high investment rate,

with considerable funds going into the property and stock markets, instead fuelled asset price inflation, mainly involving real estate and share prices.⁸⁷ Consequently, by mid-1997, several related problems had emerged from the rapid growth of the previous decade.

The Malaysian economic boom from the late eighties was helped by the significant depreciation of the ringgit against the US dollar from late 1985. Indonesia, Thailand and Malaysia undertook significant devaluations of their currencies against the US dollar as the US dollar declined against the yen. As a consequence, while one Malaysian ringgit was equivalent to a hundred yen in 1994, it could only secure half that amount of yen by 1997. Meanwhile, the Korean won, the new Taiwanese dollar and the Singapore dollar also appreciated against the US dollar, and hence, even more against the ringgit.

Contrary to the central bank's claim that the ringgit had been pegged to a basket of the currencies of Malaysia's major trading partners, for all intents and purposes, it had been virtually pegged to the US dollar for many years. The currency had long been trading within a limited band against the greenback—not unlike the other currencies in the region. By continuing to peg their currencies against the US dollar, they failed to adjust to the new circumstances, allowing their currencies to appreciate with the greenback against the yen and other yen-linked currencies in the region. The appreciation of the region's currencies rendered them even less cost competitive, adversely affecting exports and also growth itself.

Such quasi-pegging offered certain advantages, including the semblance of stability—including low inflation—so much desired by financial interests. This growing orientation towards financial sector concerns, often at the expense of the real economy, reflected the political weakness of export manufacturer interests in Malaysia—especially in terms of influencing economic policy-making. Almost all internationally competitive non-resource based industrial capability is foreign-owned. The 1990 and 1994 devaluations of China's *yuan* or *renminbi* currency put greater price competitive pressure on the emerging second-tier or second-generation Southeast Asian newly industrializing countries (NICs), including Malaysia.

In mid-1995, the decade-long decline of the US dollar against the yen was reversed after the greenback fell to 79 yen in June. Apparently, then US Deputy Treasury Secretary Lawrence Summers and then Japanese Finance Vice-Minister for International Affairs Sakakibara Eisuke agreed to let the yen weaken in an attempt to stimulate the flagging Japanese economy. According to Sakakibara, the two sides gave little consideration then to other possible ramifications of the reversal, especially with regard to the East Asian region.

The problem was exacerbated by the failure to 'progress' more rapidly to higher value-added production, mainly due to inadequate or misallocated public investments in education and training as well as limited indigenous internationally competitive industrial capabilities. As the dollar strengthened with the US economy, especially against the Japanese yen from mid-1995, the ringgit and other regional currencies followed suit, adversely affecting Southeast Asian export competitiveness.

The impact of these exchange rate appreciations varied with the countries' respective cost, output and export profiles. With exports, and growth more generally, most adversely affected in Thailand, the property market, construction activity, stock market and financial

⁸⁷ Some commentators claim that the resultant property price bubble has its roots in Japanese-type or more generically East Asian culture, norms and relationships which compromise relations between the state and the private sector as well as among businesses, invariably involving welfare-reducing, if not downright debilitating rent-seeking behavior. In so far as such relations are believed to exclude outsiders, their elimination is believed to contribute to leveling the playing field and bringing about an inevitable convergence towards supposedly Anglo-American style arms-length market relations.

institutions were also put under strain, setting up the pegged Thai baht as the choice target in the region for currency speculation. Several currency attacks from 1996 severely depleted the Bank of Thailand's reserves, eventually forcing it to let the baht float from 2 July 1997.

With the baht down, currency speculators turned their sights on the other economies in the region that were perceived to have maintained similarly unsustainable US dollar quasi-pegs for their currencies. Both the Indonesian and Filipino monetary authorities gave up defending their currencies after very brief defense attempts. Only the Malaysian central bank put up a more spirited—and expensive—defense of its currency.

The Malaysian ringgit had vacillated around RM2.5 against the US dollar during the first half of 1997. After the Thai baht was floated on 2 July 1997, like other currencies in the region, the ringgit was under strong pressure, especially because, like Thailand, Malaysia had maintained large current account deficits during the early and mid-nineties. The monetary authorities' efforts to defend the ringgit actually strengthened it against the greenback for a few days before the futile ringgit defence effort was given up by the third week of July. Before that, the ringgit rose to RM2.47 against the US dollar from RM2.53, before the authorities finally gave up ringgit support operations after hefty losses. The aborted ringgit defense effort is widely believed to have cost over nine billion ringgit, then worth almost US\$4 billion.

It was widely believed that the ringgit had become slightly overvalued by the 'quasi-peg' against the US dollar as the American economy and dollar had strengthened significantly in recent years.⁸⁸ Hence, the ringgit was expected to depreciate to around RM2.7–2.8 against the dollar, the supposed 'equilibrium' exchange rate based on calculations taking account of purchasing power parity, etc. However, the Malaysian ringgit fell precipitously after mid-July 1997, reaching RM4.88 to the US dollar in early January 1998, its lowest level ever; this represented a collapse by almost half within less than half a year from a high of RM2.47 in mid-July 1997. The stock market fell even more severely. The main Kuala Lumpur Stock Exchange (KLSE) Composite Index (KLCI) dropping from over 1300 in the first quarter of 1997 to less than 500 in January 1998, around 300 in August 1998 and 262 on September 1998, after the announcement of the capital control measures.

The sudden and massive collapse of the ringgit—politely referred to in the financial community as 'overshooting'—by about two ringgit, much more than the anticipated 'correction' to RM2.7–2.8 against the US dollar, raises serious questions about the very nature of the international monetary system. Other international, regional and domestic speculators also contributed to the collapse, further exacerbating the panic.

Such behavior generally constituted self-interested reactions to perceived and anticipated market trends, rather than as part of some conspiracy, as sometimes alleged. As investors scrambled to get out of positions in ringgit and other regional currencies, the currencies fell further, and, with them, the stock and other markets, constituting a rapid vicious cycle. With financial liberalization, fund managers increasingly have an almost infinite variety of investment options to choose from and can move their funds much more easily than ever before, especially with the minimal exit restrictions Malaysia and other countries in the region had prided themselves on. The operations and magnitude of hedge fund operations, as well as other currency speculators, have undoubtedly exacerbated these phenomena, with disastrous cumulative consequences.

Like the currencies of other crisis-hit economies, the ringgit fluctuated wildly until mid-1998, weeks before the ringgit was fixed at RM3.8 against the US dollar on 2 September

⁸⁸ For example, the yen fell from less than 80¥ to the US\$ in mid-1995 to over 120¥ by mid-1997, while the Deutschmark had floated against the US dollar before mid-1997.

1999. Much of the downward pressure on the ringgit was induced by regional developments as well as by adverse perceptions of the regional situation. There is also evidence to suggest that inappropriate political rhetoric and policy measures by the political leadership exacerbated the situation.

A Crisis of A New Type?

The Southeast Asian currency crises from mid-1997, in turn, precipitated a financial crisis, especially for banking systems in the region, which led to severe recession throughout the region in 1998, after at least a decade of sustained and rapid economic growth and industrialization. Once considered by the World Bank (1993) as an impressive example of successful development, the Malaysian economy was transformed from an economic 'miracle' into a 'debacle' by 1998.

There have been many competing explanations for this unprecedented crisis. Many popular accounts, especially in the Western dominated international media, have portrayed the crisis as primarily one of crony capitalism (Jomo 1999). Others have focussed on the vulnerability of the national financial systems in the region with growing international financial liberalization (e.g., Jomo 1998). Many observers have also highlighted the large current account deficits which Thailand and Malaysia had during most of the early and mid-nineties. Such deficits were largely financed by their net capital account surpluses during this period.

Many observers immediately assumed that the crises were due to poor macroeconomic management, as suggested by the second generation of theories seeking to explain currency crises. Except for large current account deficits and worsening savings-investment gaps, Malaysia's macroeconomic fundamentals were generally sound prior to the crisis (see Table 58). Over the previous decade, Malaysia had enjoyed rapid growth, stable inflation, falling unemployment and fiscal surpluses. As such, the first generation of currency crisis theories—which focused on public sector debt related to fiscal deficits—were also clearly irrelevant for explaining the financial crisis in Malaysia.

Table 58 Malaysia: Selected Macroeconomic Indicators, 1991-1999

Year	Real GDP (%)	Inflation (%)	Unemployment (%)	Fiscal Balances (% of GDP)	Current Account (% of GDP)
1991	8.7	4.4	4.03	-2.0	-9.2
1992	7.8	4.7	3.7	-0.8	-3.8
1993	8.3	3.6	3.0	0.2	-4.8
1994	9.2	3.7	2.9	2.3	-6.3
1995	9.5	3.4	2.8	0.9	-8.5
1996	8.6	3.5	2.6	0.7	-4.9
1997	7.7	2.7	2.6	2.4	-5.1
1998	-7.5	5.3	3.2	-1.3	12.9
1999	5.4	2.8	3.0	0.2	14.0

Source: Bank Negara Malaysia *Annual Report*, 1996, 1998, 1999.

However, it also soon became clear that all the governments affected had been maintaining decent macroeconomic balances except for balance of payments current account deficits, especially in the case of Malaysia and Thailand. These had been bridged by massive

capital inflows, mostly of a short-term nature, in the form of portfolio investments and also foreign borrowings. The debt—including foreign borrowings—mainly involved the private sector. Continued high growth and savings rates in the region further enhanced their credit standings, as did the low consumer price inflation rates despite huge financial inflows. Thus, monetary and financial policies in the region were largely encouraged by the international financial community.

Once it was clear that the region's macroeconomic balances were not seriously awry, various commentators, including US Federal Reserve Board chairman Alan Greenspan, began to focus on alleged cronyism and its supposed consequences as the new explanation for the crises. Nebulous catch-all terms—such as cronyism and Asian values as well as business practices—seemed to provide ready-made explanations for the crises. Differences in organizations, relations, practices and norms—which had previously been credited with the East Asian miracle by some commentators—were now condemned as the sources of the financial debacle. Popular versions of the political economy of rent seeking are now readily invoked and deployed in the post-crisis discourse as if to explain all, while in fact, often explaining nothing.

Thus, a popular explanation of the East Asian crisis emphasizes corruption, cronyism as well as lack of transparency, resulting in moral hazard, with adverse consequences for the economy. This diagnosis, however, fails to provide a satisfactory explanation of why the crisis—which started in Thailand—spread to the rest of the region so quickly, leading to massive disruption of the economy. Crony capitalism—which has existed for some time—fails to explain how Malaysia sustained rapid growth for four decades after independence in 1957 without experiencing an earlier financial crisis of comparable magnitude. More importantly, as pointed out by UNCTAD (1998), this explanation also ignores the similarities with the financial crises in developed and developing economies, which have been occurring with increasing frequency since the late 1970s.

Despite ongoing debates about the significance of macroeconomic fundamentals and crony capitalism in contributing to the East Asian economic crises since mid-1997, there is now little disagreement that they began as currency and financial crises. It will be argued here that the currency and financial crises in Malaysia became a crisis of the 'real economy' mainly due to the government's policy responses, partly due to financial market demands and the IMF. Related work (Montes 1998; Jomo 1998) shows that the crises have been due to the undermining of previous systems of international and national economic governance due to deregulation and other developments associated with financial liberalization and globalization. Thus, the erosion of effective financial governance at both international and national levels created conditions that led to the crises.

Industrial policy or selective state intervention in Malaysia has been of much poorer quality and considerably less effective than in the first tier newly industrialized East Asian economies of South Korea, Taiwan and Singapore for various reasons. Instead, there has been much more state intervention motivated by other (non-developmental) considerations, especially in Malaysia and Indonesia (Jomo *et al.* 1997). Such interventions—now often cited as evidence of 'crony capitalism'—bear some of the responsibility for the vulnerability of the second-tier Southeast Asian NICs to the factors that precipitated the financial crisis in the region in mid-1997. Even more importantly, such interests have influenced government policy responses in ways that have exacerbated the crisis. In other words, while 'crony capitalism' does not really explain the origins of the crisis, except in so far as crony financial interests were responsible for the financial policies from the mid-nineties which led to the crisis, it has certainly exacerbated the crisis in Malaysia.

It is worthwhile to emphasize at the outset that Malaysia's experience differs from those of other East Asian crisis-hit economies in at least four respects. First, although prudential regulation had deteriorated with growing financial liberalization, especially since the mid-eighties, the situation in Malaysia was not as bad as elsewhere in the region. Second, although the Malaysian banking system had contributed to asset price inflation, and was thus severely affected by the crisis, Malaysian banks and corporations had far less access to international borrowing than their counterparts in other crisis-affected economies. Unlike the others, foreign bank loans did not figure as significantly in the story of the Malaysian crisis, whereas capital market flows, especially into and out of the stock market, figured more prominently. Third, as a consequence of its reduced exposure to private bank borrowings from abroad, Malaysia was not in a situation of having to go cap in hand to the International Monetary Fund (IMF) or to others for emergency international credit facilities. Fourth, for most of the second half of 1997, and again from mid-1998, the Malaysian authorities deliberately pursued unconventional measures in response to the deteriorating situation, with rather mixed results.

Hence, while there are important parallels between the Malaysian experience and those of its crisis-affected neighbors, there are also important differences. It is tempting to exaggerate the significance of either similarities or contrasts to support particular preconceived arguments when, in fact, the nature of the experiences do not allow strong analytical or policy conclusions to be drawn. For example, whereas South Korea, Thailand and Indonesia experienced positive growth in the first quarter of 1999, Malaysian economic recovery only began in the second quarter. Critics have been quick to blame Malaysia's unorthodox measures for its later recovery. Conversely, the Malaysian regime has been equally quick to claim success for its approach on the basis of limited evidence of a stronger recovery since then, which critics have just as readily attributed to a technical rebound, the externally-induced electronics boom and 'unsustainable' government measures.

Policy Responses: Deepening the Crisis

Conventional policy making wisdom—including IMF prescriptions—cut government spending in the wake of the crisis to further transform what had started as a currency crisis into a full-blown financial crisis, then into a crisis of the real economy as the Southeast Asian region sharply went into recession in 1998.

The ringgit's collapse was portrayed by Malaysian Prime Minister Mahathir as being exclusively due to speculative attacks on Southeast Asian currencies. In a study published in mid-April 1998, the IMF acknowledges that currency speculation precipitated the collapse of the baht, but denies the role of currency speculation in the collapse of the other East Asian currencies. While currency speculation *per se* may not have brought down the other currencies, the contagion effect undoubtedly contributed to the collapse of the other currencies in the region not protected by the large reserves held by Japan, China, Taiwan, Hong Kong and Singapore. Contagion—exacerbated by the herd-like panicky investment decisions of foreign portfolio investors who perceived the region as much more similar and integrated than it actually is (e.g., in terms of trade or investment links, or even structural characteristics)—quickly snowballed into massive capital flight.

As acknowledged by Mahathir, the ringgit probably fell much further than might otherwise have been the case due to international market reactions to his various contrarian statements, including his tough speech in Hong Kong on 20 September 1997, at a seminar before the joint World Bank-IMF annual meeting. Arguing that 'currency trading is

unnecessary, unproductive and immoral', Mahathir argued that it should be 'stopped' and 'made illegal'.

Most damagingly, he seemed to be threatening a unilateral ban on foreign exchange purchases unrelated to imports by the Malaysian authorities (which never happened). Even before his Hong Kong speech, Mahathir had railed against George Soros (calling him a 'moron') and international speculators for weeks, even suggesting dark Western conspiracies to undermine the East Asian achievement. Thus, Mahathir's remarks continued to undermine confidence and to exacerbate the situation until he was finally reined in by regional government leaders, and perhaps even his cabinet colleagues.

The Prime Minister's partly—but not entirely—ill-founded attacks reinforced the impression of official denial, with blame for the crisis attributed abroad. The fact that there was some basis for his rantings was hardly enough to salvage his reputation in the face of an increasingly hostile Western media. Thus, until Soeharto's illness (in December 1997) and subsequent recalcitrant behavior (in the eyes of the IMF and the international financial community) in 1998, Mahathir was demonized as the regional 'bad boy'. Meanwhile, some other governments in the region had little choice but to go 'cap in hand' to the IMF and the US and Japanese governments, in desperate efforts to restore confidence and to secure funds to service the fast-growing foreign debt liabilities, although they were mainly privately-held.

Other official Malaysian policy responses did not help. In late August 1997, the authorities *designated* the top one hundred indexed KLCI share counters. Designation required actual presentation of scrip at the moment of transaction (rather than later, as was the normal practice), ostensibly to check 'short-selling', which was exacerbating the stock market collapse. This ill-conceived measure also adversely affected liquidity, causing the stock market to fall further. The government's threat to use repressive measures against commentators making unfavorable reports about the Malaysian economy strengthened the impression that the government had a lot to hide from public scrutiny. The announcement of the 1998 Malaysian Budget was seen by 'the market', i.e., mainly foreign financial interests, as only the latest in a series of Malaysian government policy measures tantamount to 'denial' of the gravity of the crisis and its possible causes.

A post-Cabinet meeting announcement on 3 September 1997 of the creation of a special RM60 billion fund for selected Malaysians was understandably seen as a bail-out facility designed to save 'cronies' from disaster. Although the fund was never properly institutionalized, and many government officials deny its existence, government-controlled public funds, mainly from the Employees Provident Fund (EPF) and Petronas, have been deployed to bail out some of the most politically well-connected and influential, including Mahathir's eldest son, the publicly-listed corporation set up by his party co-operative (KUB) and the country's largest conglomerate (Renong), previously controlled by his party and now believed to be ultimately controlled by him and his confidante, second-time Finance Minister Daim. The protracted UEM-Renong saga from mid-November 1997 was probably most damaging. The nature of this 'bail-out'—to the tune of RM2.34 billion—gravely undermined public confidence in the Malaysian investment environment as stock market rules were bent at the expense of minority shareholders.

The situation was initially worsened by the perception that Mahathir and Daim had taken over economic policy making from Anwar, who had endeared himself over the years to the international financial community. Daim's return to the frontline of policy-making caused ambiguity about who was really in charge from early to mid-1998, and about what to expect. Some of the measures introduced by the Finance Ministry and the central bank since early December 1997 and in late March 1998 were also perceived as pre-empting the likely role and impact of the National Economic Action Council (NEAC). The establishment of the NEAC

had been announced in late 1997 to be chaired by the Prime Minister, although Daim was clearly in charge as executive director. Daim was later appointed Minister with Special Functions, operating from the Prime Minister's Department, in late June 1998—right after the annual UMNO general assembly. He was subsequently made First Finance Minister in late 1998, with his protégé Mustapha Mohamad functioning as Second Finance Minister while retaining the Ministry of Entrepreneurial Development portfolio.

The question of IMF intervention in Malaysia has become the subject of some mythology, as various groups have rather different perceptions of the IMF's actual record and motives. For many of those critical of Malaysian government policy (not just in response to the crisis), IMF intervention was expected to put an end to all, or at least much, which they considered wrong or wished to be rid off. In the wake of the protracted wrangling between the IMF and Soeharto's government in Indonesia, this pro-IMF lobby in Malaysia saw the IMF as the only force capable of bringing about desired reforms which domestic forces could not bring about on their own. Ironically, many of them failed to recognize that the measures⁸⁹ introduced since December 1997 and elaborated in March 1998 were akin to what the IMF would have liked to see. These measures (*White Paper*, Box 1, pp. 25-26) included:

- Bank Negara raising its three-month intervention rate from 8.7 percent at the end of 1997 to 11.0 percent in early February 1998;
- drastic reductions in government expenditure, and
- redefining non-performing loans as loans in arrears for three months, down from the previous six months.

Such contractionary measures helped transform the financial crisis into a more general economic crisis for the country.

The currency and financial crises also contributed to new macroeconomic problems, besides undermining economic development efforts more generally:

- with the massive ringgit devaluation, imported inflation was inevitable, especially for Malaysia's very open economy, whose gross exports are equivalent to the amount it produces; it seems to import slightly less, but of course, the high import content of many manufactured exports greatly exaggerates these measures of openness.
- over zealous efforts to check inflation in these circumstances exacerbated deflationary tendencies.
- business failures, growing unemployment and reduced incomes exacerbated contractionary tendencies.
- the stock market collapse (by more than half since its peak in the first quarter of 1997) adversely affected both consumption and investment ('wealth effect').
- credit restraint policies adopted by the government from December 1997 further dampened economic activity.

⁸⁹ After tightening bank credit from December 1997, the funding of special funds for investment in food production and for small and medium industries (SMIs) as well as for car purchases (especially for the 'national cars') were increased. Nevertheless, the severe contractionary consequences of tighter liquidity have continued to slow down the economy fairly indiscriminately.

- the flight of foreign funds could not be easily replaced by domestic funds which would have had to be diverted from alternative uses.
- difficulties in recovering loans have constrained the financial system and economic activity.
- the depreciated ringgit increased the relative magnitude of the mainly privately-held foreign debt as well as the external debt-servicing burden.
- technological progress is likely to slow down with the greater costs of foreign technology acquisitions as well as the greater attraction of falling back on cheap labor and production costs, instead of making the human resource investments to achieve higher productivity.

Table 59 shows that the one-year fixed deposit interest rates rose from 7.25 percent in February 1997 to a peak of 10.28 percent in July 1998, before declining even before the September 1998 measures were introduced. Thus, even before the capital controls were introduced, interest rates rose by around 300 basis points, much less than in the neighboring economies obliged to hike interest rates to attract foreign funds, stem capital flight or pursue policies dictated by creditors, especially the IMF.

Similarly, Table 60 and Figure 21 show the base lending rate for commercial banks rising from a January low of 9.19 percent for 1997 to a peak of 12.27 percent in June 1998 before declining, again before the September 1998 measures were introduced. They also show a corresponding increase for finance companies from 10.66 percent to 14.70 percent over the same period. The increase in base lending rates for both commercial banks and finance companies thus also rose little more than three percentage points. While such an increase over a year and a half must have been onerous for borrowers, the increases were much less than in the worse affected economies in the region with their bank-based financial systems.

At least three other developments in late 1997 must have made things worst. First, the authorities adopted a tighter definition of non-performing loans in late 1997, reducing the grace period from six to three months, thus increasing the number of NPLs by redefinition in the midst of the crisis. Second, banks were obliged to meet higher statutory reserve requirements, which must have played some part in raising the cost of funds. Third, credit growth slowed down and did not rise after September 1998 despite central bank directives to increase credit growth to eight percent in both 1998 and 1999.

Thus, monetary policy from late 1997 must have exacerbated deflationary pressures due to government spending cuts from around the same time. Thus, macroeconomic policy responses to the currency and financial crises can be said to have worsened the situation, through the adoption of deflationary policies. Given the massive currency devaluation in Malaysia's very open economy, the rise of inflation at this time was virtually unavoidable, with little to be achieved by such tight macroeconomic policy. Of course, such policies were also intended to stem the capital flight facilitated by the long-standing policy of capital account convertibility. But again, there is little evidence of success on this score, just as there was little likelihood of effectiveness in this regard in conditions of contagion and herd behavior.

Table 59 Malaysia: economic growth, inflation, unemployment and interest rates, 1984-1999 (percentages)

Year	Growth*	Inflation (CPI)	Unemployment	Fixed Deposit Interest Rate (for 12 months)	Month	Inflation (CPI)	Fixed Deposit Interest Rate (for 12 months)	Month	Inflation (CPI)	Fixed Deposit Interest Rate (for 12 months)
1984	7.8	3.6	6.3	10.50	Jan-97	3.2	7.26	Jul-98	5.8	10.28
1985	-1.0	0.4	7.6	7.30	Feb-97	3.1	7.25	Aug-98	5.6	9.45
1986	1.2	0.6	8.7	6.30	Mar-97	3.2	7.25	Sep-98	5.5	6.12
1987	5.2	0.8	8.2	2.50	Apr-97	2.6	7.26	Oct-98	5.2	6.02
1988	8.9	2.5	8.1	3.30	May-97	2.5	7.30	Nov-98	5.6	5.79
1989	9.2	3.9	7.5	5.00	Jun-97	2.2	7.38	Dec-98	5.3	5.74
1990	9.7	2.0	5.1	7.00	Jul-97	2.1	7.52	Jan-99	5.2	5.66
1991	8.7	4.4	4.3	8.00	Aug-97	2.4	7.56	Feb-99	3.8	5.54
1992	7.8	4.7	3.7	7.90	Sep-97	2.3	7.63	Mar-99	3.0	5.40
1993	8.3	3.5	3.0	6.50	Oct-97	2.7	8.54	Apr-99	2.9	4.06
1994	9.2	5.0	2.9	5.30	Nov-97	2.6	9.11	May-99	2.9	3.80
1995	9.5	3.5	2.8	6.60	Dec-97	2.9	9.31	Jun-99	2.1	3.80
1996	8.6	3.4	2.5	7.18	Jan-98	3.4	9.34	Jul-99	2.5	3.79
1997	7.7	2.7	2.4	9.30	Feb-98	4.4	9.55	Aug-99	2.3	3.79
1998	-6.7	5.3	3.2	5.74	Mar-98	5.1	9.81	Sep-99	2.1	3.79
1999	4.3	2.8	3.0	3.90	Apr-98	5.6	10.03	Oct-99	2.1	3.93
					May-98	5.4	10.10	Nov-99	1.6	3.93
					Jun-98	6.2	10.24	Dec-99	na.	3.93

Note: * GDP growth rate (%) at 1978 constant prices

Sources: Bank Negara Malaysia, *Quarterly Economic Bulletin*, Table V.6, Table VI.1 and Table VI.13.
Bank Negara Malaysia, *Annual Report*, for growth and unemployment figures, various issues

Table 60 Malaysia: base lending interest rates, 1985-2000

	Commercial banks	Finance companies
1985	10.75	12.00
1986	10.00	11.50
1987	7.50	9.25
1988	7.00	9.00
1989	6.99	8.74
1990	7.49	9.20
1991	8.68	10.01
1992	9.29	10.58
1993	8.22	9.97
1994	6.83	8.40
1995	8.03	9.38
1996	9.18	10.65
Jan 1997	9.19	10.66
Feb	9.20	10.66
Mar	9.24	10.67
Apr	9.25	10.67
May	9.27	10.71
Jun	9.50	10.85
Jul	9.58	11.01
Aug	9.61	11.22
Sep	9.61	11.28
Oct	9.53	11.20
Nov	10.07	11.88
Dec	10.33	12.22
Jan 1998	10.44	12.33
Feb	11.08	13.16
Mar	11.96	14.23
Apr	12.16	14.56
May	12.21	14.65
Jun	12.27	14.70
Jul	12.07	14.49
Aug	11.70	14.17
Sep	8.89	10.54
Oct	8.49	10.00
Nov	8.04	9.50
Dec	8.04	9.50
Jan 1999	8.04	9.50
Feb	8.04	9.50
Mar	8.04	9.48
Apr	7.64	9.00
May	7.24	8.50
Jun	7.24	8.50
Jul	7.24	8.50
Aug	6.79	7.95
Sep	6.79	7.95
Oct	6.79	7.95
Nov	6.79	7.95
Dec	6.79	7.95
Jan 2000	6.79	7.95
Feb	6.79	7.95
March	6.79	7.95

Note: average rates at end of period.

Source: BNM, *Monthly Statistical Bulletin*, Table V.1.

Figure 21a Malaysia: commercial banks' monthly base lending rates and non-performing loans, 1997-1999

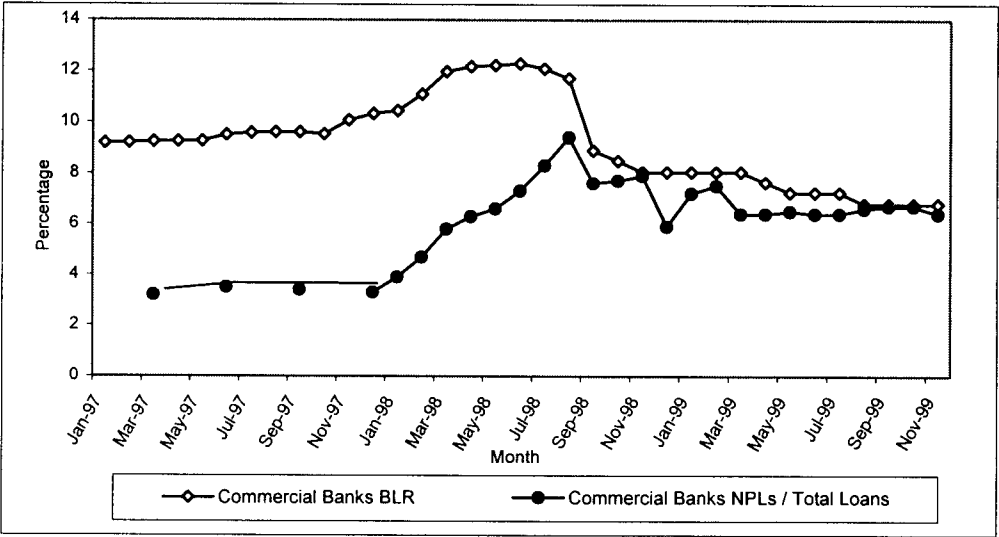
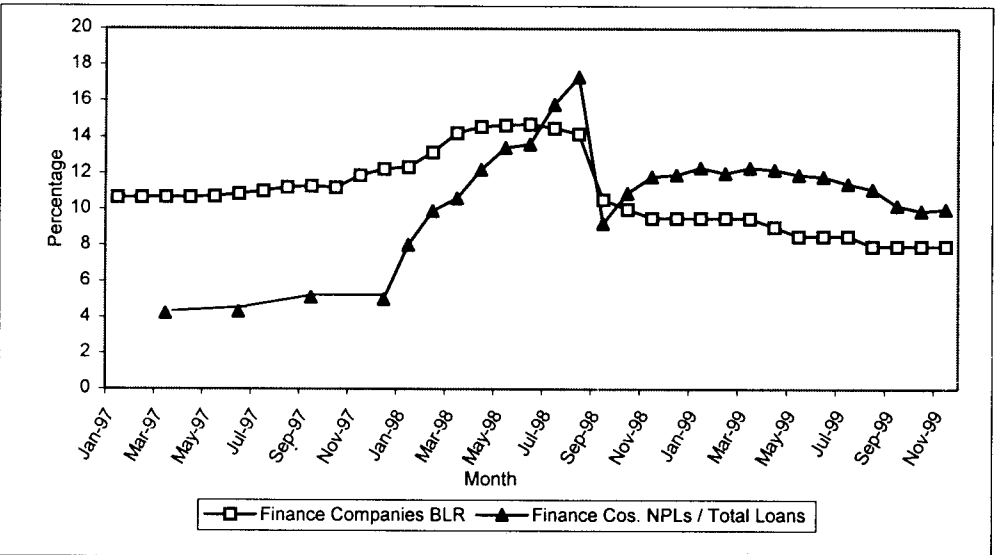


Figure 21b Malaysia: finance companies' monthly base lending rates and non-performing loans, 1997-1999



Sources: BNM, *Monthly Statistical Bulletin*, Tables V.1, V.6, and VI.12.

To make matters worse, the 1998 Commonwealth Games and Asia Pacific Economic Co-operation (APEC) summit in Kuala Lumpur and various government efforts to prop up the real property market, especially its residential component, may only have served to delay its inevitable collapse. The recent and imminent completion of many more construction projects will exacerbate the glut in high class residential, office and commercial segments of the

property market. The accelerated continuation of the new Putrajaya administrative capital is likely to exacerbate the over supply of office space. Given the heavy exposure of so many companies to the sector, especially among the KLCI's top one hundred counters, this could drag out the crisis in the country much longer than in neighboring countries, where the property markets have already collapsed.

The Malaysian Government's White Paper on the *Status of the Malaysian Economy*, issued on 6 April 1999, sums up many of the factors contributing to the ongoing economic crisis as well as most of its policy responses. However, it does so by whitewashing Mahathir's and Daim's roles in worsening the crisis, and instead implies that Anwar Ibrahim was solely responsible for all domestic policy errors. Conversely, Anwar is not credited for establishing the key institutions for financial restructuring and recovery such as Danaharta, Danamodal and the Corporate Debt Restructuring Committee (CDRC). Unfortunately, the abuse of the debt workout processes has caused concern about their integrity and the overall credibility of the recovery strategy. Such a tendentious account not only contradicts the facts, but is also unlikely to inspire the investor confidence so badly needed to ensure economic recovery.

It is well known, for example, that Mahathir's KLCI 'designation' ruling drastically reduced liquidity in the stock market, precipitating a collapse from late August 1997. Similarly, the UEM reverse take-over to bail-out Renong in mid-November 1997, supported by Mahathir and Daim, resulted in a 20 percent stock market contraction in three days! Mahathir's rhetoric about various western conspiracies against Malaysia—and the rest of the region—severely undermined international confidence and the value of the Malaysian ringgit. However, despite its current nationalist rhetoric, the White Paper shows how foreign investments are being selectively encouraged to protect and save interests the regime favors, including those who contributed to the crisis.

Banking System Distress

The private sector was badly affected by the financial crisis. Private investment decreased by 57.8 percent between 1997 and 1998 (*White Paper*, Table 1, p. 5), in line with concurrent declines in various other macroeconomic measures: private consumption fell by 12.4 percent, public consumption by 3.5 percent and public investment by 10.0 percent. In the wake of the currency crisis, interest rates rose, reflecting tighter liquidity as money supply contracted due to domestic capital flight in response to the currency crisis, the reversal of capital inflows (foreign bank lending), and tighter central bank monetary policy (as demanded by financial markets and the IMF). Commercial banks' base lending rates climbed from a monthly pre-crisis average of 9.50 percent in June 1997 to 12.27 percent in June 1998 (Table 60 and Figure 21), as finance companies raised their rates from 10.85 percent to 14.70 percent. These increases were gradual and substantial, but not sudden and astronomical. Nevertheless, the higher interest rates increased loan defaults, slowed credit growth and exacerbated economic contraction.

Loan defaults and foreclosures increased as the financial crisis undermined the real economy, gathering momentum through 1998 until the radical change in monetary policy from September. As shown in Table 61, the size of commercial banks' non-performing loans (NPLs) rose from RM9.3 billion in June 1997 to RM42.2 billion in August 1998 before dropping to RM35.3 billion in September 1998. Banks' and finance companies' non-performing loans (NPLs) as shares of total loans increased. For commercial banks, this ratio soared from 3.5 percent in June 1997 to a high of 9.4 percent in August 1998, after which the

definition of NPLs was loosened. Finance companies were worst hit, with their non-performing loans increasing from 4.3 percent in June 1997 to 17.3 percent in August 1998. These numbers had risen suddenly with the tighter redefinition of NPLs from November 1997 to include loans in arrears for only three months as compared to the previous definition period of six months before the government reverted to the six month definition in September 1998. Consequently, the ratio of NPLs to total loans fell slightly to 7.3 percent for commercial banks and 14.0 percent for finance companies in December 1998. In the aftermath of the mid-1980s' recession, NPLs had reached even higher levels, e.g., 29.6 percent of commercial banks' total loans in 1988 (see Table 61). The highest proportion of NPLs in the economy during 1998 was therefore much less than in 1988.

Table 61 Malaysia: non-performing loans, 1988-2000

End of period	Non-performing loans (RM million)			Non-performing loans / Total loans (%)		
	Commercial banks	Finance companies	Merchant banks	Commercial banks	Finance companies	Merchant banks
1988	16,935	5,413	1,203	29.6	33.7	24.8
1989	16,554	5,713	989	24.3	28.3	17.9
1990	16,562	5,858	792	20.1	21.3	12.6
1991	15,518	5,473	647	15.7	15.8	8.7
1992	15,992	6,109	583	14.7	15.6	6.9
1993	15,171	5,832	490	12.6	13.0	5.0
1994	9,643	5,130	1,107	6.9	9.9	9.5
1995	8,932	4,285	1,103	4.9	6.6	7.8
1996	8,163	4,002	315	3.6	4.7	1.7
1997 Mar	7,978	3,842	348	3.2	4.2	1.7
Jun	9,287	4,243	433	3.5	4.3	2.0
Sep	9,141	5,401	458	3.4	5.1	2.0
Dec	14,159	9,974	1,096	3.3	5.0	3.6
1998 Jan	16,746	11,088	1,563	3.9	8.0	5.3
Feb	19,206	13,448	1,898	4.7	9.9	6.2
Mar	22,278	14,282	1,821	5.8	10.6	5.0
Apr	26,131	15,862	2,266	6.3	12.2	7.1
May	28,585	17,194	2,634	6.6	13.4	8.5
Jun	32,378	17,474	3,019	7.3	13.6	9.1
Jul	36,864	19,238	3,800	8.3	15.8	12.0
Aug	42,154	20,819	4,426	9.4	17.2	14.0
Sep	35,324	13,292	3,137	7.6	9.2	8.8
Oct	37,012	14,894	3,441	7.7	10.9	9.4
Nov	39,202	16,092	4,059	7.9	11.8	11.5
Dec	32,086	16,092	3,888	5.9	11.9	10.9
1999 Jan	35,093	16,545	4,348	7.2	12.3	12.0
Feb	35,807	15,699	4,470	7.5	12.0	13.3
Mar	32,145	15,772	4,141	6.4	12.3	11.2
Apr	32,362	15,227	4,334	6.4	12.2	11.5
May	33,829	14,679	4,634	6.5	11.9	12.8
Jun	33,970	14,422	4,775	6.4	11.8	13.8
Jul	34,018	14,538	4,242	6.4	11.4	15.1
Aug	34,402	14,308	4,115	6.6	11.1	14.2
Sep	34,838	13,584	3,955	6.7	10.2	13.3
Oct	34,346	13,411	3,958	6.7	9.9	12.8
Nov	33,649	13,675	4,021	6.4	10.0	12.8
Dec	30,402	13,571	3,487	5.7	8.6	12.3
2000 Jan	30,779	13,837	3,504	5.7	8.8	12.7
Feb	30,903	13,893	3,458	5.8	8.7	12.3

Note: A loan was considered non-performing if it was not serviced for six months until November 1997, when the period was reduced to three months before reverting to six months in September 1998.

Sources: BNM, *Monthly Statistical Bulletin*, Tables III.16, III.17 and III.18.

The breakdown of non-performing loans by sector reflects the uneven impacts of the recession on the economy. Tables 62 and 63 corroborate earlier diagnoses about the differential impact of the recession on different sectors. Commercial banks' NPLs in manufacturing, the sector with the largest share of NPLs, swelled from RM2.12 billion in September 1997 to RM7.56 billion in September 1998, i.e., by 256.6 percent. Meanwhile, manufacturing's share of total loans fell from 23.2 to 17.2 percent. Every sector recorded dramatic increases in their shares of NPLs, with construction, purchase of securities, purchase of (residential and non-residential) property, real estate, business services and consumption credit heavily mired in loan default. Total NPLs are still sizeable, and in fact increased in manufacturing, construction and business services in the first quarter of 1999. Debt servicing only improved in mid-1999, months after the lowering of interest rates from September 1998. For commercial banks, loans for the 'purchase of securities' experienced the most marked improvement among the different categories of NPLs between September 1998 and March 1999 as the stock market recovered (see Table 62).

In the early months of the financial crisis, rumors led to runs on several Malaysian-incorporated banks. As a consequence, there were substantial transfers of funds from such banks to foreign-incorporated banks with good branch networks in the country. The central bank intervened to allay fears and concerns, thus preventing more widespread depositor panic in the aftermath of bank and finance company closures in neighboring Thailand and Indonesia.

By the second quarter of 1998, the Malaysian authorities had set up key institutions to save the banking system from greater distress. By early 2000, Danaharta had expended RM45 billion to take over non-performing loans from financial institutions, at a (substantial) discount, thus providing them with the means to restore badly needed liquidity to the system. Meanwhile, Danamodal had spent another RM20 billion to re-capitalize the banks in the aftermath of the havoc wreaked by the financial crisis.

Such prompt action by the Malaysian authorities contained the possibility of Thai or Indonesian style panics, in which the decline in depositor confidence in the aftermath of closures of financial institutions caused bank runs. These pre-emptive Malaysian institutional initiatives and policy measures limited the damage caused by the financial crisis to the national banking system, restoring liquidity, lowering the costs of funds, rehabilitating the banking system and reducing the growth of NPLs, saving jobs in the process.

However, the authorities have also taken the opportunity to attempt consolidation of the banking sector through directed mergers and acquisitions. The number of finance companies has already been reduced by more than half, and is expected to decline further. In mid-1999, the government announced a controversial scheme to merge all commercial banks, merchant banks and finance companies into six groups decided upon by the authorities. Widespread unhappiness about the scheme, particularly among the ethnic Chinese community, obliged the government to suspend the scheme before the November 1999 general election. In early 2000, however, the government announced an amended scheme involving ten—instead of six—groups. The four additional anchor groups are all led by bankers with personal connections to the Prime Minister, three of whom were previously thought to have fallen from grace.

Table 62 Malaysia: commercial banks' non-performing loans by sector, 1997-1999 (RM million at end of month)

Sector	Mar 97	Jun 97	Sep 97	Dec 97	Mar 98	Jun 98	Sep 98	Dec 98	Mar 99	Sep 99	Dec 99
Agriculture, hunting, forestry & fishing	235.3	229.8	226.5	246.8	259.5	380.9	454.1	568.0	573.4	609.4	635.0
Mining & quarrying	40.5	22.4	73.1	81.2	31.2	93.8	128.4	166.4	201.1	282.4	199.1
Manufacturing	1,823.9	2,324.7	2,121.1	2,734.0	3,801.1	5,395.0	7,561.6	7,220.3	7,532.1	7,761.6	7,365.0
Electricity, gas & water	18.0	5.5	7.5	23.7	122.4	403.5	236.6	38.9	32.5	58.3	39.7
Wholesale, retail, restaurant & hotel	827.3	855.6	1,007.3	1,338.6	1,969.6	2,514.5	3,293.4	3,138.0	3,442.0	3,464.1	4,060.6
Wholesale trade	377.9	395.2	499.0	687.1	1,083.1	1,512.7	1,884.7	1,753.0	1,859.9	1,872.2	2,002.2
Retail trade	341.1	355.1	370.9	471.6	612.6	762.9	941.9	878.6	904.1	962.9	1,118.7
Restaurants & hotels	108.4	105.3	137.4	179.9	273.9	238.8	466.8	506.4	678.0	629.0	939.7
Construction	966.3	1,069.2	901.2	1,349.6	3,002.1	4,127.4	5,558.4	5,220.7	5,661.4	6,558.0	6,054.7
Purchase of residential property	1,125.0	1,138.5	1,119.1	1,632.0	2,454.7	2,731.8	3,058.3	3,001.9	3,189.1	3,440.9	3,580.4
Purchase of non-residential property	508.5	589.2	574.7	907.0	1,328.9	1,825.2	2,631.5	2,398.5	2,410.4	2,263.7	2,540.4
Real estate	626.5	981.2	857.7	934.3	1,437.5	2,126.7	2,456.0	2,594.8	2,176.2	2,469.5	2,392.6
Transport, storage & communication	109.0	115.3	139.2	242.3	575.3	733.0	1,479.5	1,501.1	1,341.6	1,318.5	1,354.1
Finance, insurance & business services	292.6	368.5	400.7	886.6	1,157.6	2,227.7	2,929.6	3,092.0	3,546.1	3,391.8	3,375.9
Financial services	104.3	103.8	107.8	587.2	651.5	1,322.3	1,811.3	2,006.7	2,257.2	2,284.1	2,197.7
Insurance	5.8	3.6	2.4	4.2	8.0	113.2	108.2	138.2	142.5	144.3	156.7
Business services	182.6	261.1	290.5	295.2	498.1	792.2	1,010.2	947.1	1,146.4	963.4	1,021.4
Consumption credit:	881.2	1,041.4	805.2	1,144.8	1,851.6	2,161.3	2,492.5	2,392.2	2,347.2	2,300.3	2,246.5
Credit card loans	270.9	316.5	286.7	344.7	423.7	510.5	544.7	554.0	566.3	430.9	366.3
Personal use	563.0	677.3	430.9	715.4	1,310.9	1,485.0	1,811.5	1,766.3	1,670.7	1,779.3	1,794.7
Purchase of consumer durables	47.3	47.5	87.6	84.7	117.0	165.7	136.3	71.9	902.0	90.2	85.4
Purchase of securities	153.8	224.6	436.2	1,411.5	3,011.8	6,187.3	8,273.0	4,130.3	3,019.6	2,988.3	2,743.0
Purchase of transport vehicles	9.5	4.7	15.4	15.0	8.3	6.1	119.8	188.6	218.2	381.3	462.5
Others	360.5	316.1	456.3	1,212.0	1,266.1	1,464.2	1,741.8	1,602.0	1,386.2	1,527.2	1,582.5
Total non-performing loans	7,977.8	9,286.7	9,141.1	14,159.0	22,277.7	32,378.3	42,414.3	37,253.5	37,077.1	38,815.2	38,361.9

Source: BNM, *Monthly Statistical Bulletin*, Table III.18, p. 43.

Table 63 Malaysia: finance companies' non-performing loans by sector, 1997-1999 (RM million at end of month)

Sector	Mar. 97	Jun. 97	Sep. 97	Dec. 97	Mar. 98	Jun. 98	Sep. 98	Dec. 98	Mar. 99	Jun 99	Sep 99
Agriculture, hunting, forestry & fishing	70.1	74.1	79.4	133.4	207.2	289.8	222.5	172.1	145.3	130.9	120.4
Mining & quarrying	23.9	15.5	15.5	38.3	62.1	102.4	85.7	57.3	77.4	79.6	71.4
Manufacturing	239.8	283.9	318.3	783.2	877.8	1,423.0	1,355.2	1242.2	1213.7	1,141.5	1,117.9
Electricity, gas & water	1.0	1.5	3.0	4.3	22.4	19.9	18.3	12.9	18.5	18.3	17.8
Wholesale, retail, restaurant & hotel	91.7	88.7	99.5	164.4	313.4	620.9	538.6	621.0	796.7	578.9	597.4
Wholesale trade	25.9	24.9	33.9	62.7	130.7	234.5	239.7	238.1	350.4	271.4	282.6
Retail trade	48.9	44.3	45.8	66.0	122.2	307.5	228.9	205.1	219.5	179.8	180.5
Restaurants & hotels	16.8	19.5	19.9	35.7	60.4	78.8	70.0	177.8	226.8	127.7	134.3
Construction	722.4	563.6	447.2	972.8	1,492.1	1,861.0	2,028.8	1721.9	1978.4	2,360.3	1,804.8
Purchase of residential property	470.2	505.4	536.1	922.8	1,117.1	1,351.4	1,556.6	1099.4	1270.1	1,194.1	1,277.5
Purchase of non-residential property	153.4	202.0	359.9	772.7	1,009.4	1,445.9	1,755.9	1435.3	1560.9	1,433.6	1,240.4
Real estate	656.6	842.6	1,116.5	1,127.8	1,347.4	1,554.4	2,031.6	1903.9	844.4	508.3	505.7
Transport, storage & communication	101.3	115.8	134.6	375.2	502.7	946.3	1,076.3	996.4	813.9	795.6	560.7
Financing, insurance & business services	49.6	54.2	295.4	402.0	560.8	774.9	937.3	757.3	801.1	697.3	672.1
Financial services	8.9	8.4	259.1	304.4	333.1	303.9	355.6	320.1	289.6	308.3	269.6
Insurance	0.8	0.9	0.4	1.5	2.5	11.0	2.9	2.2	1.9	2.3	2.3
Business services	39.9	45.0	35.9	96.2	225.1	460.0	578.8	435.0	509.6	386.7	400.2
Consumption credit:	306.0	334.0	292.4	449.5	565.5	557.6	619.1	511.1	437.6	277.8	265.0
Credit card loans	70.4	67.8	73.0	116.7	114.1	109.5	174.1	196.1	95.8	40.9	47.7
Personal use	172.9	175.1	133.9	188.5	276.7	340.1	356.8	236.8	269.9	209.8	188.2
Purchase of consumer durables	62.7	91.1	85.5	144.3	174.7	108.0	88.3	78.1	71.9	27.2	29.2
Purchase of securities	60.7	79.2	407.9	865.2	1,502.5	1,515.6	2,268.3	2419.4	2098.5	1,753.4	1,885.8
Purchase of transport vehicles	748.5	992.7	1,164.2	2,812.5	4,438.0	4,554.9	5,100.7	4415.5	4200.6	3,951.7	3,919.4
Others	147.3	90.2	130.7	150.3	263.5	445.4	362.3	535.7	578.7	568.8	568.9
Total non-performing loans	3,842.4	4,243.3	5,400.6	9,974.3	14,281.8	17,463.6	19,957.2	17,901.3	16,835.8	15,489.9	14,625.2

Source: BNM, *Monthly Statistical Bulletin*, Table III.19, p. 44.

Several consequences of the financial crisis—including loss of investor confidence, sudden and massive capital outflows, credit crunch—had various adverse effects on the real economy. The impact on growth was lagged, dropping from 7.7 percent growth in 1997, including 6.0 percent in the last quarter. The Malaysian economy contracted by -6.7 percent in 1998—or by -2.8 percent, -6.8 percent, -9.0 percent and -8.1 percent in the four quarters of 1998—and by -1.5 percent in the first quarter of 1999, before recovering from the second quarter onwards. Thus, the currency and financial crises, triggered by the collapse of the baht in July 1997, thrust Malaysia and its Southeast Asian neighbors towards economic recession.

Like the early debate on the origins of the financial crisis itself, initial discussion on the impact of the financial crisis on the real economy tended toward either denial or alarm. The suddenness of the financial contraction, amplified by the contrast with the previous seven years of uninterrupted economic growth averaging around eight percent (see Tables 58, 64, 65), probably contributed to the marked divergence in reaction. Many who saw the accumulated wealth of many years suddenly dissipate refused to believe what was happening. After experiencing the financial system shock, others expected the economic recession to be similarly catastrophic by causing hyperinflation, massive unemployment and social upheaval.

Boom and Bust

The suddenness of the economic contraction, in sharp contrast to the previous decade of uninterrupted economic growth averaging around eight percent (see Tables 58 & 64), probably contributed to the marked differences in reactions. Many who saw the sustained growth and accumulated wealth of earlier years suddenly dissipate could not believe what was happening. After experiencing the severe financial shock, many expected the economic recession to be similarly catastrophic by causing massive insolvencies, unemployment and social upheaval exacerbated by hyperinflation due to the huge currency devaluations.

At the macroeconomic level, the contraction in Gross Domestic Product (GDP) was significant, especially through 1998. Tables 64 and 65 show Malaysian GDP growth rates, in total and by sector, computed annually for the 1990s, and quarterly from 1997 to 1999. The positive growth trend in the 1990s before 1998 is evident from Table 64. The quarterly data in Table 65 shows the downward trend from the third quarter of 1997 (from decreasing, but still positive growth in late 1997) to deepening recession in 1998. The decline in 1998 was especially significant in the construction and manufacturing sectors, which contracted by 23.0 percent and 13.7 percent respectively. It was less pronounced in agriculture, which declined by 4.5 percent, partly due to the adverse impact of the El Niño drought and the agronomic impact of the substantial haze due to continuing forest fires in neighboring Indonesia.

Figure 22, which traces some macroeconomic indicators from the mid-1980s to 1998, reveals important characteristics of the 1998 recession, some of which have been unprecedented. It is important to note that while national output contracted sharply and inflation jumped, unemployment increased less dramatically in 1998. Of course, such statistical indicators must be used circumspectly; while numbers are crucial for analysis, their accuracy must also be considered. The inadequacy of these indicators will also be addressed later. At this stage, one should consider some stylized facts about the Malaysian economic condition of from late 1997: Gross Domestic Product (GDP) shrank, unemployment and inflation rose, private investment and consumption fell, while credit growth declined as the proportion of non-performing loans (NPLs) rose. In terms of social welfare, the limited social security provisions in Malaysia have aggravated these economic impacts. The continued influence of powerful politically influential business interests over policy-making, even in response to the crisis, probably further undermined social welfare in net terms.

Table 64.1 Malaysia: annual changes in gross domestic product by economic activity, 1990-1999 (percentages; 1987 constant prices)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Agriculture, forestry & fishing	-0.6	-0.1	6.9	-3.1	-1.9	-2.5	4.5	0.4	-4.5	3.9
Mining and quarrying	0.1	4.7	4.6	-4.0	6.0	22.9	2.9	3.0	1.8	-4.0
Manufacturing	15.3	14.0	7.0	14.6	11.4	11.4	18.2	10.4	-13.7	13.5
Construction	18.6	15.5	10.8	10.8	15.1	21.1	16.2	10.6	-23.0	-5.6
Electricity, gas and water	6.1	0.2	18.7	28.6	14.0	18.9	9.6	-5.4	3.0	4.9
Transport, storage & communications	12.2	9.2	5.9	12.1	18.7	12.1	7.4	11.6	0.9	3.8
Wholesale and retail trade, hotels and restaurants	16.3	16.1	12.3	10.9	12.0	11.5	7.9	8.0	-3.1	2.1
Finance, insurance, real estate & business services	13.3	15.4	20.3	25.3	4.2	9.7	17.0	18.9	-4.3	1.2
Government services	2.0	4.5	5.8	7.2	5.4	1.4	1.7	8.6	1.8	6.6
Other services	11.9	12.6	9.2	10.1	10.6	11.8	7.9	7.2	3.8	2.1
GDP at Purchasers' Prices	9.0	9.5	8.9	9.9	9.2	9.8	10.0	7.5	-7.5	5.4

Source: BNM, *Monthly Statistical Bulletin*, Table VI.2.

Table 64.2 Malaysia: annual changes in gross domestic product by economic activity, 1990-1999 (percentages; 1978 constant prices)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Agriculture, forestry & fishing	0.2	0.2	4.7	4.3	-1.0	1.1	2.2	1.3	-4.0	4.6
Mining and quarrying	5.1	2.4	1.7	-0.5	2.5	9.0	4.5	1.0	0.8	-1.2
Manufacturing	15.7	13.9	10.5	12.9	14.9	14.2	12.3	12.5	-10.2	8.9
Construction	19.1	14.3	11.7	11.2	14.1	17.3	14.2	9.5	-24.5	-3.6
Electricity, gas and water	13.5	11.2	13.8	12.7	13.7	13.0	12.1	13.0	3.6	4.2
Transport, storage & Communication	13.3	10.9	6.6	6.8	12.3	13.8	9.7	8.4	1.2	3.0
Wholesale and retail trade, hotels and restaurants	14.8	14.1	11.1	11.1	8.0	10.1	9.4	7.0	-2.0	1.5
Finance, insurance, real estate and business services	14.6	12.6	10.4	10.4	10.0	10.5	14.6	9.5	4.4	1.0
Government services	4.8	4.5	2.6	9.5	9.4	3.9	4.2	6.1	2.4	3.5
Other services	10.5	9.1	8.3	8.2	7.1	7.8	8.4	7.2	2.5	4.0
GDP at Purchasers' Prices	9.7	8.7	7.6	8.3	9.3	9.4	8.6	7.7	-6.7	4.3

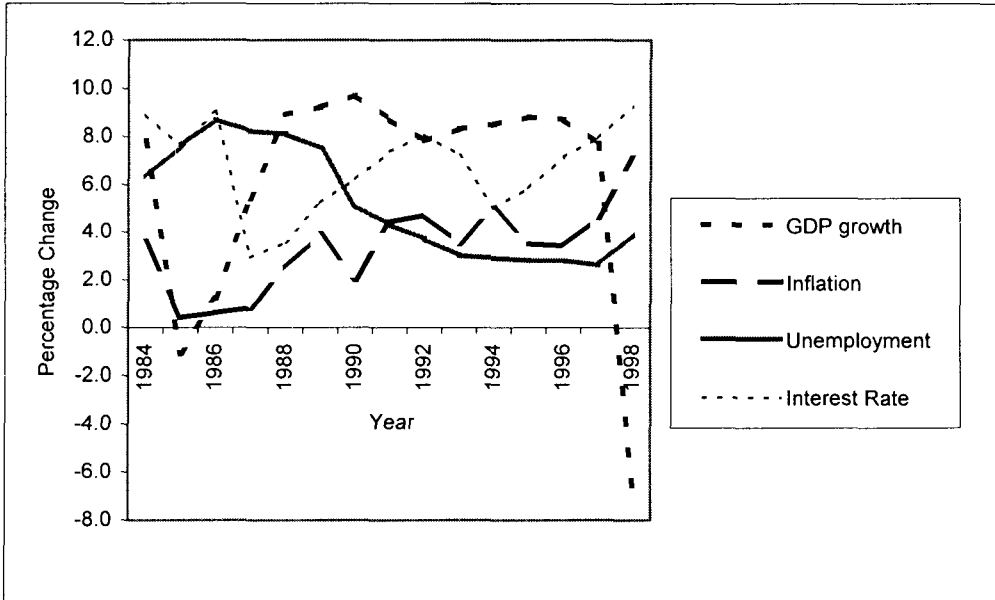
Note: Figures for 1999 are in 1987 constant prices.

Sources: BNM, *Monthly Statistical Bulletin*, October 1998, Table VI.2, p. 79; April 1999, Table VI.2, p. 82. Ministry of Finance, *Economic Report 1999/2000*, Table 2.2, pp. x & xi.

Table 65 Malaysia: quarterly change in gross domestic product by economic activity, 1997-1999 (year on year change, at 1987 prices)

	1997				1998				1999			
	1 st qtr.	2 nd qtr.	3 rd qtr.	4 th qtr.	1 st qtr.	2 nd qtr.	3 rd qtr.	4 th qtr.	1 st qtr.	2 nd qtr.	3 rd qtr.	4 th qtr.
Agriculture, forestry & fishing	1.8	3.9	-1.5	-2.1	-2.1	-6.9	-4.0	-4.8	-3.5	8.6	3.6	6.3
Mining and quarrying	-0.5	2.6	1.9	8.1	0.6	0.3	1.2	5.1	-2.3	-5.9	-3.0	-5.0
Manufacturing	11.8	9.6	11.3	9.2	-5.8	-10.3	-18.9	-18.6	-1.1	10.8	19.5	25.2
Construction	17.5	10.8	7.3	7.8	-14.5	-19.8	-28.0	-29.0	-16.6	-7.9	0.9	2.7
Electricity, gas and water	-4.3	-6.1	-7.1	-4.0	0.2	4.6	2.9	4.3	2.4	4.4	7.1	5.4
Transport, storage and communication	10.5	16.8	14.6	5.2	6.4	2.9	-1.8	-3.4	1.7	0.6	3.4	9.0
Wholesale and retail trade, hotels and restaurants	7.3	9.5	10.2	5.2	2.8	-1.9	-8.1	-4.7	-2.1	-1.5	4.0	6.8
Finance, insurance, real estate and business services	19.8	22.4	19.8	14.3	5.9	-2.6	-8.9	-10.4	-6.6	1.8	6.0	3.6
Government services	24.3	8.7	4.8	0.1	-14.9	-12.4	4.4	5.4	14.5	1.8	2.7	9.0
Other services	5.9	7.3	7.6	8.1	7.4	5.5	1.9	0.3	1.7	0.4	3.2	2.7
GDP at Purchasers' Prices	8.6	8.4	7.7	5.6	-3.1	-5.2	-10.9	-10.3	-1.3	4.1	8.1	10.6

Sources: BNM, *Monthly Statistical Bulletin*, Table VI.2; Department of Statistics, *Quarterly Gross Domestic Product*, First and Second Quarter 1999.

Figure 22 Malaysia: macroeconomic indicators, 1984-1998

Note: The interest rate used is the three-month inter-bank rate.

Sources: BNM, *Monthly Statistical Bulletin*, Tables VI.2 and VI.12.

Manufacturing and construction had experienced high growth in the 1990s. These sectors also employ substantial numbers in the labor force. Manufacturing thrived, boosted by massive foreign direct investment and export growth. After the property slump in the late 1980s, construction boomed again in the 1990s. Wholesale and retail trade, as well as hotels and restaurants also experienced a 3.1 percent contraction in 1998. The performance of these sectors generally reflects the vitality of consumer demand and is probably quite sensitive to the 'wealth effect'. The rapid expansion of these activities, amid buoyant consumer and investor sentiment, is evident in high annual growth rates from 1990 to 1997. Their decline in 1998 reflects decreasing private consumption expenditure. Similarly, the rapid, but somewhat erratic growth of financial, real estate and business services reflects the rise and fall of general market confidence. Growth in this sector fell from 18.9 percent in 1997 to -4.3 percent in 1998. Elsewhere in the economy, transport, storage and communication witnessed declining growth, from 11.6 percent in 1997 to 0.9 percent in 1998, while government services also fell from 8.6 percent to 1.8 percent growth due to fiscal cuts. On the whole, all sectors performed worse in 1998 than in the previous year, except for electricity, gas and water utilities, which had contracted earlier, during 1997. Overall economic contraction was reflected by the sharp fall in annual GDP growth, from 7.5 percent in 1997 to -7.5 percent in 1998, using 1987 as the base year, or from 7.7 percent in 1997 to -6.7 percent in 1998, using earlier data with 1978 as the base year.

Quarterly figures provide a more vivid picture of the suddenness of the recessionary impact of the financial crisis (see Table 65). The economy contracted in every quarter of 1998, compared to the corresponding quarters for 1997, specifically by 3.1 percent (first quarter), 5.2 percent (second quarter), 10.9 percent (third quarter) and 10.3 percent (fourth quarter)

respectively. The contraction abated in the first quarter of 1999, when quarterly GDP was still 1.3 percent less than in the first quarter of 1998.

Interestingly, as noted earlier, agricultural activities had begun to slow down from mid-1997, prior to the currency and financial crises, mainly due to El Niño weather conditions and Indonesian forest fires. Other sectors began to contract in 1998 in the aftermath of the financial crisis. Manufacturing and construction fell in 1998, most sharply in the third and fourth quarters. Manufacturing output plunged by 18.9 percent in the third quarter of 1998 and 18.6 percent in the fourth, while construction collapsed by 28.0 percent and 29.0 percent respectively. Government services were reduced by 14.9 percent and 12.4 percent respectively in the first two quarters of 1998, but increased in the last two quarters of 1998 by 4.4 percent and 5.4 percent respectively. In the first quarter of 1999, government expenditure was stepped up even more, i.e., by 14.5 percent, becoming the fastest growing sector for that period, reflecting government efforts to boost aggregate demand while the rest of the economy was still contracting.

Quarterly GDP figures indicate recovery on almost all fronts from the second quarter of 1999, with the quarterly equivalent of an overall year on year growth of 8.1 percent in the third quarter. These impressive positive growth numbers denote the increase from the very contractionary third and fourth quarters of 1998 when GDP dropped 9.0 percent. Nonetheless, there are other figures to suggest that the recovery can be sustained in the medium term. Importantly, in the third and fourth quarters of 1999, the manufacturing sector produced 19.5 and 25.2 percent more than in the third and fourth quarters of 1998. Over the same periods, the construction sector began to register positive quarterly growth, though only by modest rates of 0.9 and 2.7 percent respectively. The utilities and service sectors (domestic trade, transport and communication, and financial and business services) also improved their performances (see Table 65). However, the trends for agriculture and mining have been less encouraging, with adverse implications for living standards in the countryside especially in light of commodity price declines during this period, e.g., for palm oil (see Table 66).

Table 66 Malaysia: prices and export values of selected major commodities, 1991-2000

Year	Petroleum (crude and partly refined)		Palm Oil		Sawn Timber	
	Unit Price (RM/tonne)	Expt. value (RM mil.)	Unit Price (RM/tonne)	Expt. Value (RM mil.)	Price (RM/m ³)	Expt. value (RM mil.)
1991	451.2	10,195.6	906.9	5044.9	599.1	3,008.3
1992	405.0	9,146.9	974.1	5436.6	646.8	3,487.7
1993	380.0	7,996.0	985.8	5797.3	829.8	4,545.6
1994	344.0	6,548.0	1,266.7	8,365.3	911.3	4,331.1
1995	349.7	6,701.0	1,533.8	10,395.3	885.2	3,837.5
1996	412.0	7,211.8	1,296.0	9,436.0	798.9	3,120.2
1997	445.3	7,068.6	1,424.9	10,809.8	904.3	2,780.8
1998	416.9	7,509.8	2,366.4	17,779.0	941.4	2,525.7
1999	525.0	9,305.9	1,614.7	14,475.2	996.0	2,806.6
2000Q1	745.3	n.a.	n.a.	n.a.	n.a.	n.a.

Sources: BNM, *Monthly Statistical Bulletin*, Tables VIII.6. & VIII.7

It has been suggested that the fixed exchange rate and lower interest rates associated with the introduction of capital controls from September 1998 helped Malaysia rebound from the crisis. However, this is difficult to confirm as exchange rates became more stable and interest rates declined in the region generally from around the same time after the international

responses to the Russian crisis and its aftermath on Wall Street in August 1998. Also, all the crisis-hit economies in the region recovered from the beginning of 1999, whereas Malaysian recovery dates to the second quarter. And although the Malaysian recovery since has been stronger than for Thailand and Indonesia, Korea has performed more impressively. Also, Malaysia had not been as badly affected by the crisis compared to these three other economies in the first place, so meaningful comparisons remain problematic.

Trade and prices

Malaysia's external trade data suggest some significant changes in the composition of economic growth from the mid-1990s, as in the rest of the region. In 1998, imports declined by 18.3 percent, while exports only fell slightly by 0.7 percent. This contrasts with the previous sustained expansion in external trade, which grew most in 1994, when exports and imports registered 22.5 and 27.7 percent growth respectively. Importantly, the rate of increase in goods trade was already slowing down before the crisis, probably due to increased investment in and production of non-tradables during 1995 and 1996. In 1996, imports only increased 4.2 percent, while exports increased 7.2 percent. As in the rest of the region, Malaysian export growth was certainly lower prior to the financial meltdown, probably due to higher production costs with full employment and ringgit appreciation—together with the US dollar—from mid-1995.

Large proportions of Malaysia's agricultural and natural resource output are exported. Furthermore, export earnings are subject to fluctuations in the international demand for and the prices of commodities, mostly denoted in US dollars. In the case of agriculture, climate and other conditions have also had adverse impacts on output levels, e.g., during the El Niño drought and the forest fire induced haze. Table 66 shows average prices for and export earnings from selected commodities. Malaysia is not considered a major world producer of petroleum; it supplies substantial amounts of palm oil, rubber and tropical timber to international markets.

In 1998, oil prices declined. The weighted average price of crude petroleum dropped from US\$21.1 per barrel in 1997 to US\$13.8 in 1998. However, owing to the massive ringgit depreciation, the fall in refined petroleum export earnings, in ringgit per ton, was less severe, from RM445.3 in 1997 to RM416.9 in 1998. Exports of crude and partly refined petroleum substantially increased in volume, from 15.9 to 18.0 million tons, but increased only marginally in value, from 7.1 to 7.5 billion ringgit. This probably reflected official efforts to expand output to compensate for the drop in world petroleum prices. The ringgit prices of rubber and saw logs also declined from 1997 to 1998 despite the massive ringgit depreciation, slipping from 291.7 to 286.0 sen per kg, and from RM366.7 to RM344.4 per cubic meter respectively. However, not all commodity prices were adversely affected, but average sawn timber prices only increased slightly from RM904.3 to RM941.4 per cubic meter, i.e., much less than due to the ringgit depreciation.

The price of palm oil, Malaysia's largest primary commodity export after petroleum, rose from RM1,424.9 to RM2,366.4 per ton, i.e., much more than due to the ringgit's devaluation. Exports of palm oil in 1998 were lower than in 1997, slipping to 7,512.9 from 7,609.2 million tons. Despite this, the value of palm oil exports soared from RM10,809.8 million to RM17,779.0 million. By mid-1999, however, the bumper soy bean harvest began to exert tremendous downward pressure on palm oil prices, with likely impact on the fortunes of Malaysia's oil palm estates.

It is unclear to what extent the financial crisis—as opposed to other factors—impacted on the agricultural sector. Both El Niño and La Nina weather phenomena have been

blamed for inflicting drought and then floods on farmland, adversely affecting the harvests of 1997 and 1998. Such perverse climatic conditions have evidently impacted on farm output and communities, although a systematic analysis has been difficult to develop.

Malaysian economic recovery may have gained from the weak ringgit although there is little evidence of an export boom due to this, perhaps because other economies with similar export profiles also suffered similar currency devaluations. The currency devaluation undoubtedly increased import including food costs due to the high proportion of food items in Malaysia's imports. Malaysia's food import bill amounted to RM6.3 billion in 1997 and RM6.7 billion in 1998, or 19.9 and 21.4 percent respectively of total consumption goods imports. An estimated 73.6 percent of exports from and 69.9 percent of imports into Malaysia were denominated in US dollars (Haflah *et al.* 1999: 40).

Currency devaluation generally makes exports more competitive and imports more expensive; for Malaysia, considerable shares of imports are inputs into production for export, i.e., as intermediate or capital goods. In 1996, for example, the breakdown of imports was as follows: 22.4 percent capital goods, 68.8 percent intermediate goods, and 6.6 percent consumption goods, with 2.9 percent dual use goods. Hence, while the weaker exchange rate made exports more competitive, increased production costs could have offset potential gains from currency depreciation in some sectors. Thus, the currency and recession impacted on external trade, with ramifications for the rest of the economy.

Of the RM286.8 billion worth of Malaysian goods exports 1998 (30.3 percent increase from 1997), RM237.5 billion, or 82.8 percent, was from the manufacturing sector. The crucial electronic and electrical sector contributed RM195.0 billion, or 68.2 percent of the total. With this export surge, Malaysia recorded a RM58.4 billion-trade surplus, reversing four previous years of trade deficits. However, the 1998 export growth was not large enough to lead the economy out of the slump. The expansion in export-oriented manufacturing was not enough to stave off economic recession (Haflah *et al.* 1999: 5).

Producer prices

Prices of domestically produced goods increased markedly from 1997 to 1998, with inflation rising from 2.7 to 10.7 percent, before falling again in 1999 (see Table 67). A closer look at the producer price index (PPI) reveals much unevenness in accounting for this trend. The aggregate rise in prices of domestically produced goods appears to have been not evenly spread, severe or sustained. Increases in one category—animal and vegetable oils and fats – by 63.8 percent in 1998 alone skewed the overall trend in its direction. By 1999, the producer price index for domestic goods had fallen by 4.8 percent, mainly due to poorer palm oil prices. Excluding the prices of animal and vegetable oils and fats, the adjusted PPI was a much lower 3.8 percent in 1998 (Haflah *et al.* 1999: 13). Since most refined palm oil was exported, the higher palm oil prices probably did not contribute much to higher consumer prices as the higher imported food producer price index in 1998 (14.5 percent) was much higher than the food consumer price index (8.9 percent).

Prices of imports also significantly increased in 1998. As shown in Table 68, the annualized PPI for imported goods rose by 9.2 percent in 1998 as compared to a 2.8 percent rise in 1997. Importantly, the largest increases were for food and live animals (14.5 percent) and machinery and transport equipment (13.4 percent). The former must have exerted some upward pressure on food prices and the latter on industrial product prices. In the first eight months of 1999, the PPI for imported goods declined by almost one percent, with all components of the index only registering small changes. This import price stability probably

reflects the regional currency stability since the last quarter of 1998 and the impact of the ringgit peg from September 1998.

Table 67 Malaysia: domestic producer price indices, 1993-1999 (1989 = 100; % change)

	1993	1994	1995	1996	1997	1998	1999
Overall	0.7	4.0	3.9	2.3	2.7	10.7	-3.3
<i>Components:</i>							
Food & live animals	1.5	5.7	2.3	5.5	2.3	8.5	-2.3
Beverages & tobacco	7.6	1.9	2.2	0.5	0.1	1.5	10.2
Crude materials except fuel	0.1	10.0	7.0	-1.5	-4.9	3.0	2.7
Mineral fuels, lubricants, related materials	0.7	-4.5	-0.3	12.5	7.0	-2.6	14.2
Animal & vegetable oils and fats	3.1	20.0	25.9	-5.8	12.9	63.8	-29.4
Chemicals & related products	0.7	0.5	2.1	1.0	1.2	4.7	1.5
Manufactured goods classified by material	1.0	3.4	-0.1	0.8	0.1	6.8	-0.9
Machinery & transport equipment	2.4	0.4	-1.8	0.5	3.4	5.9	-0.5
Miscellaneous manufactured articles	0.4	5.4	2.3	3.4	-1.2	5.4	1.4

Sources: *Economic Report*, various issues; *BNM Annual Report 1999*, Table A. 28, p. 283.

Table 68 Malaysia: producer price indices for imports, 1993-1999 (1989 = 100; % change)

	1993	1994	1995	1996	1997	1998	1999*
Overall	-0.2	0.2	0.7	0.1	2.8	9.2	-0.9
<i>Components:</i>							
Food & live animals	4.0	-1.2	5.6	3.1	1.2	14.5	-0.7
Beverages & tobacco	-0.2	3.5	0.2	0.7	1.9	-0.6	1.8
Crude materials except fuel	-2.0	7.0	2.7	1.1	1.6	6.2	-1.3
Mineral fuels, lubricants, related materials	1.1	1.7	0.7	1.0	4.0	0.0	-2.4
Animal & vegetable oils and fats	-3.8	-5.8	0.1	-0.1	-0.1	1.9	0.3
Chemicals & related products	1.3	1.6	3.4	2.0	0.8	5.7	0.6
Manufactured goods classified by material	1.8	1.0	1.6	0.0	-0.3	7.3	-0.9
Machinery & transport equipment	2.0	-0.6	-2.7	-2.0	5.3	13.4	-1.1
Miscellaneous manufactured articles	5.6	3.4	1.7	-0.5	-1.1	5.4	0.2

Note: * January-August 1999.

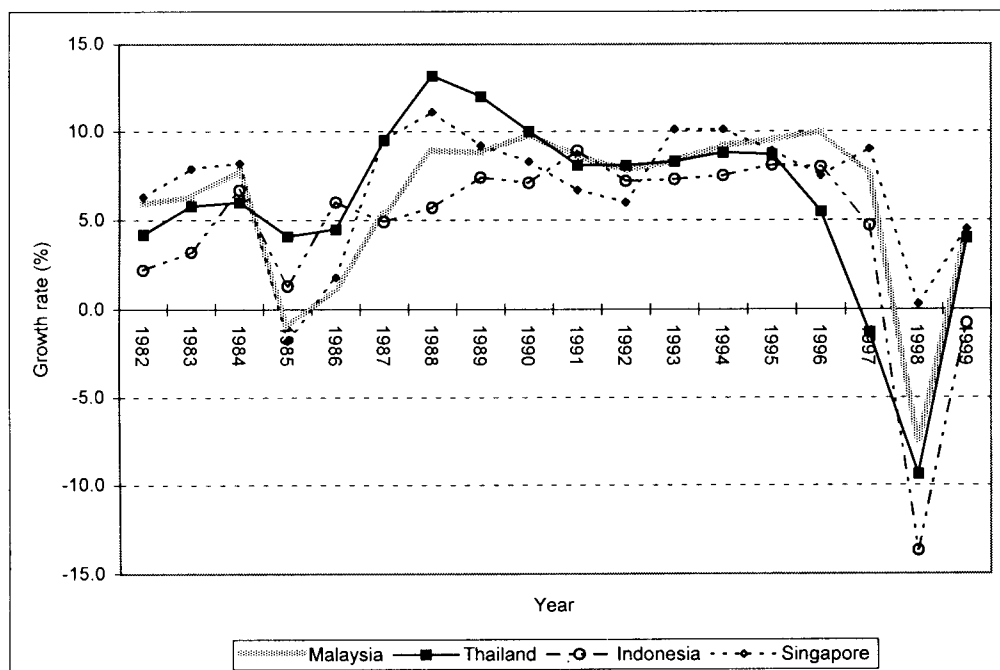
Sources: *Economic Report*, various issues.

Recovery

While the worse seems to be over in Malaysia, the same can also be said of the other crisis-hit economies of East Asia (see Figure 23). It is therefore almost impossible to honestly claim the Malaysian recovery has been either due to or despite the September 1998 measures as proponents and opponents of the Malaysian controls have been keen to claim. The economic situation throughout the region has improved since late 1998; the worst period was the second half of 1998, especially the third quarter, with the Russian meltdown and then sovereign debt default. During the first quarter of 1999, South Korea grew by 4.6 percent, Indonesia by 1.7 percent, and Thailand by 0.9 percent. Malaysia was the only East Asian

crisis-hit economy still in recession, with the Malaysian economy contracting by -1.6 percent. The Malaysian economy should be growing again year on year by the second quarter compared to the second quarter of 1998's -6.8 percent. The tide has risen throughout the region, but Malaysia seems to be lagging behind, with the recovery in Malaysia in 1999 more modest than South Korea's despite the far more severe banking crises in South Korea, Thailand and Indonesia.

Figure 23 ASEAN Four: GDP growth rates, 1982-1998



There is an ongoing, but unresolved debate over why the turnaround has occurred. Of course, those supporting the IMF point to Korea's impressive recovery and even to the Thai and Indonesian turn-arounds from early 1999 to say that their policies have worked. Meanwhile, the Mahathir regime and its enthusiasts insist that its capital controls paved the way for recovery not only in Malaysia, but even in the rest of the region! Mahathir can rightfully claim credit for being prepared to take the bold measure of introducing capital controls, but unfortunately, they were probably too late to have much positive impact, but will nonetheless continue to incur the costs of undermining confidence.

While the currency controls succeeded in killing the offshore ringgit market, thus restoring control over monetary policy, no one can prove that the controls were crucial to Malaysia's imminent recovery. At the same time, opponents of such controls cannot really show that the experiment failed. The evidence is simply not clear cut. Clearly, the Malaysian recovery has lagged behind the rest of the region, and this may have been due to the measures introduced by Mahathir in September 1998. However, for the time being, the evidence does not unambiguously support either claim as both sides can invoke statistics to support their respective claims. Bank Negara did gradually lower its intervention rate from 11 percent in early February 1998 to 9.5 percent on 27 August 1998 and then to 7 percent on 9 November 1998.

However, not all monetary measures to stimulate the economy or raise investor confidence are necessarily contingent on the imposition of capital controls, with the introduction of some such measures actually preceding the imposition of controls in September 1998. Such measures include:

- reduction of statutory reserve requirements (from 13.5 percent on 16 February 1998 to 4.0 percent on 16 September 1998, mainly to finance Danaharta and Danamodal);
- extending the grace period for reclassification of non-performing loans from three to six months of unpaid interest (*White Paper*, Box 2, pp. 28-29), and
- efforts to restore liquidity and to re-capitalise the banking system through institutions such as Danaharta and Danamodal.

While the later and weaker Malaysian recovery undermines the Mahathirist claims, but in itself does not prove the case of capital controls opponents. In any case, regardless of whether the Malaysian capital controls have been successful, everyone recognizes that it has had serious costs in terms of undermining previous confidence and goodwill among the investment community that the government has long cultivated rather successfully.

While the recovery seems to have begun, the prospects for returning to the rapid growth of the decade before 1998 are more dubious. Comparative GDP per capita data suggests that while Malaysia has lagged further behind Singapore in the region, both Thailand and Indonesia have been catching up on Malaysia (see Figure 23 and Table 69). The Malaysian savings rate remains high, but much of Malaysia's export-led growth has relied heavily on foreign direct investment (FDI) in the past. It is going to be increasingly difficult to compete with China, India and other alternative sites for such FDI. Also, the uncertain prospects for sustaining the boom in the US and for sustained recovery in Japan raise doubts about Malaysian prospects for an export-led recovery. Not surprisingly then, the NEAC has been banking on a domestic-led recovery, though its policy package (e.g., the currently undervalued ringgit) is not fully consistent with this. More importantly, domestic-led growth requires significant redistribution of wealth and income within the country, which the government has not demonstrated any inclination to undertake.

The recent crisis suggests that Malaysia's economic boom of the previous decade had been built on some shaky and unsustainable foundations. Earlier growth had become increasingly heavily reliant on foreign resources, both capital and labor. It was becoming quite clear that Malaysia's future economic progress could no longer be secured by continued reliance on its previous economic strategy emphasizing cheap labor and other production costs. Limited and inappropriate investments in human resources continued to hold back the development of greater industrial and technological capabilities in the country, as elsewhere in the region (Jomo & Felker 1999; Jomo, Felker & Rasiah 1999).

In Malaysia, the gravity of the crisis and the difficulties of recovery were exacerbated by injudicious policy responses, compromised by nepotism and other types of cronyism, though there is little persuasive evidence that cronyism in itself led to or precipitated the crisis. All this transformed the inevitable 'correction' of the overvalued ringgit into a collapse of both the ringgit and the Kuala Lumpur stock market as panic set in, amplified by 'herd' behavior and 'contagion'. Government efforts to 'bail-out' politically influential business interests and to otherwise protect or advance such interests—usually at the expense of the public (the public purse, workers forced savings, taxpayers or minority shareholders)—exacerbated the crisis in Malaysia by undermining public and foreign confidence.

Table 69 ASEAN Four: Comparative per capita gross domestic product growth, 1982-1999

Year	Annual GDP Growth Rate (%)				Per capita GDP in current US dollars				Per capita GDP ratios		
	Malaysia	Thailand	Indonesia	Singapore	Malaysia	Thailand	Indonesia	Singapore	Malaysia Singapore	Malaysia Thailand	Malaysia Indonesia
1982	5.9	4.2	2.2	6.3							
1983	6.3	5.8	3.2	7.9							
1984	7.8	6.0	6.7	8.2	2,152	769	520	6,842	0.31	2.80	4.14
1985	-1.0	4.1	1.3	-1.8							
1986	1.2	4.5	6.0	1.8	1,595	810	490	7,410	0.22	1.97	3.26
1987	5.4	9.5	4.9	9.5							
1988	8.9	13.2	5.7	11.1							
1989	8.8	12.0	7.4	9.2							
1990	9.8	10.0	7.1	8.3	2,289						
1991	8.6	8.1	8.9	6.7	2,474	1,580	610	12,890	0.19	1.57	4.06
1992	7.8	8.1	7.2	6.0							
1993	8.3	8.3	7.3	10.1							
1994	9.2	8.8	7.5	10.1							
1995	9.5	8.7	8.1	8.9							
1996	10.0	5.5	8.0	7.5	4,543	3,025	1,146	25,150	0.18	1.50	3.96
1997	7.5	-1.3	4.7	9.0							
1998	-7.5	-9.4	-13.7	0.3							
1999	4.3	4.0	-0.8	4.5							

Fortunately, Malaysian central bank regulation and managed consolidation of the banking sector helped ensure its greater robustness compared to its neighbors, though the new restructuring attempted in the wake of the crisis is less well-conceived and less likely to serve its intended ends. The authorities' push for the very rapid merger of banks and financial companies has been made particularly difficult by the uncertainties due to the turbulent times and has limited chance of success, especially in light of the recent failure of a similar Thai attempt. While the consolidation of the financial sector may be desirable to achieve economies and other advantages of scale in anticipation of further financial liberalization, the acceleration of its pace in response to the crisis seems to be less well conceived.

Regime propagandists point gleefully to the Kuala Lumpur Stock Exchange (KLSE) Composite Index (KLCI) recovery. There are many factors behind this apparently anomalous situation of delayed economic recovery and a booming stock market, and the propaganda may lull us into a fool's paradise. Unfortunately, although the nature of official denial has changed, the key economic policymakers seem to be more concerned with winning elections, saving cronies, public relations and the stock market than in sustainable real economic recovery. Instead of uniting the nation to overcome the ongoing economic crisis, leading government propagandists continue to deceive Malaysians about the actual state of the economy. While recovery in the rest of the region has involved political change, Malaysia's failure to change could well block the new dispensation the economy desperately needs.

There has also been a history of government efforts to bolster the stock market, which many blame for the EPF's loss of over RM10 billion in 1998. The National Economic Action Council's or NEAC's ongoing efforts to revise the 1 September 1998 measures—thus undermining their main original intent (to deter panic-driven capital flight)—have begun to reverse foreign investor sentiment. Foreigners and Malaysians were buying, partly in anticipation of a fillip from re-listing of the KL bourse by the Morgan Stanley index initially in February 2000, but later postponed to May 2000. Hence, the impressive stock market recovery in Malaysia since September 1998 can be attributed to several factors:

- The greater depth of the KLCI fall, from a peak of almost 1300 in February 1997 to 262 in early September 1998, has meant a greater propensity for a stock market rebound from the trough (measuring the recovery from the exceptional fall of the index from around 300 in late August 1998—as the Malaysian government has done—further exaggerates the magnitude of the upturn)
- The greater efforts of the Malaysian authorities to revive the Kuala Lumpur stock market, as has been the case since the mid-eighties, is truly exceptional, even by the standards of newly emerging markets
- After announcing a domestic-led economic recovery strategy, efforts to revive the stock market have been justified in terms of their expected 'positive wealth effect', besides reversing the adverse effects of the asset price deflation for the viability of the financial system
- Capital controls have allowed the Malaysian authorities to pursue an expansionist monetary policy with limited adverse effects for the time being. The controls helped them to lower interest rates and to increase money supply (M1) in order to increase liquidity, stimulate production and fuel the KLSE upturn, but cannot go on indefinitely as it is likely to raise domestic inflation and external pressure on the ringgit peg. Shostak (2000: 12) argues that M1 has led the KLSE share price index by about two months on average during the nineties (this matter is elaborated in the chapter on capital controls). Hence, the inevitable tightening of monetary policy would probably reverse the current stock market boom.

- It is suspected that the EPF and other Malaysian government controlled institutions bought about RM2 billion of Malaysian stock through Singapore and Hong Kong based brokers to give the impression of renewed foreign investor interest in the Malaysian market.
- Meanwhile, foreigners locked in until 1 September 1999 have withdrawn their funds from the banks, offering low interest rates, to take advantage of the stock market upturn
- A deliberate pre-polls effort to raise funds through stock market operations for the ruling Barisan Nasional coalition's electoral war chest is widely suspected.
- With political support from the middle and propertied classes desperately needed by the regime with its credibility significantly eroded by the political crisis since mid-1998, efforts to boost the stock market are considered crucial for electoral success.

There is considerable evidence from all over the world, including past Malaysian experience, for what have been called electoral or 'political business cycles', with incumbent governments spending more before polls to ensure electoral support. In May 1999, the First Finance Minister urged government officers to spend government allocations more speedily while the Second Finance Minister announced the suspension of tender procedures, ostensibly to accelerate government spending, but effectively also reducing transparency and facilitating politically-motivated tender awards. It is also necessary to reiterate the obvious, i.e., that stock market behavior is only tenuously linked to economic performance. How else could the authorities explain the Malaysian market's collapse in 1997 while the economy continued to grow by almost eight percent? Conversely, they cannot now convincingly insist that the stock market revival since September 1998 has been solely due to economic recovery.

Prospects

Though economic recovery is underway, its extent and sustainability are debatable. In 1999, the economy recovered from a smaller contraction of 1.3 percent in the first quarter to (year-on-year) expansion of 4.1 percent in the second quarter and 8.1 percent in the third quarter of 1999, from -8.3 percent in the fourth quarter of 1998. Improved external conditions (especially higher demand for electronics) and increased government expenditures accounted considerably for the much smaller contraction in the first quarter of 1999. Without the increase in government expenditure, the growth rate would still be negative. When government expenditure growth slowed down in the second and third quarters of 1999, manufacturing picked up considerably, thanks mainly to the electronics boom.

Easier and cheaper credit terms eventually helped stimulate increased private consumption, which rose by 3.0 percent from mid-1998 to mid-1999. Sales of commercial vehicles grew again from January 1999, after a decline of 76.1 percent in 1998. Passenger car sales climbed from 23,135 in the third quarter of 1998 to 51,087 (fourth quarter 1998), 55,835 (first quarter 1999) and 59,780 (second quarter 1999). Sales tax in March 1999 recorded 3.8 percent growth, the first positive growth in over a year (BNM, *MSB*, Table VI.8). Private investment indicators, however, have not been as promising. Capital formation in Malaysia shrank 31.6 percent, year-on-year, in the first quarter of 1999 and by 49.0 percent in the second quarter of 1999. Among other indicators, loans extended to manufacturing (-7.7 percent annual change from May 1998 to May 1999) as well as applications and approvals of new investments by MITI (-70.1 percent annual decline from May 1998 to May 1999) were

still negative (BNM, *MSB*, Table VI.10). The foreign contribution to manufacturing investment averaged a remarkably high 53.7 percent in the 1990s.

In the second quarter of 1999, the manufacturing sector grew by 10.4 percent from a year before. Export-oriented manufacturing gained some competitive price advantage with the depreciation of the ringgit. Exports of manufactures surged throughout 1998, especially in key sub-sectors such as semiconductors (33.3 percent annual growth in ringgit receipts) and electronics (49.6 percent), which contributed significantly to the total export growth of 32.8 percent (BNM, *Monthly Statistical Bulletin*, Table VIII.5). With imports more expensive, Malaysia gained a hefty RM36.8 billion current surplus in 1998.

Despite the massive ringgit devaluation, there has not been a commensurate export boom for many reasons, including:

- greater uncertainty and reduced confidence in the Malaysian investment environment;
- limited price competitive effect due to other devaluations in the region;
- reduced foreign demand, especially from the East Asian region;
- reduced commodity (especially petroleum and rubber) prices;
- reduced agricultural output in 1997 due to climatic (El Niño drought) and environmental (haze) factors;
- reduced investments in the region due to international economic uncertainties;
- the lag time needed for new investments to begin production.

Export earnings have nonetheless benefited from renewed demand for electronics as well as processed raw materials, mainly palm oil. The Malaysian authorities cannot really claim credit for either of these developments, though its easy credit policy has helped to revive demand for homes as well as cars, which have figured prominently in the economic turnaround since late 1998. Ominously, however, primary commodity prices have been leading the international deflationary trend in recent years, with palm oil prices likely to come under severe pressure from the recent collapse of soy bean and other vegetable oil prices.

In the long term, policies should seek to restore confidence as well as reduce volatility and short-termism. The recession has also revealed the insufficiency of many government social programs. To its credit, the government has continued support for education, health and housing by maintaining budgetary allocations to these purposes despite shrinking tax revenue (Table 70). Federal government counter-cyclical spending has been a positive development for recovery. Deficit spending raises concerns about the future repayment of public debt, and its possible repercussions on Malaysian economy and society (see Table 71). The conventional wisdom of running a surplus in good times and a deficit in lean times would apply, but not without a caveat warning against the risk of future social loss through debt servicing. Overall, the lack of a comprehensive social safety net, and the inadequacy of immediate crisis-response programs, has subjected many individuals and households to hardships that could have been better avoided or alleviated.

Table 70.1 Malaysia: Federal government operating expenditure by sector, 1995-2000 (RM million)

Selected sectors	1995	1996		1997		1998		1999		2000*	
	RM mil.	RM mil.	% change	RM mil.	% change	RM mil.	% change	RM mil.	% change	RM mil.	% change
<i>Security:</i>											
Defence	3,647	4,030	10.5	4,063	0.8	3,528	-13.2	3,602	2.1	3,920	0.1
Internal security	2,357	2,592	10.0	2,544	-1.9	2,369	-6.9	2,406	1.6	2,667	10.8
<i>Social services:</i>											
Education	8,559	10,398	21.5	10,360	-0.4	10,528	1.6	11,251	6.9	11,937	6.1
Health	2,384	3,015	26.5	3,278	8.7	3,331	1.6	3,627	8.9	4,040	11.4
Housing	80	201	151.3	121	-39.8	88	-27.3	87	-1.1	113	29.9
Total	12,141	14,824	22.1	15,051	1.5	15,063	0.1	16,446	9.2	17,774	8.1
<i>Economic services:</i>											
Agric & rural devmt	1,135	1,436	26.5	1,300	-9.5	1,121	-13.8	1,238	10.4	1,243	0.4
Public utilities	53	222	318.9	105	-52.7	397	278.1	193	-51.4	35	-81.9
Trade and industry	624	1,468	135.3	1,277	-13.0	1,279	0.2	2,124	66.1	1,665	-21.6
Transport	996	1,087	9.1	1,378	26.8	1,040	-24.5	1,247	19.9	1,257	0.8
Communications	30	36	20.0	32	-11.1	38	18.8	98	157.9	34	-65.3
Total	2,869	4,285	49.4	4,125	-3.7	4,086	-0.9	4,931	20.7	4,266	-13.5
Total	21,014	25,731	22.4	25,783	0.2	25,046	-2.9	27,385	9.3	28,627	4.5

Notes: Annual growth rates in parentheses; * Federal Budget allocation.

Source: *Economic Report*, various issues, Table 4.5.

Table 70.2 Malaysia: Federal government development expenditure by sector, 1995-1999 (RM million)

	1995	1996		1997		1998		1999	
		RM mil.	% change	RM mil.	% change	RM mil.	% change	RM mil.	% change
<i>Defence and Security</i>	2,888	2,438	-15.6	2,314	-5.1	1,380	-40.4	3,122	126.2
<i>Social services:</i>									
Education	2,044	2,091	2.3	2,521	20.6	2,915	15.6	3,865	32.6
Health	388	459	18.3	449	-2.2	716	59.5	835	16.6
Housing	403	501	24.3	735	46.7	1,030	40.1	1,081	5.0
Social and community services	678	933	37.6	1,214	30.1	1,122	-7.6	1,155	2.9
Total	3,513	3,984	13.4	4,919	23.5	5,783	17.6	6,936	19.9
<i>Economic services:</i>									
Agricultural & rural development	1,360	1,182	-13.1	1,105	-6.5	960	-13.1	1,089	13.4
Public utilities	654	733	12.1	1,496	104.1	1,968	31.6	1,850	-6.0
Trade and industry	1,218	1,212	-0.5	1,285	6.0	3,227	151.1	2,798	-13.3
Transport	3,151	4,530	43.8	3,578	-21.0	3,062	-14.4	2,893	-5.5
Total	6,440	7,693	19.5	7,501	-2.5	9,243	23.2	8,970	-3.0
Total	12,841	14,115	9.9	14,734	4.4	16,406	11.3	19,028	16.0

Note: Annual growth rates in parentheses.

Source: BNM Monthly Statistical Bulletin, Table VII.4.

Table 71 Malaysia: Federal government revenue and expenditure, 1993-2000 (RM million; percentage annual changes in parentheses)

	1993	1994	1995	1996	1997	1998	1999	2000*
Revenue	41,691 (6.2)	49,446 (18.6)	50,954 (13.0)	58,280 (14.4)	65,736 (12.8)	56,710 (-13.7)	56,690 (-0.04)	59,897 (5.7)
Operating expenditure	32,217 (0.4)	35,064 (8.9)	36,573 (4.3)	43,865 (19.9)	44,665 (1.8)	44,585 (-0.2)	48,927 (9.7)	52,351 (7.0)
<i>Development expenditure and lending:</i>								
Development fund	10,124 (4.5)	11,277 (11.4)	14,051 (24.6)	14,628 (4.1)	15,750 (7.7)	18,103 (14.9)	25,009 (38.1)	23,674 (-5.3)
Direct expenditure	8,992 (4.1)	9,950 (10.7)	12,458 (11.9)	11,970 (-3.9)	13,670 (14.2)	15,787 (15.5)	24,005 (52.0)	22,328 (-7.0)
Loan recoveries	1,004	1,303	1,531	2,028	1,305	975	1,000	1,000
Net lending	128	24	62	630	775	1,341	4	346
Total expenditure	41,337 (2.1)	45,038 (9.0)	49,099 (9.0)	56,465 (15.0)	59,110 (4.7)	61,713 (4.4)	72,936 (18.2)	75,025 (2.9)
Overall deficit/surplus	354	4,408	1,861	1,815	6,626	-5,003	-13,745	-12,969
% of GNP	0.2	2.5	0.9	0.8	2.5	-1.8	-4.9	-4.4
<i>Sources of finance:</i>								
Net external borrowing	-3,134	-4,757	-1,635	-2,177	-1,681	1,784	3,160	801
Net domestic borrowing	375	1,751	-	1,291	-2,048	11,040	16,819	13,168
Change in assets	2,405	-1,402	-225	-929	-2,897	-7,821	-6,234	-1,000

Notes: * Federal Budget allocations.

Sources: *Economic Report, 1998/1999*, Table 4.2. p. xxxv; *Economic Report, 1999/2000*, Table 4.2, p. xxx.

SOCIAL IMPACTS

Income

The above outline of macroeconomic and financial aspects of the recession lays the foundation for more specific discussion on the transmission and impact of the crisis and contraction to individuals and households in society. The Asian Development Bank has suggested four channels through which the financial and economic crisis has produced adverse social impacts:

- (1) decreased employment, earnings and incomes;
- (2) inflation of consumption items;
- (3) reduced government transfers and weakened crisis-alleviating programs; and
- (4) decline in demand for migrant labor (Haflah *et al.* 1999: 6).

While this list is limited, it provides a starting point for our discussion.

Employment and Wages

With full employment by the mid-1990s, real income gains increased in Malaysia before 1998. The recession, therefore, came as a shock to an economy that had grown accustomed to plentiful job opportunities and labor shortages. The number of net additional contributors to the Employees Provident Fund (EPF)—an indicator of employment creation/contraction—dropped by 17.5 percent from January-September 1997 to January-September 1998. While the most devastating impact of the recession was on those who lost their jobs, the recession also impacted on others who did not lose their jobs. Wages form a significant proportion of total household incomes. For many households, especially those with low and medium incomes, wages are the principal incomes. In a recession, reductions in economic activity—and consequently, in demand for labor—push wages down. Malaysian labor unions have limited membership and influence, often failing to safeguard workers' wages. While the welfare of the low-income groups may not receive much media coverage or policy attention, their plight is nonetheless real. Most have experienced reduced real incomes because of reduced overtime work opportunities (on which many workers depend for their supplementary incomes), lower nominal wage rates and price inflation, exacerbated by currency depreciation (Ishak *et al.* 1999: 42).

The impact of the economic recession on private sector wages may be inferred from production and employment data. Juxtaposing Tables 64 and 65 with Table 73, one finds employment growth related to GDP growth. In the pre-crisis boom years, Malaysian workers enjoyed an environment of burgeoning employment. Table 73 shows how high rates of employment generation—of just under five percent per annum—were sustained from 1995 to 1997. Yet, these rates remained lower than the corresponding economic activity growth rates, suggesting GDP per worker or productivity growth (Table 66). Employment in manufacturing, construction and non-government services grew most in the latter half of the 1990s. The impact of the crisis in reducing employment, therefore, came as a shock to an economy accustomed, over many years, to sustained employment growth. Employment in construction fell most sharply in 1998, with manufacturing, agriculture, as well as financial and business services also hard hit; manufacturing continued to experience severe job losses in 1999 as well. Meanwhile, employment in agriculture, forestry, livestock and fishing is estimated to have fallen from 1.49 million in 1997 to 1.43 million in 1998. The 1999 employment figures suggest some generation of new jobs as well as abatement of job losses, with a net increase in employment, reflecting the end of the recession and the onset of recovery.

Table 72 Malaysia: Federal government revenue (selected components), 1995-2000
(RM million; percentage annual changes in parentheses)

	1995	1996	1997	1998	1999	2000*
<i>Direct taxes:</i>	22,699 (+44.5)	25,851 (+13.9)	30,432 (+17.7)	30,016 (-1.4)	26,910 (-10.3)	29,096 (+8.1)
Income**	20,095 (+15.9)	22,541 (+12.2)	26,978 (+19.7)	28,240 (+4.7)	25,137 (-11.0)	27,101 (+7.6)
<i>Indirect taxes:</i>	18,972 (+9.5)	21,421 (+12.9)	23,195 (+8.3)	15,320 (-33.9)	17,481 (+14.1)	18,483 (+5.7)
Export duties	853 (-26.3)	1,041 (+22.0)	1,053 (+1.2)	623 (-40.8)	598 (-4.0)	623 (+4.2)
Import duties	5,622 (+0.1)	6,132 (+9.1)	6,524 (+6.4)	3,868 (-40.7)	4,578 (+18.4)	4,653 (+1.6)
Excise	5,280 (+22.9)	5,790 (+9.7)	6,054 (+4.6)	3,586 (-40.8)	4,500 (+25.5)	4,754 (+5.6)
Sales tax	4,869 (+17.9)	5,473 (+12.4)	6,167 (+12.7)	3,845 (-37.7)	4,285 (+11.4)	4,622 (+7.9)

Notes: * Federal Budget allocations.

** Including corporate, individual and petroleum.

Sources: *Economic Report, 1998/1999*, Table 4.3, pp. xxxvi-xxxvii; *Economic Report, 1999/2000*, Table 4.3, p. xxxi.

Table 73 Malaysia: employment by sector, 1996-1999 (thousands; % in parentheses)

Sector	Jobs created						
	1996	1997	1998	1999	1997	1998	1999
	('000)						
Agriculture, Forestry,	1,492	1,468	1,401	1,399	-23	-67	-2
Livestock & Fishing	(17.5)	(16.5)	(16.2)	(15.9)			
Mining & Quarrying	41	42	42	42	1	0	0
	(0.5)	(0.5)	(0.5)	(0.5)			
Manufacturing	2,230	2,375	2,277	2,368	144	-97	91
	(26.4)	(26.9)	(26.4)	(27.0)			
Construction	796	876	810	804	80	-66	-6
	(9.4)	(9.9)	(9.4)	(9.2)			
Transport, Storage &	410	434	435	442	24	2	7
Communications	(4.8)	(4.9)	(5.0)	(5.0)			
Finance, Insurance, Real	392	429	418	420	37	-11	3
Estate & Business Services	(4.6)	(4.8)	(4.8)	(4.8)			
Government Services ^a	871	873	875	877	2	2	2
	(10.3)	(9.8)	(10.1)	(10.0)			
Other Services ^b	2,195	2,321	2,339	2,389	127	18	50
	(25.8)	(26.1)	(27.0)	(27.1)			
Total	8,465	8,891	8,669	8,813	426	-221	144

Notes: Figures in parentheses denote percentage share of total.

^a Includes public administration, health, education and defence.

^b Includes electricity, gas and water, wholesale and retail trade, hotel and restaurants and other services.

Source: *Economic Report 1999/2000*, Table 6.1.

As noted above, changes in EPF contributions broadly reflect formal sector employment. Comparing the first eight months of 1997 with 1998, the number of net additional contributors to the EPF declined from 186,805 to 154,029, i.e., by 17.5 percent. The number of defaulters probably reflects the economic resilience of employers. During the first half of 1998, 15,561, or 5.4 percent of total registered employers defaulted on EPF contributions. In contrast, for the whole of 1997, 13,143, or 4.4 percent of total registered employers defaulted (Ishak *et al.* 1999, Table 3, p. 20). The total amount contributed to the EPF increased slightly from RM14.6 billion in 1997 to RM14.8 billion in 1998, i.e., at an annual growth rate of 1.05 percent, much lower than the growth rate of 13.30 percent between 1996 and 1997. Meanwhile, the amounts withdrawn from the EPF increased from RM3.6 billion (1996) to RM5.7 billion (1997) and RM8.4 billion (1998), i.e., at annual growth rates of 56.1 percent and 47.6 percent. Prior to 1996, EPF withdrawals grew by 15.1 percent annually on average (BNM, Table IV.1). Meanwhile, the excess of contributions over withdrawals decreased from RM9.3 billion in 1996 to RM8.9 billion in 1997 and RM6.4 billion in 1998, reversing the previously steady growth dating back to 1987. Since the mid-eighties, there have been growing fears that EPF investments in the stock market have been used to support certain politically well-connected share counters or to serve public policy objectives other than the contributors' interest in maximizing returns to their savings. Such fears gained greater currency in the aftermath of the crisis, especially after the government announced its intention in September 1997 to support certain investors to save them from financial distress.

The relationship between production and employment decreases are not clear, consistent or straightforward (see Tables 64 and 73), though output decreases give some idea of how wages have been affected by the downturn. In manufacturing and construction, the drops in output considerably exceeded the declines in employment. In contrast, the drop in agricultural employment (–5.4 percent) exceeded output decline (–4.0 percent). More detailed data on wage trends suggest varying impacts of the recession on different sub-sectors owing to different conditions. According to the Ministry of Human Resources' *Labour Market Report*, employment in certain non-manufacturing sub-sectors rose in 1998: coconut (4.5 percent), oil palm (4.8 percent), insurance, real estate and business services (4.2 percent), retail (3.6 percent) and wholesale trade (0.8 percent). Within the manufacturing sector, the following sub-sectors recorded employment growth: crude oil refining (10.9 percent), industrial chemicals (4.3 percent), wood and cork products except furniture (3.3 percent), textiles (1.5 percent) and rubber products (0.3 percent).

According to the *Economic Report, 1998/1999*, the average nominal wage per worker increased by 6.4 percent in the first seven months of 1998, compared with an increase of 11.1 percent for the corresponding period in 1997. Wage increases in negotiated agreements averaged around 10 percent during the first seven months of 1998—compared with 13.1 percent in 1997. In the manufacturing sector, where 53 percent of agreements were concluded, average wages grew at a slower rate of 8.4 percent in 1998—as against 15.0 percent in 1997. Overall wage growth in manufacturing slowed down markedly in 1998 to 0.3 percent, from 8.4 percent in 1996 and 7.3 percent in 1997 (BNM, *Annual Report 1998*: Appendix Table 1.1). Surveys found that workers on oil palm estates fared better in 1998, due to higher palm oil prices (see Ishak 1999: Chapter 2).

Labor union members comprise a small proportion of all wage earners and have limited influence in Malaysia. Nonetheless, collective agreements are signed every year, which, to an extent, reflect prevailing trends in the formal labor market and the relative bargaining power of management versus labor. Wage increases in collective agreements in most sectors were smaller in 1998 than in 1997. In manufacturing, where most collective agreements were signed (146 out of 284 in 1998), negotiated increases averaged 8.0 percent in 1998, compared to 15.0 percent in 1997. The increases were also smaller, notably in transportation (6.1 percent in 1998 compared to 10.0 percent in 1997) and services (10.1 percent in 1998, 14.1 percent in 1997). But collective wage agreements in some other sectors involved higher increases, e.g., wholesale and retail trade (13.8 percent in 1998, 11.8 percent in 1997) and mining (10.6 percent in 1998, 7.7 percent in 1997) (see Table 74). The 1998 collective agreements generally reflect lower wage increases and reduced bargaining clout of workers during recessionary times. Importantly, no collective agreements were signed between construction workers and employers between 1994 and 1998, suggesting the low level of unionization in the sector, now dominated by foreign, often undocumented contract workers. In the first half of 1999, another 113 collective agreements were signed, but no details were made available this time (*Economic Report, 1999/2000*).

Worker-management relations remained stable during 1997 and 1998. In 1997, five strikes, involving 812 workers, were recorded, resulting in a loss of 2,396 workdays. In 1998, the number of strikes and workers involved increased to 12 and 1,777 respectively, though the number of workdays lost only rose slightly to 2,635. Only 14 pickets were recorded in 1998, down from 34 in 1997. Industrial disputes were also slightly less numerous in 1998 than in 1997, but involved far fewer workers. Disputes in 1997 totaled 463, involving 139,187 workers, while 448 in 1998 involved 85,053 workers.

Table 74 Malaysia: number of collective agreements signed by sector, 1994-1998

	1994	1995	1996	1997	1998
Total	348 (112.8)	257 (79.3)	398 (113.3)	412 (130.0)	284 (142.5)
Agriculture, forestry and fishing	15 (1.5)	8 (0.1)	32 (1.3)	18 (36.0)	11 (6.7)
Mining and quarrying	0 (0)	0 (0)	6 (1.3)	7 (0.4)	4 (0.2)
Manufacturing	199 (54.9)	196 (53.5)	210 (47.7)	241 (63.4)	146 (37.3)
Construction	— (—)	— (—)	1 (0.1)	— (—)	— (—)
Finance, insurance, real estate and business services	44 (6.7)	53 (10.1)	42 (4.9)	106 (18.8)	75 (54.7)
Transport and communications	31 (3.6)	31 (3.1)	55 (9.9)	31 (0.7)	37 (42.4)
Government services	—	—	—	—	—
Other services	40 (10.0)	52 (44.5)	53 (36.5)	32 (6.5)	7 (0.1)

Note: Figures in parentheses indicate thousands of workers involved.

Sources: *Economic Report, 1998/1999*, Table 6.1, pp. lx-lxi, *BNM Annual Report, 1998*, Table A.29, p. 284.

Wages in the public sector were initially reduced or frozen, as part of the early government response to the crisis. Ministers' salaries were cut by 10 percent, senior civil servants' by 5 percent, while a freeze was imposed on salary increments for those in the higher ranks of the civil service. Public Service Department data, updated in April 1999, show the majority of government employees in the second lowest rung on the salary scale, with 44.5 percent receiving RM500-1,000 monthly; 29.6 percent receiving RM1,001-1,500, while 12.4 percent were paid RM1,501-2,000. As the majority of civil servants receive relatively low remuneration, a significant fraction encountered difficulties making ends meet with the inflation of 1998. However, lower wages, exacerbated by higher inflation, was compensated for by the financial and psychological security of public sector employment. Public sector employment was generally protected from the recession. Government employees later gained from the government's counter-cyclical spending increases from mid-1998 as well as the government desire for political support in the wake of the economic and political crises, before the November 1999 general elections and the May 2000 ruling party elections.

Unemployment and retrenchment

According to official estimates, unemployment in Malaysia rose, but did not increase as much as in Thailand, South Korea or Indonesia. The official unemployment rate for 1998 was 3.2 percent, compared to 2.6 percent for 1997 and 2.5 percent for 1996. These percentages correspond to the estimated increase in unemployed persons, rising from 233,100 in 1997 to 443,200 in 1998. This rise in unemployment was surprisingly small, considering the scale of the economic recession, possibly because undocumented workers dominated the most hard-hit sector, construction. The docile labor force generally had no choice but to accept retrenchment, pay cuts and reduced working hours. Pre-crisis full employment and limited government registration of the unemployed are among other main reasons why the official unemployment rate in 1998 was not as high as expected.

Table 75 Malaysia: labor force participation and unemployment rates, 1991-1999

Year	Labor Force Participation Rate			Unemployment Rate
	Total	Male	Female	
1991	66.6	85.7	47.5	4.6
1992	66.7	85.7	47.6	3.7
1993	66.8	87.0	46.1	3.0
1994	66.8	87.1	46.5	2.9
1995	64.5	83.8	44.3	3.1
1996	65.8	84.8	45.8	2.5
1997	67.0	85.7	47.4	2.4
1998	64.3	83.4	44.2	3.2
1999*	64.3	83.4	44.2	3.0

Note: * estimate.

Source: *Economic Report*, various issues, Table 6.1.

However, when other factors are taken into account, it appears that the low official unemployment figure may be misleading. First, the official definition of employment in Malaysia—i.e., working at least one hour per week—understates the extent of under-employment. Many people are merely under-employed, and not unemployed by this definition of employment. Thus, the extent to which official unemployment figures reflects workers' conditions is questionable. Still, changes in the official unemployment rate roughly reflect actual economic conditions. The reduction of the annual official unemployment rate to 3.0 percent in 1999 (from 3.2 percent in 1998) was slight, but recovery is better reflected by monthly unemployment rates, which fell from 4.5 percent in March, to 3.3 percent in June and to 2.9 percent in September. Second, the majority of workers in the construction sector, which was the most devastated by the crisis, were foreigners; approximately 80 percent of construction workers were believed to be foreign immigrants (see Wong 1999). The Home Ministry estimates 207,946 illegal foreign workers returned to their home countries between January and August 1998, though there is evidence of considerable re-entry. According to the authorities, 48.1 percent returned voluntarily, 27.9 percent were deported and 24.0 percent were "repatriated under the government's amnesty program, which allowed them to leave without being penalized" (Ishak *et al.* 1999: 32). These numbers are sizeable, but may not even represent a tenth of the foreign labor presence in Malaysia. The total number of foreign workers in Malaysia at the outbreak of the crisis has been estimated to be well over two million. Since their presence in the country is often neither documented nor legal, many have probably lost their jobs without official acknowledgement.

The pattern of retrenchments suggests that many job losses in the construction sector may have escaped official notice. According to the Ministry of Human Resources' *Labour Market Report*, in 1998, construction accounted for only 11.1 percent of total retrenchments, far less than the collapse in construction activity would suggest. Manufacturing accounted for the most number of retrenchments, or 54.0 percent of the total, followed by retail and wholesale trade, as well as restaurant and hotel activities (12.4 percent). Finance, property, insurance and business services, as well as agriculture, forestry and fishing were next, accounting for 7.8 percent and 6.1 percent respectively. A total of 83,865 retrenchments were officially recorded in Malaysia in 1998, a remarkable 345 percent rise from 18,863 in 1997 and 7,773 in 1996. However, these figures should be taken with circumspection, since reporting retrenchments only became mandatory from 1 February 1998. In addition, reporting

employers tend to be more law-abiding and responsible, i.e., more inclined to be concerned with employee welfare. These statistics obviously do not include unreported cases of retrenchment, let alone other job losses (e.g., of contract labor) or harsh treatment of employees. Employees have reported (to the MTUC and the Ministry of Human Resources) intimidation and coercion to accept lower wages and heavier work schedules (Ishak *et al.* 1999: 22). The situation has probably improved, since such strong-arm tactics appear to have coincided with the worse stages of the recession, and there is little evidence of prolonged opportunistic behavior by employers after labor market conditions improved. With general economic recovery, total retrenchments in 1999 also decreased to 37, 526 (*Labour Market Report 1999*).

The Employment Act, 1955, stipulates that employers are obliged to compensate employees at between 1.25 to 1.75 of the last drawn monthly pay for each year of service to give retrenched workers some respite while searching for new jobs. Compliance with these regulations has not been commendable. On October 5, 1998, the Human Resources Minister announced that RM56.7 million due as compensation to 43,889 workers retrenched during the first seven months of 1998 had not been paid by their 2,094 employers. In other words, about 23 percent of the legally prescribed compensation was still due to the workers (Ishak *et al.* 1999: 20). Retrenchment was not always the most preferred means of adapting to adverse labor market conditions; for example, if the employer anticipated that eminent economic recovery would necessitate reemployment. It is usually also not the desirable option from the perspective of worker welfare. Other options for employers to cut labor costs include pay cuts, voluntary lay-offs and voluntary separation schemes. From 1 August 1998, pay-cuts, voluntary lay-offs and voluntary separation also became subject to mandatory reporting. The government amended the Employment Act 1955 and introduced guidelines on alternatives to retrenchment such as pay cuts and work hour reductions. Employers were also encouraged to encourage and provide for part-time employment and flexible working hours, and to raise wages in line with productivity. From August to December 1998, pay cuts (67.2 percent) exceeded voluntary separation schemes (28.4 percent) and voluntary lay-offs (4.4 percent). As to reasons for retrenchment, 59.9 percent of employers cited reduction in demand for their products or services, while 11 percent cited high production costs, 8.1 percent company reorganization, 6.4 percent closure and 2.4 percent sale of the companies (MHR 1999).

While job losses and retrenchments both rose sharply in 1998, 74,610 unfilled vacancies were reported in 1998, compared to 64,463 at the end of 1997 (MHR 1999). A high proportion of the unfilled vacancies was in the plantation sector. The two main explanations for this anomaly were the skill mismatches of unemployed workers with the job vacancies and worker unwillingness to take available jobs—especially on plantations—because of low pay, poor working or living conditions, and other reasons (see Haflah *et al.* 1999: 38). In 1999, 108,318 vacancies were reported, signifying some improvement in economic conditions (*Labor Market Report 1999*).

Households experiencing declining wage incomes would presumably reduce savings or even draw on their savings. But Malaysia's savings rate, which has been among the highest in the world, did not decline much in 1998, remaining above 40 percent. Access to and availability of savings varies among households, especially among those with different income levels. Accordingly, for example, middle- and high-income strata households may have more savings to draw upon. In contrast, lower income households tend to have little left over from consumption to channel into savings. The increase in inflation probably adversely affected savings. Those with fixed incomes, including pensioners, had lower real incomes in the face of higher living costs.

Due to the economic slowdown, the job market for graduates became more competitive. The number of registered job-seekers holding degrees or diplomas increased from 5,634 in 1997 to 12,938 in 1998 (by 129.6 percent), and to 15,396 in 1999 (by 19.0 percent) (*Labor Market Report 1999*). The number of registered unemployed graduates was 4,592 in September 1998, much more than the 2,150 in September 1997 (Ishak *et al.* 1999: 19). Table 76 shows that the number of officially registered unemployed in the 20-24 age category increased more relative to other age groups, i.e., from 44.8 percent of total registered unemployed in 1997 to 48.7 percent at the end of July 1998. One factor should be noted in interpreting this observation. Mid-1998 also saw two cohorts of Malaysian university graduates come on the job market because of an earlier reduction of non-medical university education from four to three years. This untimely adjustment doubled the number of fresh graduate job applicants from these universities.

Women

Table 75 shows labor force participation rates for women did not decrease significantly in 1998. Retrenchment figures, however, reveal some discrepancy in the impact of the recession on men and women (also see Table 76). Women comprise about two-fifths of the labor force, but comprised 42.3 percent of retrenched workers in 1998. The majority (64.5 percent, or 23,387) of retrenched women were from the manufacturing sector, where weaker unionization among women and other factors made them more vulnerable to coercion and exploitation. Female-headed households, of which there are an estimated 630,500 in Malaysia, or 16.6 percent of all households, also warrant special concern (Ishak *et al.* 1999: 47). These women—who typically perform most, if not all household chores in addition to earning incomes for themselves and their families—tend to have little in terms of support facilities or networks to fall back on.

Human resource development

Malaysia's human resources have been widely credited as a major contributor to economic development. A healthy and educated labor force is a prerequisite for rapid and successful assimilation of new technologies, and for increasing productivity and efficiency. In this respect, the impact of the recession on human resources may be more long term, due to the cumulative effects of poorer provision of and access to quality education and less employee training. The Human Resources Development Fund (HRDF), established by the Ministry of Human Resources, is meant to help retrain retrenched workers, among other things. Only 572 workers benefited from this fund in 1998, and another 426 in 1999. On 12 February 1999, the government announced exemptions from payment of the Human Resources Development Fund levy for employers facing financial difficulties (MHR 1999). The government claims that RM40 million has been allocated to firms that have contributed substantially in the past to the HRDF to defray training costs (*White Paper*: 47).

Economic welfare

Available evidence suggests that the most groups badly affected by the economic recession were mainly in urban areas. The worst hit sectors, construction and manufacturing, are both mainly concentrated in urban areas, as are the highly leveraged or indebted middle- and upper-income businesses and households affected by the financial crisis.

Table 76 Malaysia: registered unemployed by age and gender, 1994-1999

End of period	Total Job-seekers	15-19 years		20-24 years		25-29 years		Male		Female	
		No.	%	No.	%	No.	%	No.	%	No.	%
1994	26,445	7,557	28.6	11,315	42.8	3,998	15.1	15,095	57.1	11,350	42.9
1995	25,546	7,800	30.5	10,967	42.9	3,576	14.0	13,935	54.5	11,611	45.5
1996	21,747	6,640	30.5	9,336	42.9	3,044	14.0	11,863	54.6	9,884	45.4
1997	23,762	5,904	24.8	11,251	47.3	3,371	14.2	12,680	53.4	11,082	46.6
1998	33,345	7,778	23.3	15,334	46.0	5,209	15.6	18,832	56.5	14,513	43.5
1999*	37,315	10,586	28.4	16,412	44.0	5,294	14.2	19,948	53.5	17,367	46.5

Note: * End of July.

Source: *Economic Report, 1998/1999*, Table 6.2, pp. lxii-lxiii; *Economic Report, 1999/2000*, Table 6.2, pp. lli-liii.

Consumption

Private consumption fell drastically as the financial crisis and recession deepened. Household consumption declined, as lower incomes reduced consumption besides encouraging some substitution in consumption. Lower incomes caused consumers to buy less, reflected, for example, in the massive drops in passenger car sales in 1998 (–54.8 percent), sales tax (–37.8 percent) and consumption credit extended by the banking system (–14.6 percent) compared to the previous year. The relative prices of goods and services also affected consumption. In the Malaysian Institute of Economic Research *Quarterly Report on Consumer Sentiments* (for the fourth quarter of 1998), an increasing number of respondents indicated a preference for deferring consumption of durable and semi-durable goods to cope with their new financial constraints (Haflah *et al.* 1999: 31).

The substitution effect due to decreased incomes is also of concern, particularly when it adversely affects the nutrition of families, especially children. Poor households typically spend larger proportions on food and ‘basic needs’, and are more vulnerable to nutritional decline or illness. Poor parents may also take their children out of schools to save on out-of-pocket expenses, or to supplement family incomes with income from child labor. The uncertainty induced by the financial crisis, and subsequent spending and savings behavior, point to the critical role of sentiments and confidence in conditioning the decision-making of individuals and households.

Cost of living

Households have had to bear with cost of living increases. Table 77 shows the consumer price index (CPI) for Malaysia. Inflation rates rose markedly to 5.3 percent in 1998 from 2.7 percent in 1997. The price of food increased by more than any other category of consumer expenditure. Accounting for 34.9 percent of the CPI, it is the main determinant of the CPI level. However, other items also became more expensive. Medical care and health expenses increased by 6.2 percent in 1998, up from 3.6 percent in 1997. Health care costs have tended to rise relatively more than the CPI since 1996. Gross rent, fuel and power expenditures also increased significantly, rising by 4.4 percent in 1998. These also account for major portions of consumer budgets.

Table 77 Malaysia: consumer price index (1994 = 100), 1993-1999 (percentage annual change)

	1993	1994	1995	1996	1997	1998	1999
<i>Total</i>	3.6	3.7	3.4	3.5	2.7	5.3	2.8
<i>Components:</i>							
Food	2.2	5.3	4.9	5.7	4.1	8.9	4.6
Beverages and tobacco	14.8	5.0	2.3	2.2	1.3	4.3	7.9
Clothing and foot-ware	0.5	-0.7	0.0	-0.7	-0.5	0.4	-2.0
Gross rent, fuel and power	3.5	2.4	3.4	3.2	3.2	4.4	1.6
Furniture and household equipment	1.3	1.4	2.8	1.1	0.1	3.9	1.3
Medical care and health expenses	5.1	3.3	3.1	3.7	3.6	6.2	3.1
Transport and communication	5.6	4.6	1.8	1.4	0.6	-0.1	0.5
Recreation, entertainment, education and cultural services	0.5	0.7	2.5	3.3	0.4	3.3	2.6
Miscellaneous goods and services	0.5	0.7	2.5	3.3	4.6	7.1	1.5

Sources: *Economic Report*, various issues; *BNM Annual Report 1999*, Table A.28, p. P35, Department of Statistics, *Monthly Consumer Price Index*.

How price inflation has impacted on household consumption at different income levels has not been assessed empirically in Malaysia. However, household expenditure surveys seem to concur with Engel's Law, which postulates that households with lower incomes allocate proportionally more of their household budgets to food than to other consumption items. A nationwide survey found that rural households earning less than RM300 per month spent up to 45 percent of their incomes on food. In urban areas, households earning less than RM200 spent 38.6 percent on food, while households earning RM200-299 spent an average of only 29.7 percent (Shireen 1998: 159).

Table 78 shows the inflation rates for various food items. The total inflation rate did not change significantly from March 1997 to March 1998. However, certain food items witnessed considerable price increases, e.g., sugar (14.1 percent annual increase up to March 1998) and fruits and vegetables (13.0 percent over the same period). Price hikes for food items have, in some instances, been associated with price controls, e.g., in February 1998 (Haflah *et al.* 1999: 12). The severity of food price inflation seems to have been associated with the collapse of the ringgit and the high import content of food consumed. Macroeconomic data indicate the recession was at its worse in late 1998, while the inflation rate for food was highest in September 1998 (8.9 percent). In that month, all components of the food CPI witnessed large increases. Another worrying characteristic of the food price inflation has been the rise in the cost of home-cooked food.

Table 78 Malaysia: consumer price index for food items, 1997-1999 (% annual change)

Food Items:	March 1997	Sept. 1997	March 1998	Sept. 1998	May 1999
Sugar	0.4	0.3	14.1	18.9	n.a.
Fruits and vegetables	1.9	2.1	13.0	14.2	5.6
Coffee and tea	0.1	0.7	5.5	9.6	6.4
Fish	7.0	7.1	7.6	9.3	10.5
Meat	11.7	3.7	5.7	8.5	n.a.
Rice, bread & other cereals	7.3	4.1	n.a.	6.4	7.4
Oils and fats	2.7	-1.6	5.1	5.6	n.a.
Food at home	5.6	3.6	n.a.	9.1	6.3
Food away from home	7.0	5.6	n.a.	8.3	4.5
<i>Total</i>	<i>6.0</i>	<i>4.3</i>	<i>6.6</i>	<i>8.9</i>	<i>5.8</i>

Note: n.a.—not available.

Source: Department of Statistics, *Monthly Consumer Price Index*, various months, p. 3.

Savings and financial security

Malaysia's gross national savings during 1993-97 averaged 36.5 percent, and was on the increase from 1995 to 1997, rising steadily from 35.3 percent to 39.4 percent. Despite the recession, gross national savings amounted to 41.2 percent of GNP in 1998, indicating a continuing increase in the savings rate despite the drop in income. Meanwhile, the expected growth in EPF contributions decreased in the aftermath of the financial crisis that will also have adverse consequences for future retirees withdrawing their EPF savings.

Debt burden

Interest rates initially rose in Malaysia after the crisis began to stem capital flight, and to thus protect the ringgit from depreciation. This adversely affected those with debt to service. Households and businesses faced difficulties paying higher interest on their loans as incomes declined. In particular, non-performing loans for the purchase of houses, transport vehicles, credit card and consumer goods increased markedly in 1998. According to a BNM survey, from the onset of the crisis to October 1998, 7,393 cars—worth RM258.5 million—were repossessed (Ishak *et al.* 1999: 23). Tables 61 and 62 reflect this trend of growing unserviced loans. For commercial banks, non-performing loans increased from RM1,119 million in September 1997 to RM3,058 million (by 173 percent) in September 1998 for the purchase of residential property, from RM805 million to RM2,492 million (by 210 percent) for consumption credit, and from RM436 million to RM8,273 million (by 1797 percent) for the purchase of securities. For finance companies, NPLs for the purchase of transport vehicles swelled from RM1,164 million in September 1997 to RM5,101 million in September 1998 (by 338 percent). A considerable number of highly leveraged households and individuals have come under great pressure to service their debts, and may have had their homes or cars repossessed.

The increase in interest rates, however, should not be overstated. Base lending rates (BLR) for banks, for instance, never rose more than three percent, and certainly by much less than neighboring Thailand (see Figure 21 and Table 68). The commercial banks average BLR increased from 9.61 percent at the end of September 1997 to 12.21 percent at the end of May 1998. The finance companies' average BLR increased relatively more, but still by less than four percentage points, rising from 11.22 percent at the end of September 1997 to 14.70 percent at the end of June 1998. Obviously, highly leveraged businesses and households are more vulnerable to shocks to the financial system. The decrease in interest rates since September 1998 has reduced the weight of such debt, though rates in Malaysia became higher than Thai rates.

Health and education

Social expenditures on health and education arguably contribute significantly to economic development. Some aspects of health care have been severely affected by the crisis. There has been an increase of 30 percent in the prices of imported drugs, which comprise 60 percent of pharmaceutical drugs used in the country. As the prices of medicines increased rapidly, household welfare, especially for the low income social segments, have been adversely affected. An estimated 75 percent of hospital equipment is imported; hence, in the long term, one can expect a lagged adverse impact on health care due to the ringgit depreciation and development spending cutbacks in purchasing or upgrading medical equipment (Abu Bakar 1998: 7). Private hospitals and clinics reported drops of between 15 to 50 percent in the number of patients seeking treatment. At the same time, the Ministry of Health reported a 10-18 percent increase in patient load of (Haflah *et al.* 1999: 19). The decline in allocations for public health—despite rising federal health expenditure—and increased health service charges has reduced access of low-income households to affordable healthcare. Many of those previously able to pay for private medical treatment have turned to public services. As a result, various government health services have become overloaded and overcrowded. The relative scarcity of doctors in government hospitals and clinics—4,719 compared to 6,051 in private practice—aggravates the pronounced shortage due to under-provision and over-subscription (Haflah *et al.* 1999: 6).

Primary school enrolment appears to have been fairly unaffected by the downturn. According to Ministry of Education data, the number of under-enrolled primary schools (i.e., with less than 150 pupils) declined from 1,538 in January 1997 to 1,511 in January 1998 and 1,407 in January 1999; i.e., at the beginning of each school year. The states of Sabah and Pahang accounted for most of these under-enrolled schools; Sabah's total fell from 378 to 320, and Pahang's from 99 to 71. Secondary school enrolment at the start of the 1998 and 1999 school years did not undergo significant declines either. Unfortunately, data on drop-out rates are not publicly available. The impacts of economic recession on the quality of education are also difficult to identify and assess. Presumably, some families have had to withdraw their children from school, while undernourished children do not learn as much or as well.

The impact of recession on education may not be reflected in enrolment rates. For example, a major financial burden to low-income families, who tend to have larger families, is the cost of buying textbooks. In December 1998, the government announced that it would pay RM400 to civil servants, in lieu of a bonus, and as financial assistance for the purchase of school textbooks. In addition, the eligibility ceiling for the government's book loan scheme was raised from RM1,000 to RM1,001-1,500, so that more families would be entitled to this benefit. These concessions were made after much pressure from low-income parents, who asserted that rising costs and constant or dwindling financial resources made it more difficult for them to support schooling expenses. The RM1,000 ceiling applies to all national primary and secondary schools, while the new relaxed ceiling only applies to national primary and public religious secondary schools. National-type (Chinese and Tamil language) schools have been excluded from this scheme (Ishak *et al.* 1999: 30-31).

Tertiary level education has probably been worse affected. The sudden increase in foreign education costs, due to the collapse of the ringgit, has compelled many students to seek alternatives locally. Malaysia has long had a very high proportion of tertiary students studying abroad, especially in the UK, Australia, US, Canada, India and Taiwan. For Malaysian public universities' 1998 intake, 112,000 candidates vied for 40,220 places, i.e., only 35.9 percent of applicants managed to enroll. Universities have increased enrolment to accommodate the increased demand, but without significantly increasing teaching staff and other university facilities. Private higher education institutions—which have proliferated since the mid-1980s—have also reported increased enrolments. Despite the availability of new options, there have been those who have had to postpone or cancel their study plans. According to the British Council, Malaysian student enrolment in UK universities fell from 18,015 in 1996-97 to 16,791 in 1997-98 and an estimated 14,000 in 1998-99. For the 1999-2000 session, enrolment was estimated to have increased to 15,000, with a forecasted further increase to 16,500 in 2000-2001. While these figures are rebounding and indicate recovery on the part of families and the government to sponsor children's or scholars' higher education abroad, the weak ringgit implies that many of those paying for this education are facing, or will face, financial strains. On the public side, federal government allocations for scholarships and educational aid increased from RM669 million in 1997 to RM769 million in 1998. This was probably due to currency depreciation requiring larger ringgit allocations, and not necessarily a reflection of additional support for students.

Marginalized and vulnerable groups

Some brief mention should be made of certain groups particularly vulnerable to the economic downturn. This is not to suggest that these groups are unimportant, but data on the actual impacts of the recession are difficult to obtain. Unfortunately, systematic information from charitable organizations, affected by declines in donations, is not available on a wide

scale. The extent and adequacy of community support—in lieu of adequate state-provided social safety net—is quite unclear. However, a few groups can be singled out:

1. The elderly, especially those dependent on pension incomes or remittances from family members, including those residing in old folk's homes, face various problems. Surveys suggest that many of the rural elderly have been adversely affected by the lower earnings of and transfers from children or relatives working elsewhere (Ishak *et al.* 1999: 23-24).
2. People with special needs, the disabled and orphans. Organizations that care for these groups seem to be facing dwindling resources.
3. Single-parent households, mostly headed by women, face particular problems and pressures, as mentioned above.
4. Rural farmers, rice cultivators, fishermen and plantation workers are vulnerable to shifts in commodity and food prices, as well as input costs. For instance, tenant rice farmers, endure severe cost fluctuations, mainly accruing to rent. For small-scale fishermen, on the other hand, equipment and fuel have risen, reducing their net incomes (Ishak *et al.* 1999: 54-56).

Poverty

The 1997 currency and financial crises and the ensuing recession did not result in widespread unemployment, extensive impoverishment and a groundswell of social discontent in Malaysia. Nonetheless, the recession caused more households to slip into poverty. The poverty rate increased from 6.7 percent in 1997 to 8.0 percent in 1998, reversing the long-standing trend of declining poverty, e.g., from 8.9 percent in 1995. The incidence of hardcore poverty—defined as households receiving less than half the poverty line income—also rose, from 1.4 percent to 1.7 percent (Table 79). The number of households living below the poverty line increased from 346,000 in 1997 to 422,100 in 1998, i.e., by 22 percent, according to another social impacts survey (Ishak *et al.* 1999: x). The same survey reports that dislocation and dispossession as direct results of the crisis—due to job loss, reduced working hours, inflation, etc.—are estimated to have pushed an additional 53,100 into poverty in urban areas alone. The incidence of hardcore poverty—defined as households receiving less than half the poverty line income—also rose, from 1.2 percent to 1.7 percent (Ishak *et al.* 1999: x). The efficacy of official policies in addressing poverty is difficult to ascertain, though such efforts may well have increased during the downturn. A sum of RM100 million was allocated to Amanah Ikhtiar Malaysia for the provision of interest-free loans to the very poor, and RM200 million for a micro-credit scheme to assist petty traders and hawkers in urban areas (*White Paper*: 48).

As the Malaysian economy and rural incomes continue to recover, poverty can be expected to decline. Many issues surrounding social policy still need to be addressed in the long term, in particular, to ensure more egalitarian access to education and health services. Malaysia has made much progress in terms of human development in the last few decades. Health, education and other social indicators continue to show positive trends in spite of the recession. While access to health services is high by developing country standards, and primary schooling is virtually universal, there are growing concerns regarding the quality of education and health services. The ongoing plans to privatize and commercialize tertiary education institutions and health services will have long term consequences for social welfare, especially in the aftermath of the recession. It is difficult to identify and quantify, with great certainty, the impacts of the 1997-98 crisis on human development. Unfortunately, there is

little evidence of much progress in social policies despite, or perhaps because of the severity of the crisis and recession.

Table 79 Malaysia: incidence of poverty and number of poor households, 1995, 1997, 1998 and 2000 (percentage and thousands)

	1995			1997			1998	2000		
	Total	Urban	Rural	Total	Urban	Rural	Total	Total	Urban	Rural
Malaysian Citizens										
Incidence of poverty	8.9	3.7	15.3	6.1	2.1	10.9		5.5	1.9	10.0
No. of poor households	370.2	84.6	285.6	294.4	55.4	239.0		276.0	53.2	222.8
Incidence of hardcore poverty										
Poverty	2.1	0.8	3.7	1.4	0.4	2.5		0.5	0.1	1.0
No. hardcore poor h-hlds.	88.4	19.2	69.2	67.3	11.6	55.7		25.4	2.8	22.6
Overall										
Incidence of poverty	9.6	4.1	16.1	6.8	2.4	11.8	8.0	6.0	2.2	10.7
No. poor households	417.2	95.9	321.3	346.0	67.4	278.6	399.1	323.7	64.7	259.0
Incidence of hardcore poverty										
poverty	2.2	0.9	3.7	1.4	0.5	2.4	1.7	0.5	0.1	1.0
No. hardcore poor h-hlds.	93.5	20.5	73.0	70.3	13.8	56.5	82.9	27.3	3.0	24.3

- Notes: (1) Poverty estimation for 1997 is based on the following poverty line incomes: RM460 per month for a household size of 4.6 in Peninsular Malaysia, RM633 for a household size of 4.9 for Sabah, and RM543 for a household size of 4.8 for Sarawak.
 (2) Figures for 1998 are based on National Economic Action Council (NEAC) estimates.
 (3) Hardcore poverty is estimated using half the poverty line income.
 (4) Figures for 2000 are projections.

Source: *Mid-term Review of the Seventh Malaysia Plan, 1996-2000*, reproduced in Hafiah *et al.* 1999, Table 4, p. 16.

Government expenditure and social programs

Malaysia has been lauded in the international development discourse for its success in providing public services, especially health and education. Many lower income households have enjoyed some government transfers and services, and have even become dependent on and continue to expect of government subsidies. Generally, therefore, changes in government social expenditure tend to be felt more by lower-income households. Government intervention, especially for interethnic economic redistribution, has extended such expectations of government transfers to higher-income Bumiputera households.

Rising medical, food and other costs, and the relatively higher expenses and opportunity costs of sending children to school have made education for children of the poor more vulnerable to the crisis and its consequences. One of the early policy responses to the financial crisis was to reduce government spending. Facing declining government revenue and financial market hostility to fiscal deficits, expenditure was cut in order to limit the budgetary deficit through a series of austerity measures. However, such fiscal conservatism was abandoned by mid-1998 in favor of a counter-cyclical fiscal strategy. Total government revenue shrank by 13.7 percent between 1997 and 1998, but only by 0.04 percent between 1998 and 1999 (Tables 71 & 72). Direct taxes collected by the federal government in 1998 were 1.4 percent lower than in the preceding year; in 1999, there was a decrease of 10.3 percent. Other tax revenue declined by larger margins: 40.8 percent for export duties, 40.7

percent for import duties, and 37.7 percent for sales tax. As shown in Table 71, the first major fiscal deficits of the 1990s—of 1.8 percent and 4.9 percent of GDP respectively were recorded in 1998 and 1999.

Tables 70.1 and 70.2 show various recent changes in allocations of public funds for government operating and development expenditure by sector. Aggregate expenditure for social services—education, health and housing—remained quite constant between 1997 and 1998, although housing expenditure dropped relatively. Social services operating expenditure rose from RM15.1 billion in 1998 to RM16.4 billion in 1999, or by 9.2 percent. Social services expenditure accounted for 30.9 percent of the total operating budget in 1995, 33.1 percent in 1997 and 28.5 percent in 1998. Within this category, funds designated for education rose from RM10.4 billion in 1997 to RM10.5 billion in 1998 and then RM11.3 billion in 1999, an increase of 6.9 percent. Economic services operating expenditure remained at around RM4.1 billion in 1997 and 1998, before jumping to RM4.9 billion in 1999, i.e., rising by 20.7 percent. It is worth noting the reductions in allocation for agricultural and rural development in 1997 and 1998.

Federal government development expenditure continued to grow in the face of the crisis (*Economic Report, 1999/2000*, p. xxxiv, Table 4.6). Total development expenditure rose by 14.9 percent in 1998 and by 38.2 percent in 1999, after rising by 4.1 percent in 1996 and 7.7 percent in 1997. Social services development expenditure grew by 13.4 percent in 1996, 23.5 percent in 1997, 17.5 percent in 1998 and an allocated 20.9 percent in 1999. However, the share of total government development expenditure for social services has fared less well, rising from 27.2 percent in 1996 to 31.2 percent in 1997 and 31.9 percent in 1998, before falling to 27.9 percent in 1999. While the relative shares for education, health and housing did not suffer badly, other social services experienced a drop from 7.7 percent in 1997 to 3.7 percent in 1999. As Table 70.2 shows, allocations to most sectors increased in 1997 and 1998. Notably, defense and security allocations fell in successive years, but increased by an incredible 126.2 percent in 1999—perhaps to compensate for much more modest increases in earlier allocations for defense and security operating budgets. Education, health and housing development expenditure have risen at considerable rates, except for a small decline for health in 1997. The allocation of funds for education and health is shown in greater detail in Tables 80 and 81.

Table 80 Malaysia: government budget allocations for education, 1997-1999

	1997	1998		1999	
	RM mil.	RM mil.	% change	RM mil.	% change
Education (total)	9,924.7	12,510.4	26.05	13,520.0	8.07
Level/type					
Preschool, Primary, Secondary	6,281.7	6,838.1	8.87	7,302.0	4.64
Tertiary	73.6	77.8	5.79	87.9	12.90
Technical	223.7	289.9	29.61	304.7	5.09
Private	1.3	1.9	53.54	1.3	-33.83
Special	25.0*	28.9	15.62	26.6	-7.94

Source: Hafifah *et al.* 1999, Table 6, p. 18, compiled from *Federal Government Budget Report 1998, 1999*.

Table 81 Malaysia: government budget allocations for health, 1997-1999

	1997	1998		1999	
	RM mil.	RM mil.	% change	RM mil.	% change
Health (total)	3,703.2	4,238.0	14.4	4,512.3	6.47
Public Health	675.2	661.5	-2.02	653.6	-1.20
Medical Treatment	1,628.8	1,656.3	1.69	1,642.8	-0.81

Source: Haflah et al. 1999, Table 7, p. 21, compiled from *Federal Government Budget Report 1998, 1999*.

The government increased its expenditure once again from mid-1998 and again in its 1999 and 2000 Budgets, in line with its counter-cyclical measures to revive the economy. One notable increase in the first half of 1999 was for education, which rose to RM5.6 billion from RM5.1 billion in January-June 1997—an increase of 8.9 percent (BNM, *MSB*, Table VII.3). Aggregate social services spending in the first halves of 1998 and 1999 came to RM6.8 billion and RM7.5 billion respectively, equivalent to a 9.8 percent annual increase. RM664 million was spent on agriculture and rural development in January-June 1999, compared to RM627 million for the corresponding period the year before, making for a rise of 5.9 percent.

Specific social programs for crisis alleviation

The following specific programs and funds were designated for certain sectors or needy groups in response to the crisis (Haflah *et al.* 1999: 34-35). These were primarily credit schemes, also sometimes referred to in other contexts in this study:

- Under the auspices of the Ministry of Health and the Ministry of Education, an additional RM200 million was set aside for rural social infrastructure facilities.
- The Fund for Food program, with an initial start-up allocation of RM300 million, was established to increased food production through provision of low-interest loans to small farmers and Farmers' Associations.
- An additional allocation of RM100 million for the Hardcore Poverty Development Program was designed to provide loans to the hard-core poor for income-earning activities through Amanah Ikhtiar Malaysia (AIM).
- The Small-Scale Entrepreneur Fund (RM100 million) and Economic Business Group Fund (RM150 million) were set up to provide assistance to petty traders, hawkers and small entrepreneurs—including women entrepreneurs—in urban areas.
- The Small and Medium-Scale Industry (SMI) Fund, with startup financing of RM750 million, was mandated to aid small and medium scale businesses to expand production. Loans were mainly channeled for the purchase of equipment and machinery.
- The National Higher Education Fund, with an initial RM320 million allocation, is meant to provide financial assistance to students in local universities and colleges.

Funding for and implementation of immediate aid and crisis-response programs has generally been disappointing. The Fund for Food Program, which provides low-interest loans to farmers, saw only RM199 million—out of an allocated RM700 million—approved as loans. Similarly, the Special Scheme for Low and Medium Cost Housing approved only RM241

million (out of an available RM2,000 million), while the Small-Scale Entrepreneur Fund approved RM882 million out of an available RM1.5 billion (Haflah *et al.* 1999: 46). Whatever the reasons, substantial proportions of the credit program allocations have not been taken up, when they could have generated much needed economic activity or boosted demand.

Small and medium size industries (SMIs) have been afflicted by the recession, but have not been given as much official attention as politically well-connected big business interests. The number of insolvencies partly reflects the extent of the impact of the financial crisis and recession on businesses. For about a year from July 1997, more than 2,000 businesses declared bankruptcy. In contrast to the limited attention to SMIs, conglomerates and large businesses have attracted much more official attention as well as media coverage, with many enjoying considerable support and protection from government policies. Limited financial resources and access, intense competition, poor political connections, and limited government support, *inter alia*, have made SMIs more vulnerable to crisis and contraction.

To aid floundering SMIs, the government set up a Rehabilitation Fund for Small and Medium Industries (RFSMIs) in 1998, with an initial endowment of RM750 million. This measure is intended to assist viable SMIs that face credit constraints; 30 percent of total loans approved from this fund may be used to restructure problematic existing loans (*White Paper*, p. 36). The adequacy and effectiveness of this fund have yet to be ascertained, but the modest funds committed stand to SMIs contrast with the RM65 billion already committed to financing Danaharta and Danamodal bank rescue operations involving NPL restructuring and bank recapitalization.

Conclusion

This study began by reviewing some aspects of the economic crisis in Malaysia: severe GDP contraction, price inflation and modest increases in unemployment. The impacts on different economic sectors of the recession and the dissipation of ringgit value were considered. The overall economic contraction was most pronounced in the second half of 1998. Sectors vulnerable to crises of confidence, job losses or sudden currency depreciation, such as construction and manufacturing, have accordingly been the worse affected. Similarly, the highly leveraged suffered under the burden of high interest rates while low-income households were hurt by reduced transfer payments.

The speed of recovery—certainly swifter than many predicted—suggests the partly cyclical nature of the crisis. Businesses, workers and families appear to have weathered the crisis reasonably well, thanks in part to the high savings rate, relatively low public debt, docile labor force, relative political stability, and reasonable human resource base. Nonetheless, various structural problems, such as heavy dependence on foreign direct investments, intermediate goods and technology, and declining international competitiveness persist. Badly-needed structural and institutional reforms, particularly to the financial system, have not been forthcoming. Instead, the forced bank mergers appear to have consolidated the financial power of the politically well connected.

Employment data suggest that those employed in construction and manufacturing were hardest hit by job losses. Consumer price trends suggest that low-income groups probably suffered most due to large increases in the consumer price index mainly due to the ringgit depreciation, especially for food. Producer price trends suggest that agricultural producers have suffered heavily due to agricultural price trends, especially for rubber, and more recently, for palm oil. However, it may be wrong to attribute lower agricultural incomes to the financial crisis alone owing to the effects of drought and forest fires. Also, the adverse

wealth effect of the asset price deflation have cut incomes and consumption of the top decile or quintile of Malaysian households, with negative multiplier effects throughout the economy, e.g., in terms of demand for services and consumer durables. Easy and cheap credit fostered by government policy since September 1998 may well have helped reverse such effects.

The most obvious victims of the crisis would be those who lost their jobs, mainly from the construction, manufacturing and financial services sectors. A second identifiable group would include businesses, households and individuals who experienced drops in real incomes for various reasons. These could include lower prices and output (not necessarily due to the crisis), job losses, pay cuts, reduced working hours, reduced overtime work opportunities as well as higher consumer prices. A third group would be those who became insolvent due to the crisis, e.g., highly leveraged businesses that have sunk with their debt burdens. Many of these victims would include middle- and high-income individuals and households most affected by higher interest rates, asset (stock, property) price drops as well as more difficult access to credit. A fourth group would include beneficiaries of government spending, especially on social expenditure, particularly social welfare transfers.

The increased incidence of retrenchments, lay offs, and other means of cost reduction that have hurt employees draws attention to Malaysian labor laws which by and large favor management and capital at the expense of labor. Union membership is low, partly because of the inefficacy of the unions—which is, in turn, mainly due to severe strictures on labor organization. At various levels, authorities have the leeway to exercise considerable discretionary power. In times of recession, when cost reduction became a paramount concern, labor is especially vulnerable to measures undermining their welfare. A system that consistently weakens labor cannot adequately safeguard its welfare, for management interests can impose the burden of cost-cutting to be disproportionately borne by labor. Malaysia does not have a national minimum wage, although the Wages Councils Act (1947) provides for minimum wages in sectors or regions when the need arises (Jomo and Vijayakumari 1999: 6-7). Wage reduction measures, therefore, lack guidelines and minimal levels to be adhered to. Human resource development efforts have been more pro-active. The Human Resource Development Council, initiated in 1993, has managed to train 800,000 workers by 1999 when 247,785 training places involving RM106 million in financial assistance were approved (*Labor Market Report 1999*).

The issue of social safety nets—or their absence—has also come to the fore in the wake of the financial crisis. Government responses to the crisis have revealed some commitment to key social sectors, perhaps because abandonment of these sectors may be politically hazardous. The slowness of government response, as Haggard (1999) points out, mirrors lack of experience in providing social safety nets. This tardiness is all the more surprising when many 'initiatives' are, in fact, extensions of existing programs (p. 23). The small number that the Training Scheme for Retrenched Workers managed to assist (572 in 1998 and 426 in 1999) at considerable expense (RM2.5 million and RM2 million respectively), is unfortunate in a situation where many more could have benefited. The preponderance of more advanced and expensive types of training reflects its bias toward highly-skilled labor and professional work: 31 percent of workers on the scheme were in the computer field, 27 percent in technical engineering fields, and 42 percent in management fields.

The full impact of the 1997-8 economic crisis in Malaysia is difficult to assess for various reasons. First, various concurrent developments complicate careful assessment of the actual impact of the crisis. These included the El Niño drought, La Nina heavy rains, heavy smoke palls from forest fires in neighboring Indonesia as well as commodity price deflation (and presumably adverse terms of trade trends) since the mid-1990s. Second, there is still

considerable debate over the origins, nature and consequences of the crises; more prudent bank regulation, a more stock market oriented financial system as well as different policy response, especially from September 1998, distinguishes the Malaysian experience rather profoundly. Third, a great deal of relevant data has not been made available to the public. Fourth, much available data is widely considered suspect. The employment impact of the crisis is especially difficult to measure because of the unreliability of labor data, especially for undocumented immigrant workers, as well as the widespread 'casualization' of employment relations in recent years, e.g., the increasingly widespread use of contract labor.

As is well known, the 1997-8 economic crises gave rise to distinctively different regimes in the three most adversely affected economies, namely Thailand, South Korea and Indonesia. Yet, to varying degrees, all three new regimes were obliged to accept many externally imposed reforms in order to secure and sustain emergency credit facilities from the IMF. Although there was never any real need for Malaysia to require such aid or to accept such conditionalities for any other reason, the Malaysian authorities did briefly implement such monetary and fiscal policies favored by financial markets from late 1997. However, such policies began to be reversed from the second quarter of 1998, and more dramatically, from September 1998, with the sacking of the incumbent Finance Minister and the imposition of capital controls as well as several related monetary measures.

Meanwhile, relatively successful early policy responses to the financial crisis may well have served to contain the potential spread of a banking crisis. But stricter pre-crisis prudential regulation as well as more limited exposure to foreign borrowings may well have been more important in averting a more serious banking crisis. While the authorities now claim that the September 1998 measures enabled interest rates to be brought down, comparison with Thailand shows Malaysian interest rates to be lower before September 1998 and higher after that. Although the central bank set an eight percent credit growth target for 1998 and 1999, actual growth was rather modest, staying below two percent despite a massive increase in credit for share and residential property purchases and a decline in lending for manufacturing and other productive purposes.

It is still too early to assess the full socio-economic impact of the 1997-8 economic crisis. There is still doubt as to whether the affected East Asian economies will be able to resume their pre-crisis growth trajectories. The recent phenomenon of commodity price deflation has enhanced doubts about the likely welfare gains from further export-oriented industrialization. Recent trends seem to suggest that generic manufactured goods not enjoying strong intellectual rights—and associated monopoly rents—are as vulnerable to price pressures as primary commodities. Consequently, productivity gains have not been translated into commensurate welfare gains for producers. The advent of China, India and others as lower cost producers in similar production niches in global commodity chains threatens a 'race to the bottom' with the intensification of competition. Much will therefore depend upon whether Malaysia will be able to constantly reposition itself ahead of its competition. It is unclear how sustainable short-term successes in particular niches will be in the medium to long term.

Economic policy priorities continue to remain in the recovery mode. And while much of the recovery so far has come from fortuitous export booms, especially in electronics, the official emphasis continues to be on domestic-led economic recovery. Such domestically oriented economic policies have had some effect, e.g., as reflected by the revival of consumer spending and related manufacturing output. Hence, it is difficult to identify the new developmental thrusts of post-crisis economic policy. At this point, it appears that the government is fairly indiscriminating in trying to attract all possible investments despite the

minister's claim that manufacturing investment approvals have declined due to greater government selectivity.

Before the crisis, there seemed to have been a greater emphasis on attracting higher value-added investments in view of full employment, the high and fast-growing presence of foreign workers and the official desire to progress more rapidly up the technological ladder. But this seems to have been suspended, at least temporarily, perhaps due to the exigencies of economic recovery. Consequently, it now seems as if Malaysia is once again interested in the kinds of investments it seemed to have become averse to just before the onset of the crisis. However, it seems quite likely that Malaysia will revert to its policy of more selective high technology, high productivity investments as recovery proceeds. But even during the earlier pre-crisis phase, there was little evidence of enough commensurate efforts in education, training and human resource development more generally as well as stricter supportive labor migration policies.

Many of the costly misplaced priorities and burdensome liabilities of the last two decades may well continue to take their toll on Malaysian competitiveness beyond the short term. Most worrying is the modest pace of human resource development with widening gaps in skills and other technological capabilities behind Singapore, Taiwan and Korea. Malaysia's modest entrepreneurial capabilities have been additionally retarded by ethnic and crony political biases. The historical domination of the economy from the colonial era by foreign investment has been extended well into the post-colonial period, encouraging accumulation on the basis of 'know-who' types of rent-seeking rather than entrepreneurial 'know-how'. Meanwhile, the costs of doing business in Malaysia have risen unnecessarily with the privatization of potentially profitable utilities, infrastructure and other essential services.

The growing bias in favor of politically well connected big businessmen over the last two decades may well have been reinforced by the policy responses to the crisis. This is especially clear from the nature and beneficiaries of various officially sanctioned—if not initiated—bail-outs, including business interests closely associated with the Prime Minister and Finance Minister, as well as various businesses privatized to well-connected 'cronies'. As noted earlier, although the original forced bank merger scheme was revised, the identities of the additional bankers accommodated have only reinforced this impression of cronyism at the highest level.

Small and medium sized enterprises have actually received greater official attention in recent years in line with government efforts to promote a broad-based Malay business community. Such efforts have also been politically important for reinforcing the changing political patronage considered necessary to retain political hegemony for the ruling UMNO and particular political leaders. More so than in the late 1980s, various support measures were initiated in the wake of the crisis by then Finance Minister Anwar Ibrahim, and later extended by the National Economic Action Council (NEAC) run by current Finance Minister Daim Zainuddin. Such efforts have met with mixed success, but more importantly, their financing has been far more modest than the funding for bailing-out the banking system, which is now in excess of RM65 billion.

But, as noted earlier, regardless of the actual success of the September 1998 measures, effective media control has ensured that much of the business community has been appreciative of such government initiatives in response to the crisis. In contrast, much of the ethnic Malay community—including its fast growing and influential middle class—have been increasingly alienated by the growing concentration of power and influence among the politically well connected elite, as well as by some of its social consequences and cultural manifestations. Not surprisingly then, the ruling coalition managed to secure additional

political support from the non-Malay business community while alienating much more of the Malay middle class in the November 1999 general election.

References

- Abu Bakar Suleiman *et al.* 1998. "Impact of the East Asian Economic Crisis on Health and Health Care: Malaysia's Response" *Asia-Pacific Journal of Public Health* 1998, 10 (1): 5-9.
- Bank Negara Malaysia (BNM). 1999. *Annual Report 1998*. Kuala Lumpur: BNM.
- Bank Negara Malaysia (BNM). *Monthly Statistical Bulletin (MSB)*, various issues. Kuala Lumpur: BNM.
- Government of Malaysia. 1999. *White Paper: Status of the Malaysian Economy*. Kuala Lumpur: Government of Malaysia.
- Haflah Piei, Musalmah Johan, Syarisa Yanti Abubakar. 1999. "The Social Impact Of The Asian Crisis: Malaysian Country Paper." Malaysian Institute of Economic Research for Asian Development Bank, Manila, July.
- Haggard, Stephan (with Nancy Birdsall). 1999. "The Social Fallout: Safety Nets and Recrafting the Social Contract." (draft)
- Ishak Shari *et al.* 1999. "Social Impact of Financial Crisis: Malaysia." Report submitted to the United Nations Development Program, Kuala Lumpur.
- Jomo K. S. (ed.) 2000. *Malaysian Eclipse*. London: Zed Books.
- Jomo K. S., and Vijayakumari Kanapathy. 1999. *Economic Liberalization and Labor in Malaysia: Efficiency and Equity Considerations in Public Policy Reform*. Report for International Labor Office, Geneva.
- Ministry of Finance, Malaysia. *Economic Report*, various issues. Kuala Lumpur: Ministry of Finance.
- Ministry of Human Resources (MHR), Malaysia. 1999. *Labour Market Report, 1998*. Available at URL: <http://www.ksm.gov.my>
- Shireen M. Hashim. 1998. *Income Inequality and Poverty in Malaysia*. Lanham, Maryland: Rowman and Littlefield.
- United Nations Development Program (UNDP) Malaysia. 1998. *The Social Impact of the Financial Crisis*. Kuala Lumpur: UNDP.
- Wong, Diana. 1998. "Social Consequences of the Economic Crisis." Paper presented at a seminar on "The Economic Crisis in Malaysia and the Role of the Media," Asian Institute for Development Communication, Kuala Lumpur, 22 July.

Malaysian Official Data Sources

- Bank Negara Malaysia (BNM). 1999. *Monthly Statistical Bulletin*. <http://www.bnm.gov.my>
- Civil Service Department. 1999. <http://www.jpa.gov.my>
- Department of Statistics. 1999. <http://www.statistics.gov.my>
- Ministry of Education. 1999. <http://www.moe.gov.my>
- Ministry of Finance. 1999. *Economic Report 1998/99*. <http://www.treasury.gov.my>

Appendix Table 1 Malaysia: key macroeconomic variables, 1985–1998 (percentages)

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
GDP growth rate (%) at 1978 prices	-1.0	1.2	5.2	8.9	9.2	9.7	8.7	7.8	8.3	9.2	9.5	8.6	7.7	-6.7
Share of GDP (at current prices)														
Gross national savings	25.6	25.5	31.5	31.2	28.8	30.3	29.2	31.6	34.6	33.6	33.9	37.1	37.3	39.6
Consumption expenditure	67.4	67.9	62.7	63.7	66.1	65.6	65.9	63.3	60.9	60.4	60.3	57.1	56.2	51.5
Private	52.1	51.0	47.3	49.4	52.1	51.8	52.2	50.3	48.3	48.1	47.9	46.0	45.3	41.5
Public	15.3	16.9	15.4	14.3	14.0	13.8	13.7	13.0	12.6	12.3	12.4	11.1	10.9	10.0
Gross capital formation	29.8	26.3	23.0	24.1	29.8	33.0	36.4	36.6	38.9	40.2	43.6	42.5	43.1	26.8
Private	15.8	14.3	13.8	15.4	18.9	21.9	24.0	22.3	24.9	27.6	31.2	31.3	31.8	15.6
Public	14.0	12.1	9.1	8.7	10.9	11.2	12.3	14.3	14.0	12.6	12.4	11.2	11.3	11.2
<i>Balance of Payments (net)</i>														
Current account	-2.0	-0.4	8.3	5.2	0.7	-2.1	-8.6	-3.7	-4.6	-7.6	-9.7	-4.4	-5.6	12.9
Official long-term capital	3.2	3.0	-3.1	-5.6	-2.4	-2.4	-0.5	-1.9	0.6	0.4	2.8	0.3	1.6	0.8
Private long-term capital	2.2	1.8	1.3	2.1	4.4	5.3	8.1	8.8	7.5	5.5	4.7	5.0	5.1	3.0
Balance of long-term capital	5.5	4.7	-1.8	-3.5	2.0	2.9	7.6	6.9	8.1	6.0	7.5	5.3	6.8	3.7
Basic balance	3.5	4.3	6.6	1.7	2.7	0.8	-1.0	3.1	3.4	-1.6	-2.3	0.9	1.2	16.7
Private short-term capital	1.1	-0.1	-3.1	-3.2	1.5	1.1	3.8	7.9	8.1	-4.3	1.1	4.1	-4.6	-7.3
Errors & omissions	-0.5	1.8	0.2	0.3	-1.0	2.5	-0.3	0.1	5.4	1.7	-0.9	-2.5	-0.4	4.8
Overall balance	4.1	6.1	3.6	-1.2	3.3	4.5	2.5	11.1	17.0	-4.2	-2.0	2.5	-3.9	14.2
Implicit capital inflows	6.1	6.5	-4.7	-6.4	2.6	6.6	11.2	14.8	21.6	3.3	7.8	6.9	1.7	1.2
Short-term capital inflows	0.6	1.8	-2.9	-2.9	0.6	3.7	3.5	8.0	13.5	-2.6	0.3	1.6	-5.0	-2.5
Reserves (months of retained imports)	5	7	7	5	4	4	4	6	8	6	4	4	3	6
Services balance as % of GNP	-14	-13	-11	-12	-12	-9	-10	-10	-10	-9	-9	-8	-9	-8
Current account as % of GNP	-2	-1	9	5	1	-2	-9	-4	-5	-8	-10	-5	-6	14

Notes: Short-term capital inflows = Private short-term capital + Errors and omissions.

Implicit capital inflows = Balance of long-term capital + short-term capital inflows.

Sources: Bank Negara Malaysia, *Quarterly Economic Bulletin*, Table VI.1, VIII.1; BNM, *Annual Report*, various issues, for GDP figures.

Appendix Table 2 Malaysia: Ringgit Exchange Rates with US Dollar & Japanese Yen, 1984-1999 (annual/monthly averages)

Year	RM equivalent for one unit of		Month	RM equivalent for one unit of		Month	RM equivalent for one unit of	
	US\$	¥		US\$	¥		US\$	¥
1984	2.34	0.0099	Jan-97	2.49	0.0212	Jul-98	4.15	0.0295
1985	2.48	0.0105	Feb-97	2.49	0.0202	Aug-98	4.20	0.0290
1986	2.58	0.0154	Mar-97	2.48	0.0202	Sep-98	3.81	0.0284
1987	2.52	0.0175	Apr-97	2.50	0.0199	Oct-98	3.80	0.0313
1988	2.62	0.0204	May-97	2.51	0.0211	Nov-98	3.80	0.0316
1989	2.71	0.0197	Jun-97	2.52	0.0220	Dec-98	3.80	0.0324
1990	2.70	0.0188	Jul-97	2.57	0.0223	Jan-99	3.80	0.0336
1991	2.75	0.0205	Aug-97	2.75	0.0233	Feb-99	3.80	0.0326
1992	2.55	0.0201	Sep-97	3.01	0.0249	Mar-99	3.80	0.0312
1993	2.57	0.0232	Oct-97	3.29	0.0271	Apr-99	3.80	0.0318
1994	2.62	0.0257	Nov-97	3.39	0.0271	May-99	3.80	0.0312
1995	2.51	0.0268	Dec-97	3.77	0.0291	Jun-99	3.80	0.0315
1996	2.52	0.0231	Jan-98	4.40	0.0338	Jul-99	3.80	0.0317
1997	2.81	0.0232	Feb-98	3.82	0.0304	Aug-99	3.80	0.0335
1998	3.80	0.0300	Mar-98	3.74	0.0291	Sep-99	3.80	0.0354
1999	3.80	n. a.	Apr-98	3.73	0.0283	Oct-99	3.80	0.0358
			May-98	3.81	0.0283	Nov-99	3.80	0.0363
			Jun-98	3.99	0.0285	Dec-99	3.80	n. a.

Note: n. a. – not available.

Source: Bank Negara Malaysia, *Quarterly Economic Bulletin*, Table V.6.

Social Impact of the Asian Crisis in the Philippines

by

Gloria O. Pasadilla
Assistant Professor

University of Asia and the Pacific
Manila, Philippines*

* Excellent research and data collaboration of Carol Pascual, Karina Robes, and Patrick Ella is hereby acknowledged. I also wish to thank Dr. Cid Terosa for co-authoring Chapter 3. All remaining errors are mine.

Executive Summary

This report documents the macroeconomic and sectoral effects of the crisis, its impact on income distribution, as well as the effects of the crisis on some of the 'intangibles' like health, education, housing, etc. This study finds that the crisis caused a slight increase in unemployment but that this effect was tempered by the decline in the labor participation rate resulting from the lack of job opportunities. There was no significant urban-rural migration because the El Niño hampered the rural sector from providing jobs to displaced urban workers. A more significant effect was felt among the overseas Filipino workers (OFWs) deployed all over the Asian region in terms of uncertain future job prospects and reduced remittances. Using the framework of Social Accounting Matrix (SAM), this study finds that if the effects of the Asian crisis and El Niño were not isolated, the combined effect was most adverse on the poor, particularly on the low middle-income class. In isolation, the consequences of the Asian crisis still appear to impinge more on the same income group but that the decline in their income would not have been as adverse. Finally, cuts in government budgets and decreases in income affected expenditures in education, health and other social projects that more directly benefit lower-income families.

The study is organized into five chapters. Chapter 1 presents an overview of the economy from the 1980s until the onset of the crisis in 1997 and discusses points of vulnerability that partly explain why the Philippines easily succumbed to the financial contagion. Further, it offers some explanations why the effects of the crisis have not been as dramatic as were in Thailand, Korea and Indonesia. This study traces the trajectory of the economy from the last five years of the Marcos regime to the tumultuous transition during the Aquino term and the renewed economic vigor under the Ramos administration. It discusses the period of increased flows of foreign capital and financial liberalization that caused the same weaknesses as in other Asian countries like overvalued currency, ballooning trade deficit, increased portfolio inflows and increased bank lending and the incipient asset bubble.

The second chapter considers the macroeconomic and sectoral effects of the Asian crisis, particularly on industries, labor and employment, overseas Filipino Workers (OFWs) and inflation. It computes the *net external orientation* of industries to assess their relative sensitivity to exchange rate devaluation and determine likely industrial winners and losers from the crisis. The index of net external orientation predicts that the entire Philippine manufacturing sector, far from benefiting from a supposed increase in competitiveness from devaluation, would lose from weakness in the currency because the import costs outweigh the benefits from exports. This was actually borne out by the actual negative performance in terms of gross value added of most industries in 1998.

Chapter 2 also reports that the rise in the number of laid-off workers due to closures and retrenchments was most acute in the manufacturing, wholesale and retail trade and finance, insurance and real estate. Moreover, most of the affected firms were located in Metro Manila and the other urban areas. Job contraction was also most pronounced among the lower job scale such as production, clerical and agricultural workers rather than the executive and managerial positions. Unpaid family workers declined while salaried workers increased which indicates that these people opted to join the salaried labor force to augment family income in 1998.

Focusing on the OFWs, the impact of the crisis was most evident in the slowdown in deployment of workers and the decline in remittances in 1998 especially from Asia. The study argues that this would have greater impact on the middle-income families in the urban areas where most OFWs come from. Finally, inflation was observed to have risen to almost 10% in 1998 but this could not be solely attributed to the Asian crisis. Most of the rise was due to increases in food prices, which comprises more than half of the Consumer Price Index (CPI) basket. A close look at the CPI and its components points to the fact that the exchange rate and thus the Asian crisis, had little to do with the rise in inflation in 1998.

Chapter 3 makes use of the social accounting matrix (SAM) to obtain the direct and indirect effects of the fall in demand in the industries. An impact analysis was carried out to determine the effects of a decline in production of industries on factor and household income. Results show that there was a substantial drop in entrepreneurial income from agriculture, which affects more rural families, as well as a significant drop in wages and salaries derived from non-agricultural activities, which therefore impact more on urban dwellers. The chapter also presents a simulation experiment to isolate the effects of the Asian crisis from those of El Niño. The result suggests that the decline in income from the Asian crisis would still have affected the low middle-income class the most but that the drop in income would have been mitigated.

The final chapter is devoted to the social impact of the economic crisis. It starts off with the discussion of the expenditure pattern of different income classes, which highlights differences in their quality of lives. In particular, the percentage of income spent by families on education and medical care increases with income, while food expenditures decrease with income. The chapter then tackles the effects of the fiscal budget cuts and reduction in family incomes on health, food and nutrition, shelter, education and women in the labor force. These effects include: reduced medical services and supplies, limited housing loans, suspension of educational projects, limited training of school personnel, etc. The study points out an increase in the participation of women in the labor force suggesting increased pressure to augment family income.

The study also discusses existing social safety nets in the country and their limitations during the crisis. Presently, the social safety nets in the country—the Social Security System (SSS) and the Government Service Insurance System (GSIS)—have limited coverage. The assistance they were able to extend to those affected by the crisis came only in the form of loans. Other government help was in the form of providing training for displaced workers.

The Asian crisis brought to the fore the need for reforms not only in the financial and corporate sectors but also in institutionalized safety nets. Food subsidy and unemployment insurance are services which are worth looking into by the government. However, long-term solutions should be geared towards improvement of human capital, i.e., improved education, better infrastructure to increase agricultural productivity and greater efforts at regional development.

I. The Philippine Economy: Before and During the Asian Crisis

While the 1980s saw the ASEAN countries grow by leaps and bounds, for the Philippines, it was a lost decade. Gross Domestic Product (GDP) during the period grew by a meager average of 1.8% amidst double-digit inflation and high external debt. Structural reforms were initiated and put in place in the second half of the 1980s but investors' confidence on the economy was adversely affected by a series of military coup attempts and political uncertainties.

The economy grew faster in the 1990s, prior to the Asian crisis. From 1990 to 1996, the economy posted an annual average of GDP growth of 2.8%. Inflation declined to single digit, fiscal deficits turned into surpluses and capital flows started to divert themselves to the Philippines thus helping turn the balance of payments into surplus and easing the repayment of foreign debt. Financial reforms throughout the 1980s had likewise led to a more stable and stronger banking system. Overall prospects of the economy were bright and investor confidence was at its peak.

However, signs of increasing vulnerability had likewise emerged during the same period. The surge of capital inflows, the appreciating real exchange rate and the consequent decline in price competitiveness, the rising trade deficit, the rapid growth of private credit, the associated build-up in real estate prices have all brought about concerns of increasing vulnerability of the economy to financial contagion.

This chapter provides an overview of the Philippine economy from the 1980s to the pre-crisis 1990s, analyzes the increased economic vulnerability and the immediate macroeconomic effects of the crisis. Lastly, this chapter provides an explanation why the Philippines was not as adversely affected as Thailand, Indonesia and Korea and comparatively less overwhelmed compared with the time of the debt crisis of the 1980s.

A. Pre-crisis economy

Legacy of the Marcos years (1966-1986)

The Marcos regime ushered in some economic progress, particularly in the first years of the martial law regime in the early 1970s. The country witnessed its highest Gross National Product (GNP) growth ever of more than 9% and 8% in 1973 and 1976, respectively. Since then, these impressive growth records had been unmatched, even during the height of investor confidence on the Philippine economy in 1994 to 1996. Average growth rate from 1972 to 1979 was more than 6%, still the highest annual average growth relative to other periods.

However, when President Marcos was finally forced out of his 20-year rule by the peaceful revolution in 1986, he left a country saddled in huge external debt, an empty government coffer and a tattered economy that was barely out of the foreign debt crisis. At the nadir of the Marcos regime, from 1983 to 1985, real GDP contracted by an average of more than 4%, inflation soared to 54% and the external accounts hemorrhaged from huge capital flight causing a huge devaluation of the peso. Meanwhile, social instability was shown in riots, rationing of basic commodities, bank closures and mass layoffs. The former president's long years of rule as a virtual dictator also left the country with a very fragile democratic institution that was evident in the teetering political transition in the second half of the 1980s.

President Marcos left a legacy of both progress and crisis. The lessons learned from this crisis, however, made the Philippine economy relatively more prepared and resilient to the next crisis that came a decade later.

Aquino and the People Power (1986-1992)

The Aquino administration muddled through a difficult transition period that was punctuated by military discontent and natural disasters that exacerbated the economic stagnation. GNP growth, during the period, averaged only more than 4%. However, the period 1986 to 1992 ushered in serious structural reforms that set the stage for the next administration. These major reforms in almost all areas of the economy took time to yield positive results because of political uncertainty. During her term, President Aquino suffered through three failed coup d'etat as well as major natural calamities such as the Mt. Pinatubo eruption and the Baguio earthquake that diverted much of the attention and resources away from long-term structural issues.

Nevertheless, the firm foundation for a more internationally competitive economy and sustained growth was painstakingly set up. In the trade sector, the tariff structure was simplified and the number of regulated items was reduced from 1,924 items to 183 during the period 1986 to 1993. In the fiscal sector, the government dismantled government monopolies, particularly in the agricultural sector, and embarked on an ambitious privatization program of many government corporations and financial institutions. It also initiated tax structure reforms.

In the financial sector, it removed the loan allocative function of the Central Bank, relaxed a substantial number of exchange controls such as the surrender requirement for export proceeds and the Central Bank approval of foreign exchange transactions. The government also liberalized the entry of foreign investors within the provisions of the Philippine constitution. Export enterprises were, for the first time, allowed foreign ownership of up to 100%.

Ramos Administration (1992-1998)

The Ramos administration continued the economic structural reforms initiated by the Aquino administration with relative ease and with more visible success. One very significant institutional reform was the reconstitution of an independent central bank, the Bangko Sentral ng Pilipinas. It was freed from the burden of huge losses incurred especially during the Marcos years when delineation between fiscal and monetary sectors was blurred. Its regulatory capacity was also strengthened. Moreover, the government also allowed the entry of ten foreign banks to foster competition and efficiency in the banking system, liberalized bank branching rules, rehabilitated government-owned specialized banks and weeded out weak private commercial banks through closure, consolidation and merger. As regards competition policy, it dismantled entry barriers in industries such as telecommunications, land, sea, and air transport, banking and cement. All these reforms were complemented with an aggressive privatization program that became one of the major baits for foreign capital to enter.

The result was a transformation into a more competitive open market economy. Since 1994, investments, exports, and private consumption increased amidst government budget surpluses. From the 1.6% real GNP growth in 1992, the economy jumped to 5.3% growth in 1994 and to a peak of 6.9% growth in 1996. Inflation was down to single digit since 1992, despite the brief rice shortage, upward wage adjustment and increase in power rates and oil prices (see Table 83). Lower inflationary expectations, reduction in reserve requirements and positive fiscal balances eased the pressures on interest rates.⁹⁰ Balance of payments surpluses

⁹⁰ Historically, nominal interest rates in 1990s were lower than the 1980s average.

due to the expansion of both exports and capital flows enabled the economy to build up gross international reserves and to improve debt service capability.

Table 82 Comparison of economic indicators in various administrations, 1980-1998

	In Percent		
	Marcos 1980-1986	Aquino 1987-1992	Ramos 1993-1998
Growth Rates:			
Gross Domestic Product (GDP)	-1.28	3.25	3.53
Gross National Product (GNP)	-1.83	4.11	4.04
Debt Service/Exports	25.41	48.00	25.66
Inflation	17.80	10.83	7.85
Investment/GDP	22.57	20.52	23.75
Fiscal Surplus/GDP	-3.03	-2.34	-0.24

Source: Bangko Sentral ng Pilipinas.

Table 83 Macroeconomic fundamentals, 1990-1996 in million dollars unless otherwise stated

	1990	1991	1992	1993	1994	1995	1996
GDP (in billion US \$)	44.3	45.4	53.0	54.4	64.1	74.1	83.5
Inflation (% p.a. CPI)	14.1	18.7	8.9	7.6	9.1	8.1	7.9
Overall BOP Surplus/Deficit (as % of GNP)	-0.2	4.6	2.8	-0.3	2.7	0.8	4.7
Trade Balance	-4,020	-3,211	-4,695	-6,222	-7,850	-8,944	-11,342
Net International Reserves	1,008	3,111	4,275	4,408	5,536	5,603	4,197
Investments-Savings Gap (as % of GNP)	-5.8	-1.9	-1.6	-5.5	4.5	-4.3	-4.5
Current Account	-2,567	-869	-858	-3,016	-2,950	-3,297	-3,953
Capital Flows	905	1,925	2,063	2,769	3,873	3,443	4,257
Direct Investments	528	529	675	864	1,289	1,079	1,226
Portfolio Investments	-48	125	62	-52	269	1,201	-171
Loans and Others	425	1,271	1,326	1,957	2,315	1,163	3,202
Long-term	406	922	666	2,105	1,313	1,219	2,690
Short-term	19	349	660	-148	1,002	-56	512

Source: Bangko Sentral ng Pilipinas, *Selected Philippine Economic Indicators*, 1998.

B. Financial liberalization and economic vulnerability

In line with the liberalization policies, the newly independent central bank revised the regulations on foreign exchange transactions, effectively ushering in a free flow of foreign exchange transactions in the country. Full and immediate repatriation of capital and unrestricted convertibility were allowed. These measures improved the Philippines' standing in the global community and heightened the flow of foreign funds.

Since 1993, foreign direct and portfolio investments surged, offsetting a yawning current account deficit. Portfolio investments swelled by 479% and foreign direct investments

by 60% on this year. Shares of portfolio investments to total capital flows⁹¹ continuously increased from barely 8% in 1991 to 35% in 1995. Shares of foreign direct investment declined from 37% to about 35% while shares of loans declined from 55% to 30% during the same period (see Table 84). Compared to the other Asian countries, the surge came in fairly recently though, and at a much lower magnitude - only 4% of GDP and less than a total of \$20 billion total flows from 1986-1993. This is low compared with the 9% and 8% share of Thailand's and Malaysia's GDP, with values of approximately \$60 and \$30 billion, respectively (Corbo and Hernandez 1996: figure 1, p.71).

Table 84 Capital Flows, 1990-1999

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Total	1,172	1,516	1,564	4,590	3,805	4,220	6,462	5,667	4,756	6,305
Loans	674	835	633	2,455	1,313	1,276	2,841	4,824	2,740	4,716
% share*	57.51	55.08	40.47	53.49	34.51	30.24	43.96	85.12	58.57	74.79
Growth rate	76.90	23.89	-24.19	287.84	-46.52	-2.82	122.65	69.80	-43.20	72.12
Direct Investments	550	556	776	1,238	1,591	1,459	1,520	1,249	1,752	1,077
% share*	46.93	36.68	49.62	26.97	41.81	34.57	23.52	22.04	36.00	17.08
Growth rate	-3.17	1.09	39.57	59.54	28.51	-8.30	4.18	-17.83	40.27	-38.53
Portfolio	-52	125	155	897	901	1,485	2,101	-406	264	512
% share*	-4.44	8.25	9.91	19.54	23.68	35.19	32.51	-7.16	5.43	8.12
Growth rate	-117.9	-340.38	24.00	478.71	0.45	64.82	41.48	-119.32	165.02	93.94

** % share to total (loans+direct investment+portfolio).

Source: Bangko Sentral ng Pilipinas.

Most of these foreign equity investments went to manufacturing industries and public utilities and more recently, to banks and other financial institutions. From 1993 to 1994, manufacturing accounted for as much as 74.41% of foreign equity. However, in 1996, banking and financial institutions started to capture the lion share of total foreign equity investments (see Table 85), primarily as a result of financial services liberalization, particularly in the insurance, pension and mutual funds industries. This translated to a 139% expansion in the banking system resources from end-1992 to 1996 (Orbeta 1998).

The increased inflows to the Philippine economy boosted gross international reserves to more than four months worth of imports in 1996, up from less than two months in 1990, reaching an all time high of close to \$12 billion in 1996 (see Table 86).

There was also increased pressure for the exchange rate to appreciate,⁹² forcing monetary authorities to intervene in the foreign exchange markets. In order to clip inflationary pressures, monetary authorities sterilized foreign exchange intervention through open market operations, resulting in increased nominal interest rates.

⁹¹ Capital flow in this context is the sum of direct investments, portfolio investments, and medium- and long-term loans.

⁹² The peso appreciation was caused not only by the increase in foreign investments but also by the remittances of overseas foreign workers and withdrawals from Foreign Currency Deposit Units (FCDUs). These two items had grown rapidly in the 1990s, so much so that, in 1993, remittances reached \$2.3 billion, equivalent to 4% of GNP and withdrawals from FCDUs were \$1.7 billion or 3% of GNP. Both workers' remittances and withdrawals of FCDUs were at least twice as large as net portfolio flows (Lamberte 1994).

Table 85 Direction of foreign direct investment, 1993-1999, in million dollars unless otherwise indicated

	1993-94*	1995	1996	1997	1998	1999
Total	630	815	1,281	1,053	848	1,894
Banks & Financial Inst.	42	90	513	226	193	258
Share to Total (%)	6.60	11.02	40.07	21.49	21.83	13.62
Growth Rate (%)		116.17	471.48	-55.90	-14.68	33.68
Manufacturing	469	338	478	172	245	1049
Share to Total (%)	74.41	41.46	37.29	16.35	27.75	55.39
Growth Rate (%)		-27.90	41.38	-63.95	42.56	-83.23
Mining	21	42	3	3	161	27
Share to Total (%)	3.35	5.14	0.25	0.28	18.99	1.43
Growth Rate (%)		98.58	-92.34	0	5266.67	-83.23
Commerce	9	94	85	78	162	166
Share to Total (%)	1.42	11.55	6.62	7.40	18.29	8.76
Growth Rate (%)		954.68	-9.91	-8.05	107.51	2.47
Services	39	30	35	33	12	17
Share to Total (%)	6.12	3.71	2.70	3.17	1.37	0.90
Growth Rate (%)		-21.43	14.39	-3.65	-63.76	41.67
Public Utility	50	219	121	298	68	340
Share to Total (%)	7.89	26.84	9.41	28.27	7.67	17.95
Growth Rate (%)		340.04	-44.88	146.92	-77.20	400.00
Agriculture, Fishery & Forestry	0.17	0.16	1.45	0.14	0.30	0.82
Share to Total (%)	0.03	0.02	0.11	0.01	0.03	0.04
Growth Rate (%)		-3.83	788.96	-90.61	120.59	173.33
Construction	1.19	2.06	45.36	242.76	6.11	2.04
Share to Total (%)	0.19	0.25	3.54	23.05	0.69	0.11
Growth Rate (%)		72.54	2,107.25	435.2	-97.48	-66.61

*annual average

Source: CEIC.

There were concerns that such sterilization was choking the economy, considering that the fiscal sector was already operating with a tight purse shown in the huge fiscal surpluses. It was argued that the fiscal surplus was already dampening domestic demand and that further monetary tightening was not giving enough room for the economy to grow. Yet, despite this, the economy posted remarkable growth from 1993 to 1997.

As in other countries, the apparent strength and steadiness of the exchange rates gave an impression of stability and thus ameliorated capital inflows. Increased flows resulted in a boom in the stock market, real estate industries and non-tradable activities. Figure 24 shows that increased trading in the stock exchange coincides with the period of increased capital flows, rallying during the period 1993 to 1997 when increased capital flows were also observed.⁹³ Real estate prices also shot up. The land prices in Makati and Ortigas, two commercial and financial districts in Manila, more than doubled between 1992 and 1997 (see Figure 25). Construction activities, particularly in the urban centers, also jumped precipitously, and lending to the real estate sector also grew by 90%.

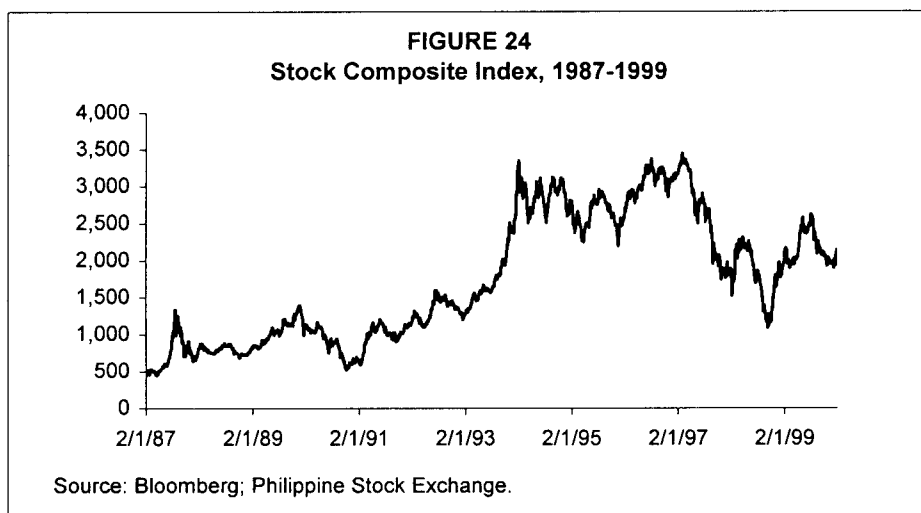
⁹³ Lamberte (1994) shows the close link between capital inflows and Philippine stockmarkets through granger causality from net portfolio investments to composite price index. He also finds that portfolio investments significantly and positively affect investment ratio, thus contributing to improving productive capacity in the economy. On the other hand, remittances of workers affect personal consumption expenditures, while FCDU withdrawals affect neither the investment ratio nor consumption.

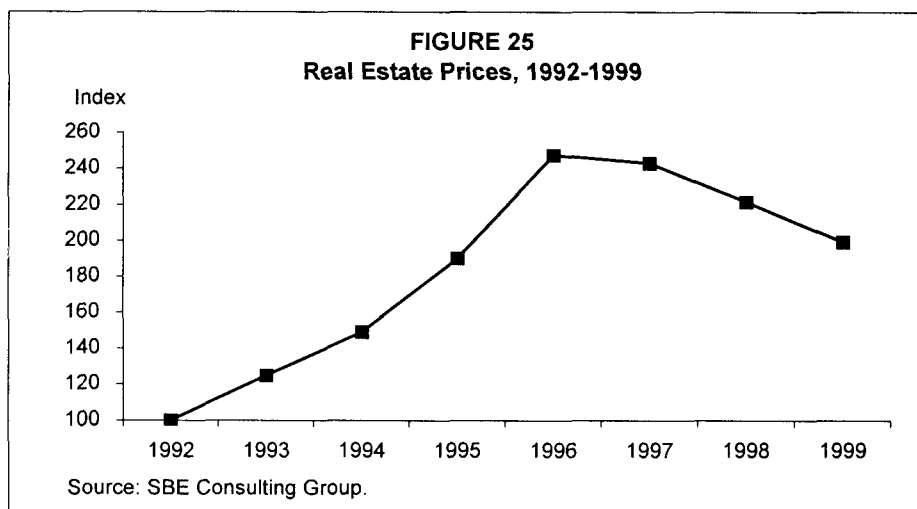
Table 86 Effects of capital inflows, 1991-1999, in million dollars unless otherwise stated

	1991	1992	1993	1994	1995	1996	1997	1998	1999
Gross Int'l Reserves (in billion \$)	4,526	5,338	5,922	7,122	7,762	11,745	8,768	10,806	15,107
Average Monthly Imports	1,004	1,210	1,466	1,778	2,199	2,657	3,030	2,460	2,561
Import Cover	4.5	4.4	4.0	4.0	3.5	4.4	2.9	4.4	5.9
REER	68.18	76.37	74.65	79.57	84.30	91.54	87.76	69.50	74.52
Growth Rates:									
REER**	-1.48	12.02	-2.25	6.59	5.94	8.59	-4.13	-20.81	7.22
M3	15.48	11.04	24.64	26.50	25.31	15.76	20.95	7.37	19.27
M4	16.46	13.09	28.48	24.32	26.32	23.84	25.06	8.21	16.29
TBR91	21.35	16.12	12.25	13.69	11.35	12.39	13.12	15.27	10.20
Budget Deficit (as % of GDP)	-2.11	-1.18	-1.48	0.96	0.58	0.29	0.06	-1.87	-3.74
Trade Deficit (as % of GDP)	-3.73	-3.16	-6.83	-6.06	-5.64	-5.48	-6.61	1.70	8.77
Current Acct. (as % of GDP)	-1.91	-1.62	-5.55	-4.60	-4.45	-4.77	-5.30	1.97	9.40

* at 1980 prices.

Source: Bangko Sentral ng Pilipinas; CEIC.



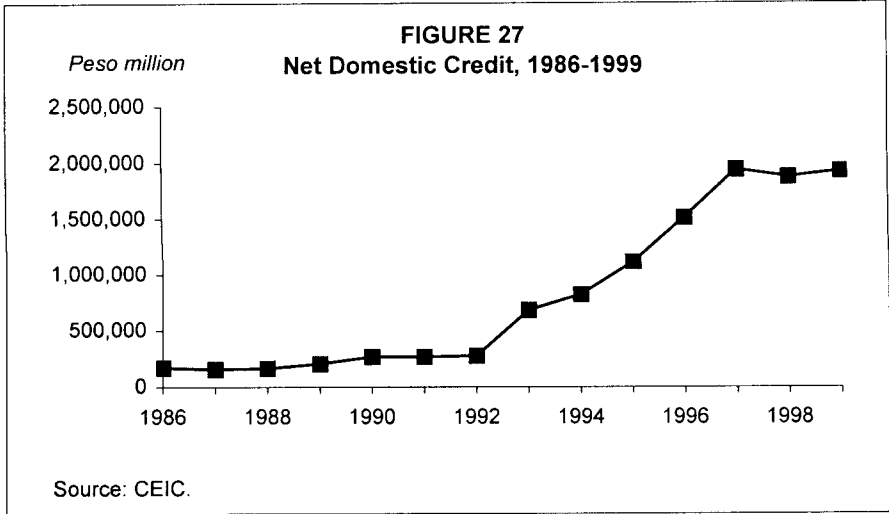
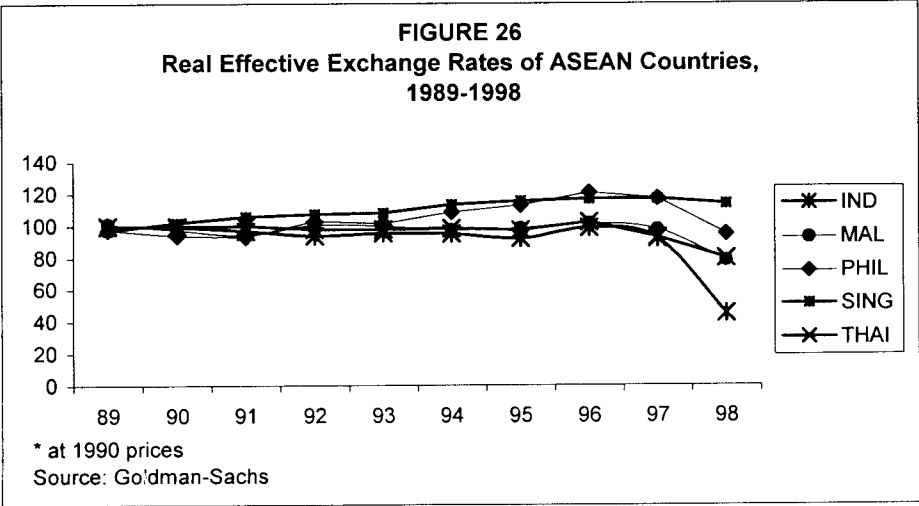


Thus, while the country basked in the increased international optimism in the economy, the surge of capital inflows has paved the way for increased vulnerability of the economy to external shocks and financial contagion. This vulnerability was manifested in the appreciating real exchange rate, rising trade deficit, rapid growth of private credit facilitated, in large part, by the huge influx of capital, and the associated build-up in real estate prices, particularly in Metro Manila.

Trade Deficit and Competitiveness. Growing concern over price competitiveness for the Philippines was made apparent with the appreciating real effective exchange rate and ballooning trade deficit. Real effective exchange rate has been increasing since 1991. In fact, computed real exchange rate indices of ASEAN countries show that the Philippines appeared to be the country that experienced the greatest real exchange rate appreciation (see Figure 26). The yuan devaluation in 1994 contributed to the lower price competitiveness for the Philippines during this period. Due to large capital inflows, the country was not able to match this devaluation thereby passing up the chance of correcting its overvaluation.

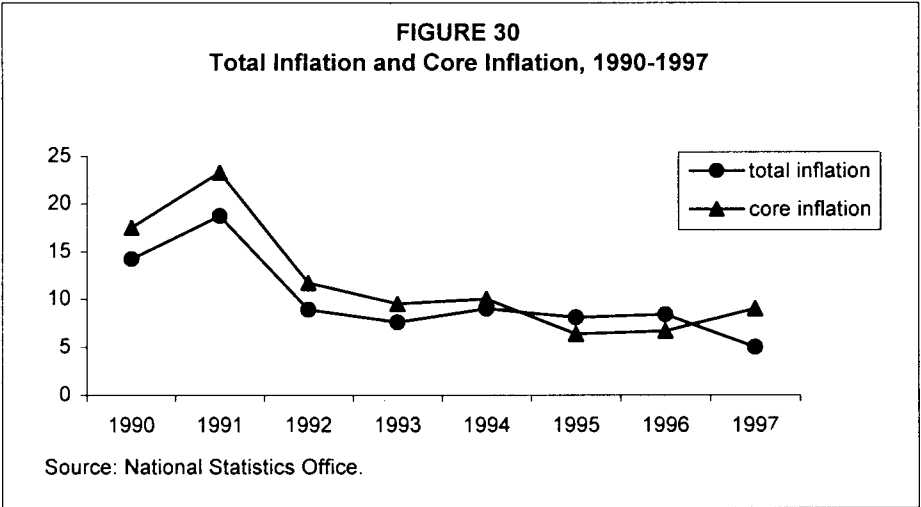
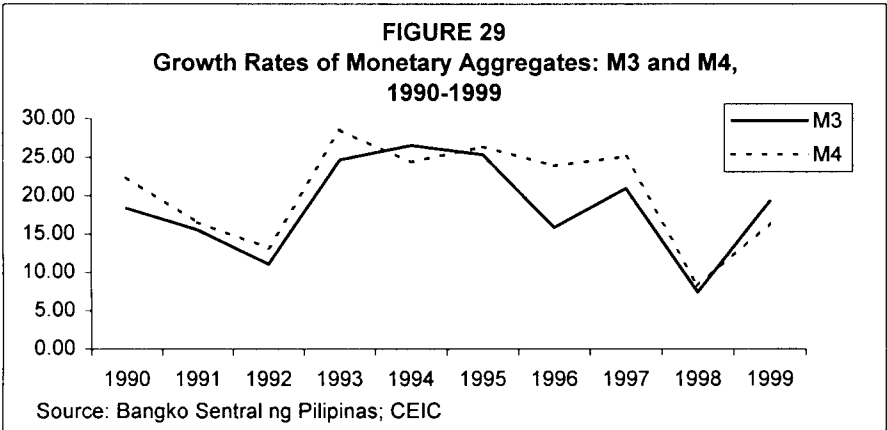
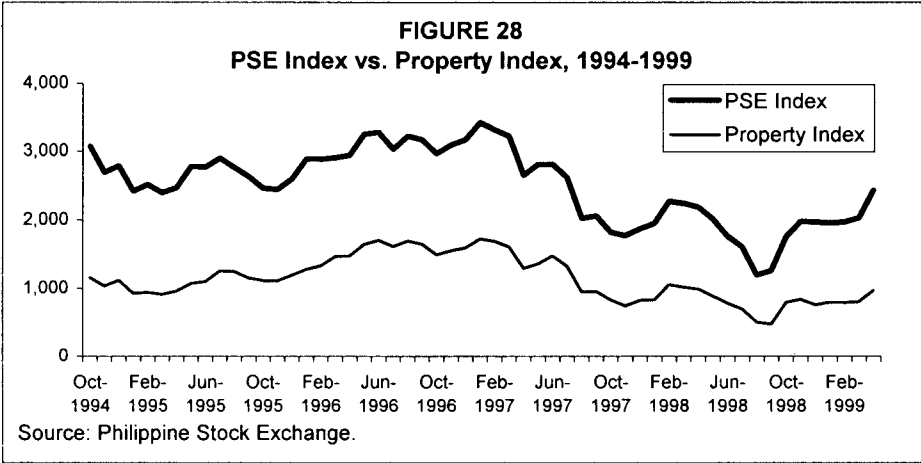
Eroding price competitiveness was made apparent in the trade and current account deficits that have been on the rise since 1991. Even as the capital account registered surpluses during most of the 1990s, the current account, particularly the trade balance, was persistently negative. The imports and exports gap was yawning throughout the decade, reaching a peak of 14% of GDP in 1996 and 1997 because of slackening demand, particularly in semiconductors. The current account deficit, in contrast, was more discreetly negative at a 4-6% range throughout the decade, due to increased overseas workers remittances. Without it, current account deficits would have reached as high as 12% of GDP in 1997.

Increased Bank Lending. The surge in commercial bank lending was also symptomatic of the growing bubble. Total commercial bank loans markedly went on an upward trend starting 1992 and grew very rapidly at an average of 41% since 1994 (see Figure 27).



Much of these increased lending went to the financial and real estate sectors, thus contributing to asset inflation. The fact is that even the stock market boom was a real estate boom because most of the highly transacted stocks were real estate companies. A look at the composite and property price indices indicates that much of the increases in the stock market index have been due to movements in property prices (see Figure 28).

The increase in bank lending was expected to fuel domestic liquidity and thus, to increase inflationary pressures. However, money supply, as measured by M3 (see Figure 29) showed no alarming signs of extraordinary growth, partly explaining the relatively stable inflation growth. Since 1992, inflation remained at single-digit, except in 1995 when the country experienced a rice shortage. Even then, the core inflation (CPI less food items) remained at single-digit (see Figure 30).



However, the growth of M4 suggests that much of the bank lending were actually in foreign currency rather than in peso.⁹⁴ Orbeta (1998) estimates that about a fifth of the loans granted to banks in 1996 was denominated in foreign currency and that the banks' foreign lending expanded by a hefty 425% between 1993 to 1996. This raised concerns on the capability of borrowers to absorb foreign exchange risks in case of a sharp devaluation.

Portfolio Inflows. Lastly, the surge of portfolio flows since 1993 also increased the vulnerability of the economy to adverse change of sentiments. As previously discussed, the share of portfolio inflows to total capital inflows rapidly increased to more than \$1 billion in 1995 then quickly turned negative the following year. This is evidence indeed of the fickleness of this type of capital flow, as well as of the increasing vulnerability of the economy.

C. Immediate effects of the crisis and government response

Period of speculation and defense

In April 1997, when Thailand's financial woes surfaced, the extent of the damage that the events in Thailand can do to the rest of the ASEAN was still unforeseen by most. As Thailand's situation worsened in May, other ASEAN countries began to suffer limited spillover effects. Philippine authorities quickly reacted by intervening in the exchange markets and by raising interest rates. As early as mid-May, the BSP's overnight lending rates started to show increased fluctuations. On May 19, overnight rates climbed up to 20.1% from an average of about 10% since the beginning of the year (see Figure 31.2). It subsided to an average of about 15% up to late June, before new rounds of high increases again took place in July.

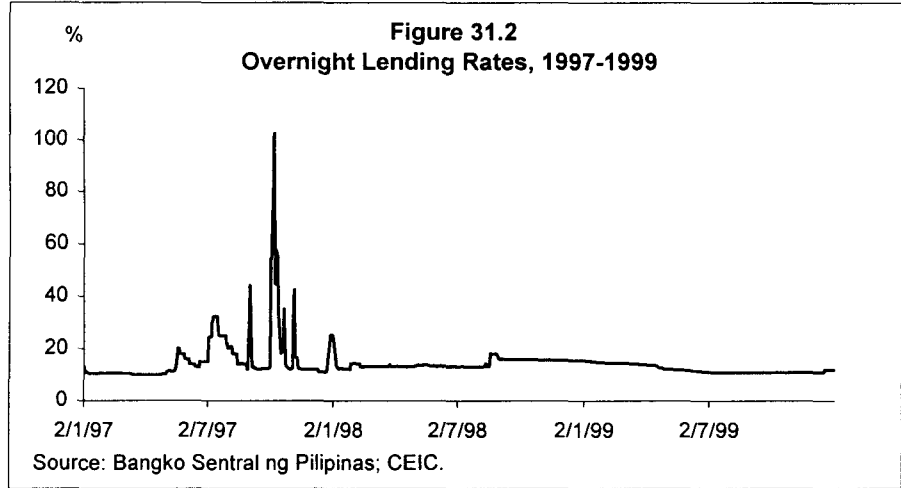
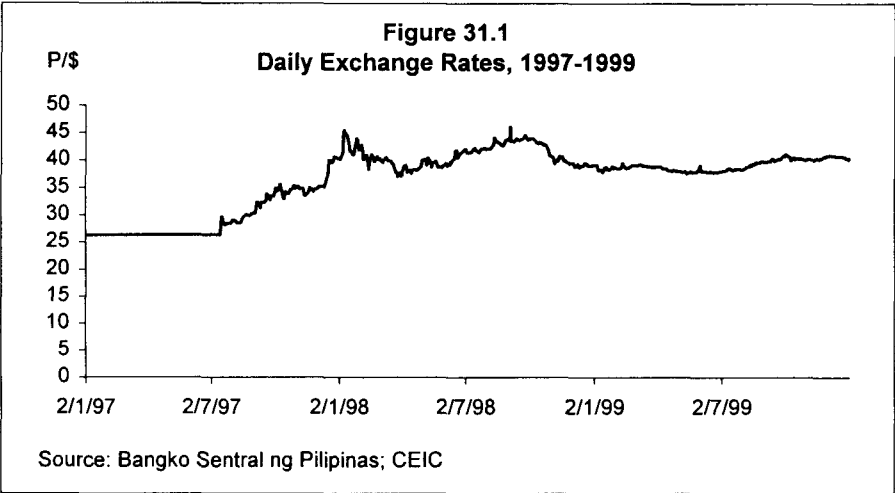
Soon after Thailand's move to a floating system on July 2, 1997, the peso, like all the other ASEAN currencies, was under intense speculative attack. Philippine monetary authorities tried to defend the average peso/dollar value of about P26.3 by further increases in interest rates as well as foreign exchange intervention. Overnight lending rates climbed up and reached a high of 32.4% and subsequently hovered around an average of 24.3% for the rest of July. Gross international reserves went down by close to \$3 billion in an effort to affect demand and supply in the foreign exchange market but to no avail. The peso finally went on a float in July 11 to P29.45 to a dollar from P26.37 the day before.

From the time the peso was allowed to float, the peso value went on a downward spiral (see Figure 31.1). It was not the case that after the currency adjusted once and for all, the speculation abated. The continued uncertainty in Asia precipitated further depreciation throughout the rest of the year and managed to break through the P40/1\$ psychological barrier. Once it was broken, it was feared that it would go on a free fall and reach P50/1\$. Fortunately, it somewhat stabilized to a little over P40/1\$ by yearend.

Another factor that was aggravating the speculation then was the political uncertainty arising from the growing tension associated with the "anti-charter change."⁹⁵ A peaceful protest rally was held on September 21, and the peso somewhat stabilized between P33 to P34 to the dollar.

⁹⁴ Lim and Woodruff (1998) illustrates the policy bias in favor of foreign currency intermediation in the Philippines prior to the Asian crisis. This partly explains the growth in foreign currency lending as compared to domestic currency lending.

⁹⁵ People suspected that President Ramos wanted to change the constitution to allow him to seek a second term for the presidency. Many civic and religious leaders opposed such move because it was reminiscent of the Martial Law years when Marcos manipulated the constitution in order to stay in power.



However, BSP began confusing the market by being “in and out,” leading to new signs of volatility. Overnight interest rates showed signs of extreme movements in early October, reaching a very high rate of more than 102% on October 7, then going back down to about 21% in just about a week. These moves suggest that the BSP’s moves were an effort to prevail over speculators in the foreign exchange market. By the end of 1997, the peso depreciated to P39.95—a more than 50% change from its June value of P26.384.

The peso did not show any more abrupt move until early January 1998 when the exchange rate reached P45.05 associated with the continued instability in the region, particularly the threatening yuan devaluation, further weakening of the yen, and the continued speculative attack on the Hong Kong dollar. This time, however, monetary authorities clearly allowed the currency to go and depreciate along with the rest of the Asian currencies, evidenced in the lack of movement in the overnight rates. Subsequent improvements throughout East Asia further stabilized the peso in 1998 and recoup some of the value it had lost the previous year.

Effects on other economic variables in 1997

At the outbreak of the Asian crisis, the government's official line was that the Philippines was not in crisis. With good reasons because, although the peso depreciated more than 50%, the economy nevertheless continued to grow. Real GDP grew at 5.1%, slightly lower than the 5.7% growth chalked up in 1996. Consumption and investments posted respectable growths, perhaps reflecting the general sense then that the Asian crisis was going to last but a very short time. Further, export growth was the highest in Asia largely because non-Japan Asia has the lowest share of Philippine exports while its main export markets, the United States and Western Europe, were experiencing unprecedented growth.

On the supply side, the meager 2.7% growth from the agricultural sector, which was largely due to El Niño, was offset by a more robust growth of 5.7% in the services and industry sectors, which comprise 42% and 34% of GNP, respectively. The main source of dollar earnings, the remittances of workers from abroad continued pouring in and propped international reserves. Inflation remained at single digit despite the large degree of peso depreciation.

The impact was felt most in the financial sector. Banks severely cut domestic lending, partly because of the exceedingly high and unstable interest rates and partly because of the uncertainty in the business and economic environment. A survey by the World Bank reveals an increase in the number of rejections of bank loan applications in the different sectors particularly during the second half of 1997, suggesting greater credit tightening (see Table 87). During the first half, an average of about 5% of bank applications from the different sectors was rejected. This proportion more than doubled to 12% during the second half and onwards.

Table 87 Bank loan rejections, 1997-1998, as percent of firms

Industry	1st half 1997	2nd half 1997	1998
Chemicals	2.4	7.0	9.3
Food Products	5.3	16.8	11.6
Electronics	5.6	7.8	6.7
Textiles	6.5	6.5	14.9
Wearing Apparel	6.9	16.1	18.2
All Sectors	5.6	11.9	12.1

Source: World Bank, Asiaweek (April 16, 1999 issue).

In the first nine months of 1997, net capital inflow was still positive at \$6.7 M, but the second half definitely showed reduction of inflows. Gross inflows for the first three quarters of the year amounted to \$3.9 billion compared to \$4.5 billion for the same period in 1996. Withdrawal of capital by residents, amounted to \$3.7 billion for the first three quarters compared to \$2.5 billion the previous year (Orbeta 1998). Despite the high interest environment, investors actually started withdrawing their investments since 1996, even before the peso was allowed to depreciate in July due to the limited capability of the domestic debt market to absorb fund from equity withdrawals.

Another major casualty was the stock market prices. The composite price index plunged by more than 50% from 3,000 to less than 2,000 index points. Most of this decline was brought about by the collapse in property prices. Curiously enough, like capital inflows, the stock market prices have been on a downward trend since 1996, after consistently increasing since 1991 (see Figure 24).

Still, most of the effect of the Asian crisis was not felt in 1997 but in 1998 as will be discussed in the subsequent sections.

Government responses

The response of the monetary authorities at the outset was a decided defense of the currency. It raised overnight lending rates to high levels and spent more than \$1.5 billion defending the peso before the currency was finally allowed to float.

After the exchange rate floated on July 11, the trading band of the peso was widened. The central bank put restrictions on the sale of non-deliverable forward contracts to non-residents to limit speculation against the peso. Overnight lending facility was suspended on August 20 to have a firmer grip on liquidity. It also temporarily raised the liquidity reserve requirement.

Even as there were talks about a backlash of capital controls throughout Asia, the BSP stood by free market principles and did not revert to administrative capital control policy.

Most of the central bank's short-term measures were primarily aimed at cutting speculation in the foreign exchange market. Among these measures include: 1) introduction of a non-deliverable forward facility by the BSP in order to ease the pressure in the spot peso-dollar market from domestic borrowers wanting to cover their unhedged positions; 2) lessening the maximum amount of dollars, from \$100,000 to \$25,000 and subsequently to \$10,000, that banks can sell without the required documentation; 3) increase in interest rates; 4) tightening banks' use of dollar funds for speculative purposes by lowering their overbought and increasing their oversold positions; 5) redefining overbought and oversold computation by subtracting the forward contract sales from their daily foreign exchange positions; and 6) consolidating subsidiaries' accounts in the computation of net foreign exchange positions.

As the crisis unfurled, monetary authorities addressed the problem of investors' confidence by tightening bank supervision and regulation. It tightened bank liquidity reserves and prescribed a regulatory limit on loans made to the real estate sector to no more than 20% of the total loan portfolio of a commercial bank. It also decreased the collateral value to only 60% of appraised real estate value, redefined criteria for past due loans from six to three months of defaults and prescribed a 30% liquid cover on all foreign exchange liabilities of foreign currency deposit units (FCDUs).

The BSP also tightened corporate governance by outlining the expected duties and responsibilities of banks' board of directors and required disclosure of non-performing loans ratio to total loans. Likewise, it required a general loan loss provision equivalent to 2% of gross loan portfolio as well as specific loss provisions for different categories of loans. Tables 88 and 89 show the schedule of loan loss provisions and the capital requirement of banks adopted and planned by the central bank.

Table 88 Schedule of compliance allowance for probable loans, in percent of loan amount

Classification	Existing	12/31/98	4/15/99
Loans especially mentioned	0	2.5	5
Substandard			
Collateralized	0	12.5	25
Uncollateralized	25	25	25
Doubtful	50	50	50
Loss	100	100	100

Source: Bangko Sentral ng Pilipinas

Table 89 Minimum capital requirement for banks, in million pesos

Banks	Existing Requirement	Improved Requirement and Compliance Period		
		12/24/98	12/31/99	12/31/00
Expanded Commercial Banks	3,500	4,500	4,950	5,400
Commercial Banks	1,625	2,000	2,400	2,800
Thrift Banks	240	290	377	464
w/in Metro Manila	200	250	325	400
Outside Metro Manila	40	40	52	64
Rural Banks	40	40	52	64
w/in Metro Manila	20	20	26	32
Cities in Davao & Cebu	10	10	13	16
1 st , 2 nd , 3 rd class cities & 1 st class municipalities	5	5	6.5	8
4 th , 5 th , 6 th class cities & 2 nd , 3 rd , 4 th class municipalities	3	3	3.9	4.8
5 th , 6 th class municipalities	2	2	2.6	3.2

Source: Bangko Sentral ng Pilipinas

On the fiscal side, fiscal authorities directed a 25% mandatory reserve on all non-personnel-related expenditures in the budget of all government departments, except the Education Department. This was in view of the projected short fall in tax revenues, particularly from the customs bureau, as a result of much reduced volume of imports (see Table 90). Despite the cost-cutting measures across the board, the national government still posted its first deficit of about 1% of GDP in 1997 after four consecutive years of fiscal surplus.

Table 90 National government operational budget for 1999, in billion pesos

	1997	1998	% change	1999	% change
Tax Revenues	413.0	416.6	0.9	484.1	16.2
BIR	314.7	337.2	7.1	396.3	17.5
BOC	95.6	76.0	-20.5	79.8	5.0
Others	2.7	3.4	25.9	8.0	135.3
Non-Tax Revenues	59.7	45.9	-23.1	37.8	-17.6
Total Revenues	472.7	462.5	-2.2	521.9	12.8
Expenditures	470.2	512.5	9.0	590.3	15.2
Surplus/Deficit	2.5	-50.0	-2100.0	-68.4	36.8

Source: Bureau of Treasury, Department of Finance.

D. Two crises compared

While the Philippine economy was similarly subjected to the speculative run that plagued Asian economies, the question why it has appeared relatively unscathed remains. Another question that comes to mind is why the recent crisis has not been as severe as the crisis the economy had gone through in the 1980s.

Perhaps, the main reason for the latter's difference lies in the political and economic preconditions prevailing at the time the economic shock struck. The years 1983 to 1985 were

very troubled times for the Philippines. Not only did the world interest rates and foreign debt rise, the political scene was also very unstable, what with an ailing president (then President Marcos) on the one hand, and a serious communist threat on the other. Thus, when the debt moratorium was imposed in 1983, massive capital flight, street protests, bank closures, and massive labor layoffs ensued. The current Indonesian situation is, in fact, reminiscent of the Philippines circa 1980s.

In contrast, the recent crisis hit the economy at a time of political stability, relative financial sector strength and high confidence in the economy. The democratic institutions restored by the Aquino administration in the second half of the 1980s have somewhat matured during the Ramos presidency.

Moreover, the external shock in 1981 to 1982 struck when the Philippine economy was already at a precarious state because it had hardly recovered from the two oil shocks of the 1970s. On the other hand, the Asian crisis hit the Philippine economy when it was performing remarkably well, up until the collapse of the Thai baht. The growth inertia this provided explains why Philippine growth in 1997 did not immediately decline but rather continued to rise. In contrast, the GNP, at its nadir, contracted by more than 9% in 1984 and another 7% the year after (see Table 91).

Table 91 Selected economic indicators 1983-1985 and 1997-1999

	1980s Crisis			Asian Crisis		
	1983	1984	1985	1997	1998	1999
Real GNP growth	1.65	(9.11)	(6.96)	5.30	0.10	3.58
Real GDP growth	1.87	(7.32)	(7.31)	5.17	(0.50)	3.23
Growth in dollar exports of goods	(0.30)	7.75	(14.15)	22.81	16.92	18.80
Real Agriculture growth	(3.38)	(0.93)	(1.88)	2.93	(6.60)	(6.57)
Real Industry growth	1.52	(11.51)	(15.75)	6.14	(1.70)	0.51
Real Services growth	5.56	(6.53)	(2.08)	5.46	3.50	3.93
Per capita GNP (in P)	12,640	11,245	10,201	12,616	12,354	12,518
Per capita GDP (in P)	12,828	11,601	10,491	12,016	11,783	11,940
Interbank call loan rate	16.49	28.29	20.16	17.90	13.80	10.80
Change in interbank rate	34.72	71.55	(28.73)	42.06	(22.91)	(21.74)
Treasury bill rates (91 day)	14.26	28.24	25.87	13.10	15.30	10.20
Change in TBR	3.48	98.04	(8.39)	5.65	16.79	(33.33)
Exchange rate	11.11	16.70	18.61	29.47	40.89	39.09
Change in exchange rate	30.13	50.27	11.43	12.42	38.75	(4.40)
Inflation (IP/GDP 1994=100)*	14.24	53.79	23.20	5.90	9.80	6.60
Unemployed (thousands)	2,053	2,388	2,545	2,640	3,145	3,102
Change in unemployed		16.34	6.54	3.69	19.01	(1.37)
Unemployment rate	10.27	11.61	12.18	8.70	10.05	9.65
Gross International Reserves (in terms of import-months)	1.54	2.01	2.74	2.9	4.4	5.9

* Base year for 1983 and 1984 inflation is 1985.

Source: UAP-SEC; CEIC, National Statistics Coordinating Board; Bangko Sentral ng Pilipinas.

Why the Philippines was relatively unscathed relative to Thailand, Indonesia, or Korea may be partly explained by luck. That is, the crisis struck while the Philippine bubble was still incipient. Perhaps, two years hence, the bursting of a bigger bubble would have caused much more severe damage.

The other part, however, may be explained by the structural difference of the Philippines with its Asian neighbors. First, its early bout with cronyism during the Marcos regime taught the country enough about the dangerous links between vested interests sanctioned by the government and financial and economic mismanagement. This lesson is just now being learned by Thailand, Indonesia and Korea. In a government clean-up, the Aquino administration did away with many crony-controlled government monopolies, which, besides being notorious for inefficiency and corruption, were significant drains to government coffers. Thus, unlike the most afflicted economies in Asia, the Philippine economy at the onset of the crisis had no big bailout commitments that could compromise its credibility.

Second, the financial system crisis in 1983 to 1985 led to a reinvigorated and relatively more stable banking sector and more prudent central bank supervision. The entire banking system's actual exposure to real estate, for instance, was significantly less than the BSP's mandated maximum of 20% of total loans. Banks were also required to set aside foreign currency assets in liquid instruments equivalent to 30% of their foreign exchange liabilities. Likewise, required capital adequacy ratios by authorities were actually even higher

Box. Lessons from Previous Financial Crises in the Philippines

The Philippines suffered through two systemic financial crises in the 1980s: the liquidity crisis in 1981 and the balance of payment-cum-financial crisis in 1983-84.

The first is now popularly known as the 'Dewey Dee affair' since it was triggered by the absconding of a well-known indebted businessman by the same name. Its cause was traced to the laxity in the regulations of the commercial paper market where even practically bankrupt companies were able to issue debt papers.

The 1983-84 crisis, on the other hand, was closely intertwined with the external turmoil from the international debt crisis. Thus its repercussions were far more severe. While the liquidity crisis in 1981 concerned mostly nonbank quasi-banks—although back then, these had potential danger of deteriorating into a full-blown run on the entire financial system—the second hit even fairly large commercial banks directly, but most especially, government banks. The two crises are, nevertheless, connected because the government bailouts of quasi-banks and distressed corporations in 1981 were precisely what made the Philippine financial system highly susceptible to the balance-of-payment troubles two years later.

The Dewey Dee affair

When Filipino businessman Dewey Dee fled the country in 1981 leaving several hundred million pesos in debt, he triggered a collapse of the commercial paper market, which, up till then had been tiptoeing on a dangerous balance beam. Before its collapse, the Philippine commercial paper market had been undergoing a typical adverse selection problem since the late 1970s. The high cost of borrowings through commercial papers drove prime companies out of the market and left the field to weaker companies. These companies were either seeking short-term financing for long-term investment, partly a result of the lack of a long-term financial market, or were covering operating losses. The expensive commercial paper they issued were, in turn, intermediated by undercapitalized investment

(Continued on page 249)

than the ratio established by the Bank for International Settlements (BIS). Furthermore, the Philippine banking system did not appear to be over the leverage compared to the more afflicted economies. Total bank loans to total assets had been considerably less than the more than 100% ratios of other Asian countries. Finally, non-performing loans, though increasing, were still manageable, evident in its relatively low ratios to total loans (see Table 92).

Table 92 Philippine Banking System: Selected Ratios, 1990-1999 (in percent)

	NPL/Loans	Loans/Assets	Loss Provisions to Total Loans
1990	7.86	49.84	4.42
1991	7.31	49.98	3.83
1992	7.21	51.00	3.27
1993	6.00	55.64	2.55
1994	5.41	57.58	2.03
1995	4.93	61.45	1.72
1996	3.51	65.28	1.39
1997	4.54	57.26	1.64
1998	10.23	50.98	3.06
1999	12.34	46.73*	5.55

* Commercial Banking System.

Source: Bangko Sentral ng Pilipinas.

Box. (Continued)

houses and other quasi-banks, and sold to investors who scarcely paid attention to the underlying worth of the commercial paper but only to its high earnings yield.

While the going was good, the long-term investment needs and loss covering were patched up by the continuous roll-over of money market loans. This delicate balance, however, was upset by the flight of Dewey Dee. When news of his escape broke out, pretermination of placements by money market investors ensued, turning quasi-banks suddenly illiquid. Corporations were hampered from rolling over their loans, while some otherwise healthy banks suffered minor runs as depositors started withdrawing funds from those with suspected significant exposures to Dee's businesses. The money market shrunk, and other corporations that could not obtain financing collapsed.

The central bank response was a general bailout. It opened its rediscounting window for the first time to nonbank quasi-banks, which it was not previously empowered to assist, as the window was, hitherto, exclusively for banks. Though the commercial papers were purchased by investors on a 'no recourse' basis, the central bank provided liquidity to the financial institutions in order to prevent panic from escalating and the credit process from being interrupted. Investors were therefore able to encash their commercial papers almost without cost.

Many insolvent quasi-banks closed down, however. Others floundered from the penalty rates imposed by the central bank. For these institutions to be paid by the corporate issuer of the commercial paper, the government also created the Industrial Fund to help distressed corporations. This mechanism allowed lead banks like the Development Bank of the Philippines (DBP) and the Philippine National Bank (PNB) to channel government funds into loans or equity in these corporations. The fresh government funds thus allowed the corporations to redeem their old commercial papers from the financial institutions which, in turn, paid back their loans from the central bank. This circular government intervention (shown in Figure B1) helped resuscitate confidence in the financial system, albeit at significant cost that was to be revealed two years afterwards.

(Continued on page 250)

Third, while it might have been disadvantageous in the past to link exports very closely to the US economy because output can fluctuate wildly according to US economic growth, it proved to be a boon to the Philippines during the Asian crisis. Philippine exports to the US and Europe comprised more than 50% of total exports, with the US alone taking more than 30%. Because the US and Western Europe were the regions fueling world demand during the global meltdown, Philippine exports shot up in 1998. Unlike the Asian tigers, the Philippines has comparatively low export links with the other ASEAN countries, thus leaving its export performance untrammelled by the Asian turmoil.

Finally, after almost two decades under dictatorship, the Philippine political succession is now much better established under the system of democratic election. The contribution of political stability that comes with clear electoral mandate cannot be underestimated because through it, a credible economic policy can be designed and be made to work. Countries like Indonesia or Malaysia do not have this Philippine advantage.

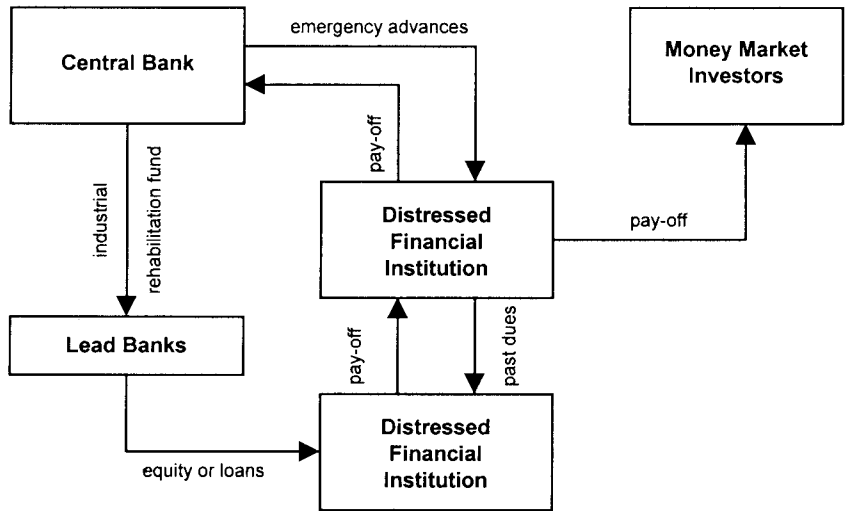
II. Macroeconomic and Sectoral Impact of the Asian Crisis

This chapter discusses in greater detail the impact of the Asian crisis on the industrial sectors, on labor and on overseas Filipino workers, particularly those deployed in the affected economies in Asia. It also assesses the impact of exchange rate depreciation to domestic

Box. (Continued)

The private sector responded with greater conservatism. Following the liquidity crunch, banks practically limited lending only to prime businesses. It also led to improved regulation of the commercial paper market to weed out paper issues from bankrupt corporations. Interest rates across banks and nonbank quasi-banks were also deregulated to prevent similar adverse selection problem in the money market.

Figure B1: Anatomy of a rescue
Financial bailout in 1981 liquidity crisis



(Continued on page 251)

prices. The first section analyzes the different winners and losers in the industrial sectors, the net effect of devaluation and how the tightness in the loans market exerted pressure on different industries. The next section studies the effect of the crisis on employment and unemployment, as well as on the structure of the labor force. The third section puts a special focus on a group of the Philippine labor force, the overseas Filipino workers who, in the past, have contributed significantly to the balance of payments but whose continued contribution is threatened by the lingering financial crisis. Finally, the effect of the crisis on domestic prices is discussed.

Effects on the Industrial Sector

Growth rates in gross value added of industries in 1998 show that, except for consumer goods, intermediate and capital goods—indeed the entire manufacturing sector—posted negative growth (Figure 32). How much of this must be due to the Asian crisis is discussed in this section.

An important step towards this end is an analysis of the impact of the exchange rate devaluation on individual manufacturing sectors. Following Campa and Goldberg (1995), we computed the *net external orientation (NEO)* of the different manufacturing industries in the 1994 60x60 Input-Output Table to have a workable indicator of the direction and sensitivity of Philippine manufacturing to exchange rate shifts. Briefly, the net external orientation is

Box. (Continued)

International debt crisis (1983-84)

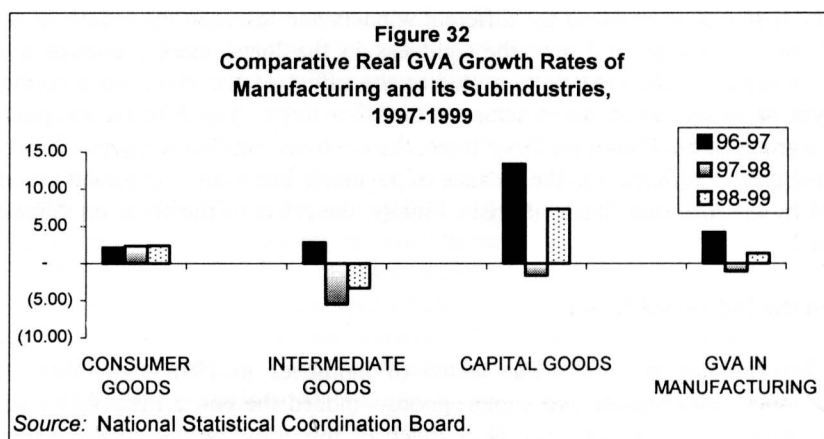
The growing confidence after the 1981 central bank rescue was dashed in 1983, after the assassination of Senator Aquino and the balance-of-payments crisis came in full force. The ensuing banking problem was far worse, affecting even large commercial and thrift banks.

This time, partly because government resources were already much more limited, the central bank response was to let insolvent private banks fail. Majority of the private commercial and thrift banks, however, were able to weather the crisis primarily as a result of increased conservatism from the 1981 liquidity crisis. Private banks' balance sheet position were, thus, much more improved and stronger when the balance-of-payment difficulties hit.

The same did not hold true with government banks like PNB and DBP. Because they have been heavily involved in rescuing ailing quasi-banks and granting loans to distressed corporations during the liquidity crisis in 1981, the government banks found themselves saddled with huge nonperforming assets two years down the road. The sharp peso devaluation also catapulted the share of their foreign liabilities in proportion to total long-term borrowings. Without support from the central bank, these banks would not have been able to continue operating. The central bank, for its part, was rendered practically insolvent by the new round of financial support.

When the Aquino government took over in 1986, PNB and DBP were rehabilitated by transferring billions of nonperforming assets and other liabilities to the national government, paring down their total remaining assets, and improving their profit performance. Their charters were revised to make them able to resist behest loans from then on. Some 30% of government shares in PNB were eventually privatized and nonperforming assets transferred to the Asset Privatization Trust, re-packaged and sold off to the private sector, albeit some at a loss.

(Continued on page 252)



Box. (Continued)

Major regulatory changes in the financial sector during this episode included more stringent measures to minimize mismanagement and insider abuses. This means: limitations on directors, officers, or stockholders and their related interests (DOSRI) accounts, i.e., borrowings by directors and officers, from the banks; inclusion of contingent liabilities in determining loan limits to single borrowers; annual financial audit by independent auditors; increased transparency particularly of DOSRI deposits. The central bank also put a cap on bank issues of loan and letters of credit guarantees. In sharp contrast to the general bailout policy in the 1981 crisis, the central bank spelled out its policy toward improving stability and soundness of the banking system, which meant refraining from sustaining weak banks except in times of general financial emergency (Lamberte 1989).

Lessons unheeded?

To date, many of the lessons have been heeded. Particularly, private sector banks' relatively strong bank balance sheets, reduced dependence on government support, etc., explain partly why the Philippine financial system did not have it too bad when the Asian financial crisis hit. Yet, a lot remains to be implemented, particularly in terms of government supervision and regulation.

The central bank has stressed higher bank capitalization and increased transparency, particularly on DOSRI deposits. This is a step in the right direction. But another crucial area of reform is the legal protection of regulatory staff against lawsuits for action taken in performance of their duty. Without legal protection, bank supervisors are impeded from carrying out prompt and corrective action on ailing banks that can help mitigate further losses. Reducing the scope of discretionary action by bank supervisors, i.e., putting in place mandatory action for certain bank infringement of BSP regulations, say, on capital requirements, can likewise lead to a more prompt correction.

Another measure that can aid quicker bank resolution lies in a measure by the Monetary Board which can facilitate a bank receiver like the Philippine Deposit Insurance Corporation to step in at the right moment to prevent further asset deterioration.

Summing up, the lessons from these two systemic financial crises underscore the need for a clear system of reward and punishment in the market, as well as for improved quality of bank and nonbank regulation. General bailouts of financial institutions, for instance, though the fastest way to address financial disturbance, usually also contain the seed of their own destruction. Moreover, the quality of banking regulation and supervision remains, now more than ever, the key for the continued stability of the banking system. As the old adage goes, an ounce of prevention is worth much more than a pound of cure.

computed as the difference between the export revenues share and the imported input shares to total output. The latter is computed as the sum of the product of input values and each input's import penetration is defined as the ratio of imports over total output.⁹⁶ A positive and high NEO indicates that the specific industry has greater export revenues share than imported costs share and therefore stands to benefit from the devaluation. Conversely, a negative NEO implies that it will be a net loser from the exchange rate fall.

The result of the study shows that majority of Philippine manufacturing firms actually have a negative NEO, which means that the devaluation may not have proven to be beneficial to the entire manufacturing sector (Table 93). This is borne out by the fact that overall NEO of manufacturing is negative and actual growth performance of the sector was also dismal both in 1997 and 1998.

Table 93 Net external orientation of manufacturing industries, 1997

INDUSTRY	NEO
Food manufacturing	Low
Beverage manufacturing	Negative
Tobacco manufacturing	Negative
Manufacturing of textiles	Negative
Manufacturing of wearing apparel except footwear	Negative
Leather manufacturing and products	High
Wood manufacturing cork and cane except furniture	Moderate
Manufacture and repair of furniture and fixtures	Negative
Manufacture of paper and paper products	Negative
Printing, publishing and allied industries	Negative
Manufacture of industrial chemicals	Negative
Manufacture of other chemical products	Negative
Manufacture of petroleum and coal products and petroleum refineries	Negative
Rubber product manufacturing	Negative
Plastic products manufacturing	Negative
Manufacture of pottery, china and earthenware	Negative
Glass manufacturing and glass products	Negative
Cement manufacturing	Negative
Manufacture of other non-metallic mineral products	Negative
Manufacture of structural clay and concrete products	Negative
Iron and steel basic industries	Negative
Non-ferrous metal basic industries	High
Manufacture of fabricated metal products	Negative
Manufacture of machinery except electrical	Negative
Manufacture of electrical machinery, apparatus, appliances and supplies	High
Manufacture of transport equipment	Negative
Manufacture of professional, scientific, measuring and controlling	Negative
Manufacture of photographic and optical instruments	Negative
Other manufacturing industries	Moderate

⁹⁶ See Appendix for the computation details of net external orientation.

Dividing the result into four groups with high, moderate, low, and negative NEO,⁹⁷ the study again shows that those with positive net external orientation posted positive growth in 1998 while those with negative NEO did not do as well (Table 94). Since the industries with negative NEO comprise about 46% of total manufacturing shipments,⁹⁸ overall manufacturing performance was therefore negative for 1998. The only counterintuitive result in the study is the negative growth performance of industries with high net external orientation, which, theoretically, should have performed best from the exchange rate depreciation. This may be explained by the very high aggregation of industries in the input-output table that tends to mask individual industry vulnerability to exchange rate shifts.^{99,100}

Table 94 Growth rates of manufacturing industries, according to net external orientation, 1994-1997

	1994-1997*	1998 Real Growth Rate (** unweighted)	1998 Real Growth Rate (* weighted)
High	8.4	-2.8	-0.9
Moderate	2.6	1.7	0.0
Low	3.9	3.1	0.4
Negative	5.9	-5.5	-2.5

* average. ** weighted by export shipments.

Source: National Statistical Coordination Board; UAP School of Economics.

Effects on Labor

The overall picture from labor statistics is that the effect of the Asian crisis was generally most felt in 1998 than in 1997, but that surveys in 1999 point to an improved labor market. Labor force participation dropped in both 1997 and 1998 suggesting that some must have voluntarily dropped off from the labor force as a result of lack of opportunities. Women participation in the labor force, however, has increased, particularly in the personal, social, and community services industry. Come 1999, labor force participation had indeed improved.

Average unemployment rose in 1998. Most of the unemployment occurred in Metro Manila. Moreover, majority of the drop in jobs in 1997 and 1998 were in the lower end of the job scale like production, clerical and agricultural workers and less in the executive and managerial jobs. Unpaid family workers declined while salaried workers increased, suggesting that some were forced to join the salaried workforce to augment family income. Finally, the sectors that has absorbed the most number of workers were the personal, social and community services and wholesale and retail trade sectors while manufacturing and financial services industries shed off the most labor.

⁹⁷ Industries considered with high NEO have more than 10% difference between export share and imported input share; moderate, between 2% to 10%; low below 2% but positive; negative, if less than zero.

⁹⁸ Industry exports shipment is approximated using the data in the 1990 Input-Output Table as the share of exports to total output.

⁹⁹ Consider, for instance, the manufacture of electrical machinery, appliances, and supplies, which has a high net external orientation. If semiconductors were taken out of the group, it is doubtful if the rest of the industries within it would still have a high net external orientation.

¹⁰⁰ Another plausible explanation is that some of these industries might have had relatively greater foreign currency debt exposure which could have undermined whatever benefits derived from increased export sales. This paper, however, does not verify this possible explanation.

Participation Rate, Employment, and Unemployment. In 1998, the Philippine economy posted the highest unemployment rate since 1990. The unemployment rate of 10.1% was a marked increase from the average of 8.4% from 1990 to 1996, when the economy exhibited a predominantly declining unemployment trend. This figure could have even gone higher if the labor force participation rate did not go down from 66.7% in 1996 to 66.3% and 66.1% in 1997 and 1998, respectively. That is, if some did not decide to drop out of the labor force as a result of the dearth of opportunities (see Table 95). In absolute terms, unemployment levels increased by 504,000 persons on the average, bringing the total unemployed persons to 3.1 million in 1998. The labor force dropout was most pronounced among the younger age bracket, i.e., among the 15-24 age bracket. This suggests that most of the jobs that have been cut were temporary and/or short-tenure jobs rather than full-time and long-tenure jobs.

Underemployment, ironically, declined slightly by 0.6% from 1997 to 1998, or 6.1 million underemployed persons, perhaps reflecting the lack of inclination to look for a second job because of unavailability of opportunities anyway.¹⁰¹ However, visible underemployment rate—the number of persons working less than 40 hours a week—increased its share in the labor force in 1998 by almost one percentage point relative to its 1997 level. This was a result of shortened work hours and reduced workdays by firms wishing to cope with the crisis. In 1999 however, the number of underemployed increased, growing at a rate of 6.23%, up from the previous year's decline of 0.64%. This may indeed be a reflection of improving conditions as workers renew their search for other opportunities.

While employment growth rate in 1998 was virtually flat, survey results in 1999 clearly pointed to some improvements. Employment grew by 3.8% on the average. Full time employment likewise improved, from 62.9% of total employment in 1998 to 63.1% in 1999 suggesting that the crisis-coping measure of reduced work hours had abated. Unemployment, however, also increased as a result of improved labor force participation of close to one percentage point, especially among women, youth and urban workers.

Table 95 Labor force participation, employment, and unemployment

	1990-96	1997	1998	1999
Labor Force (' 000)	26,973	30,355	31,056	32,081
Participation Rate	65.77	66.30	66.13	66.60
Employment (' 000)	24,443	27,715	27,911	28,980
Growth Rate	90.63	2.00	0.71	3.83
% share	90.63	91.30	89.95	90.40
Unemployment (' 000)	2,530	2,640	3,144	3,102
Growth Rate	8.40	9.00	10.10	-1.34
% share	9.00	8.70	10.05	9.70
Underemployment (' 000)	5,212	6,121	6,082	6,461
Growth Rate	2.57	7.03	-0.64	6.23
% share	19.32	22.10	21.80	22.30
Visible Underemployment ('000)	2,620	3,031	3,306	3,466
Growth Rate	4.78	-0.36	9.06	4.84
% share	9.71	10.90	11.85	11.96

Source: Bureau of Labor and Employment Statistics, Department of Labor and Employment.

¹⁰¹ In the Philippines, an employed person is underemployed if he is still actively looking for work. A person is visibly underemployed if he works for less than 40 hours in a week.

Closures and Retrenchments. Data on closures and retrenchments likewise suggest that the crisis effect was greatest in 1998. Total number of firms that reported closures and retrenchment in 1998 almost reached 3,000 compared to only more than 1,000 firms in 1997 and 1996. But in 1999, a total of 2,266 establishments resorted to permanent closure/reduction or rotation of workforce—a bit lower compared to the 2,637 establishments reported in 1998.

Of the 3,000 firms that reported closures and retrenchments in 1998, more than 2,000 firms retrenched while around 600 reported permanent close downs. These translate to more than 76,000 permanently laid off, more than 50,000 temporarily laid off and another 27,000 workers put on shorter work hours (Table 96). Likewise, in 1999, more notices of retrenchment or reduction of workforce than closures were filed.

Of the affected firms in 1998, more than 30% attributed their difficulties to a slump in market demand. Many also cited other significant reasons like reorganization and downsizing, depreciation and financial losses. Only about 10% considered depreciation and 3% put the economic crisis, as reasons for their firms' closures and retrenchments (Table 97). This is probably because most of the crisis effects were already bundled up with the slump in market demand.

Meanwhile, in 1999, slump in market demand was not much of a problem as in 1998. Organizational restructuring, either through reorganization and downsizing or change in management/merger, and financial reasons accounted for most of the permanent layoffs/closures filed during the period.

Data on closures and retrenchments give further proof that the most affected sectors in the Asian crisis were manufacturing, wholesale/retail trade and financing, insurance and real estate, as most of the affected firms belonged to these sectors. More than 33% of the firms that closed down or retrenched in 1998 were manufacturing firms, close to 20% were in wholesale and retail trade and 16% in finance, insurance, real estate and business services. Consequently, more than half of the affected workers, too, were in the manufacturing sector while less than a third were in the services sector. In particular, as much as 12,462 workers or 8% of the total affected workers belonged to wholesale and retail trade,¹⁰² while close to 12,000 workers or about 7.6% were in construction. This result implies that majority of the affected workers were in the low-end of the job scale rather than managerial staff.

Table 96 Establishments resorting to closure/retrenchment due to economic reasons and workers affected, 1997-1999*

ESTABLISHMENTS REPORTED				
Year	Total	Closure	Retrenchment	Rotation, etc..
1997	1,264	350	972	51
1998	2,637	510	2,150	321
1999	2,266	505	1,788	n.a.
WORKERS AFFECTED				
Year	Total	Permanent Layoff	Temporary Layoff	Rotation, etc.
1997	62,734	39,186	19,843	3,446
1998	155,198	76,726	50,744	27,728
1999	87,697	n.a.	49,873	37,824

n.a. – not available

** Details may not add up to total due to multiple reporting.

Source: Employer's Monthly Report on Employee's Termination submitted by establishments to DOLE Regional Offices.

¹⁰² This is most likely due to the reported practice in the wholesale and retail trade of retaining very few permanent employees. The rest of their employed workers tend to be hired on a contractual or temporary arrangement.

Table 97.1 Establishments resorting to closure/retranchment due to economic reasons and workers affected by industry, 1998

Industry	Number of Establishments		Number of Workers Affected				
	No.	%	No.	%	Permanent	Temporary	Rotation, Etc
All Industries	3,072	100.0	155,198	100.0	76,726	50,744	27,728
Agriculture, Fishery and Forestry	95	3.1	2,946	1.9	2,483	389	74
Industry	1,254	40.8	110,563	71.2	43,561	44,668	22,334
Mining and Quarrying	48	1.6	2,286	1.5	1,479	714	93
Manufacturing	1,025	33.4	96,336	62.1	35,952	39,732	20,652
Electricity, Gas and Water	8	0.3	84	0.1	82	2	0
Construction	173	5.6	11,857	7.6	6,048	4,220	1,589
Services	1,723	56.1	41,689	26.9	30,682	5,687	5,320
Wholesale and Retail Trade	600	19.5	12,462	8.0	9,246	1,868	1,348
Transportation, Storage & Communications	257	8.4	9,891	6.4	8,895	385	611
Financing, Insurance, Real Estate & Business Services	491	16.0	11,521	7.4	8,091	2,214	1,216
Community, Social & Personal Services	375	12.2	7,815	5.0	4,450	1,220	2,145
Reasons	No.	%	No.	%	Permanent	Temporary	Rotation, etc.
Total	3,072	100.0	155,198	100.0	76,726	50,744	27,728
Lack of Market	925	30.1	64	41.3	22,846	23,549	17,762
High cost of Production	234	7.6	9,085	5.9	5,615	2,927	543
Lack of Raw Materials	89	2.9	14,567	9.4	1,982	10,869	1,716
Lack of Capital	224	7.3	6,920	4.5	4,251	1,648	1,021
Redundancy	396	12.9	9,262	6.0	8,424	608	230
Uncompetitive Price of Product	12	0.4	338	0.2	273	6	59
Reorganization	407	13.2	15,919	10.3	14,137	1,313	469
Peso Depreciation	309	10.1	12,862	8.3	6,095	3,012	3,755
Financial Losses	277	9.0	10,790	7.0	7,358	2,477	955
Economic crisis	98	3.2	5,749	3.7	2,994	1,869	886
Minimum Wage Rate Increase	19	0.6	572	0.4	195	143	234
Competitions from Imports	10	0.3	528	0.3	386	142	0
Change in Management/Merger	19	0.6	950	0.6	914	36	0
Others	53	1.7	3,499	2.3	1,256	2,145	98

This continued during the first four months of 1999 [add 1999]. Majority of the establishments that were affected by closures/retranchments was from the manufacturing sector, followed by wholesale and retail trade and real estate, renting and business activities. Similarly, most of the job losses were recorded in these sectors.

The above report is similar to the result of a World Bank survey of 3,710 firms which finds that of the more than 80% of the labor force working in manufacturing as production workers, about 77% were fired as a result of the crisis, while only less than 10% of the managerial staff were displaced (Table 98).

Table 97.2 Establishments resorting to closure/retranchment due to economic reasons and workers affected by industry, 1999^{*}

Industry	Number of Establishments		Number of Displaced Workers	
	No.	%	No.	%
All Industries	2,266	100.0	69,735	100.0
Agriculture, Fishery and Forestry	65	2.9	1,524	2.2
Industry	846	37.3	41,096	58.9
Mining and Quarrying	19	0.8	769	1.1
Manufacturing	716	31.6	36,153	51.8
Electricity, Gas and Water	14	0.6	490	0.7
Construction	97	4.3	3,684	5.3
Services	1,355	59.8	27,115	38.9
Wholesale and Retail Trade	452	19.9	6,873	9.9
Transportation, Storage & Communications	193	8.5	6,124	8.8
Financing, Insurance, Real Estate & Business Services	148	6.5	4,588	6.6
Community, Social & Personal Services	86	3.8	1,225	1.8
Reasons	No.	%	No.	%
Total	2,266	100.0	69,735	100.0
Product Demand	534	23.6	18,140	26.0
Financial	657	28.9	24,431	35.2
Organization	939	41.4	21,850	31.3
Lack of Raw Materials	55	2.4	2,454	3.5
Minimum Wage Rate Increase	12	0.5	236	0.3
Others	69	3.0	2,624	3.8

^{*}Details may not add up to total due to multiple reporting.

Source: Establishment Termination Reports submitted by employers to DOLE Regional Offices.

Table 98 Structure of workforce in Asia

Occupation	Indonesia		South Korea		Philippines		Thailand	
	% total	% fired	% total	% fired	% total	% fired	% total	% fired
Managerial and Technical Staff	7.4	4.48	16.6	11.43	8.6	9.55	11	4.1
Production Workers	75.6	77.09	54.9	43.71	82.4	76.62	75.4	77.86
Non-Production Workers	17	15.13	28.6	32.5	9.1	12.92	13.7	8.27

Source: World Bank, Asiaweek (April 16, 1999 issue).

Most of the firms that closed down in 1998 were small-sized establishments (with less than 20 workers) while more large establishments (with more than 100 workers) reported retrenchments rather than closures. Meanwhile, in 1999, 73.4% of displaced workers were from large-sized establishments. Most of these establishments resorted to reduction of workforce, while the small establishments accounted for most of the establishment closures.

Table 99 Establishments resorting to closure/retranchment due to economic reasons and workers displaced by employment size, 1999

Employment Size	Establishment Reporting				Displaced Workers	
	Total	%	Closure	Reduction of Workforce	No.	%
All employment sizes	2,266	100.0	505	1,788	69,735	100.0
less than 20 workers	604	26.7	286	335	3,497	5.0
20-49	431	19.0	107	330	6,118	8.8
50-99	490	21.6	52	440	8,845	12.7
100 or more workers	741	32.7	60	683	51,275	73.4

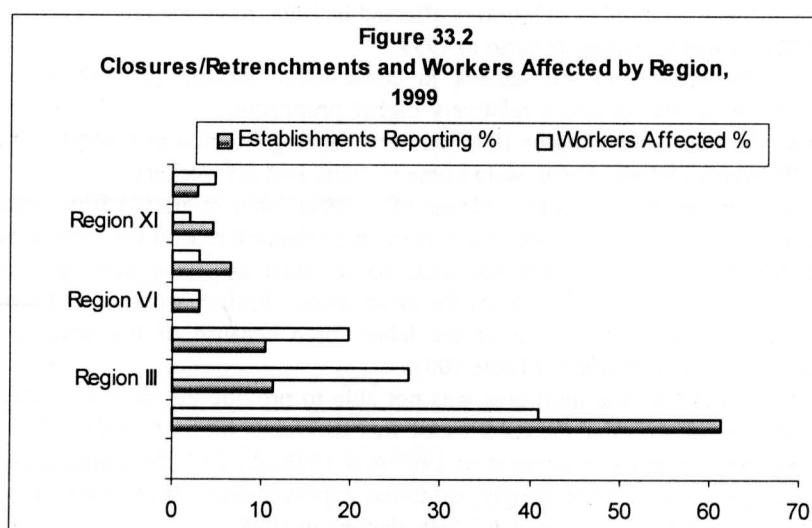
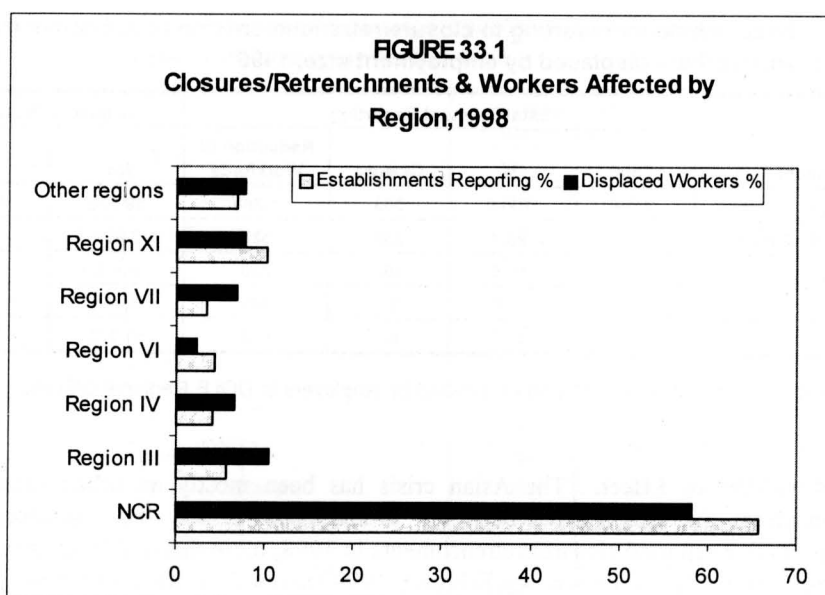
Source: Establishment Termination Reports submitted by employers to DOLE Regional Offices.

Rural-Urban Effect. The Asian crisis has been mostly an urban sector crisis because much of the effects have been felt in the urban areas. For instance, of the establishments that reported closures/retranchments in 1998, more than half were from Metro Manila (see Figure 33). In the January-February 1999 survey data, the large share of Metro Manila in the total number of closures/retranchments was maintained at close to 2/3. Meanwhile, of the total number of workers affected in 1998, more than half were, likewise, in Metro Manila. It was the same scenario in 1999.

Possibly because of the setback in construction industry growth, other regional growth centers have also posted a relatively higher proportion of affected workers from the Asian crisis. Central Luzon (Region III), Southern Tagalog (Region IV), and Central Visayas (Region VII), which includes Cebu, were home to many laid off workers.

However, there is no clear evidence of rampant labor migration from urban to rural areas as a result of the crisis. In fact, labor force participation rate in the rural areas in 1997 and 1998 dropped, suggesting that the rural sector must not have been able to provide temporary jobs for laid off workers from the urban areas. Rather, workers in the rural sector must have temporarily dropped out of the labor force because of the adverse economic situation and lack of opportunities (Table 100).

One reason why the rural area was not able to provide the necessary safety net for displaced urban workers is that the rural sector was also badly hit by El Niño. This is evident in the drop in agricultural employment in 1997 and 1998. As El Niño went away, however, agricultural employment, unsurprisingly, exhibited improvements. It grew by an average rate of 6.48% for the year 1999, up from the 3.29% decline in 1998.



Source: Bureau of Labor and Employment Statistics. *Establishment Termination Reports submitted by employers to DOLE Regional Offices, 1997-1999.*

Table 100 Selected indicators of labor by area, 1997-1999

	URBAN			RURAL		
	1997	1998	1999	1997	1998	1999
Labor Force ('000)	14,165	14,607	15,048	16,190	16,449	17,034
Participation Rate	63.7	63.9	64.3	68.8	68.2	68.8
Employment Rate	88.9	87.5	87.4	93.4	92.1	92.9
Unemployment Rate	11.1	12.5	12.6	6.6	7.9	7.1
Underemployment Rate	18.3	18.2	18.8	25.3	24.8	25.2

Source: Current Labor Statistics, Department of Labor and Employment; National Statistics Office.

Another reason why the urban to rural migration did not occur is that even as unemployment rate was higher in the urban areas, the chances for re-absorption in the labor sector were also higher. The fact that the greatest increase in employment was from Metro Manila means that many of those laid-off were also able to find jobs albeit probably in a different sector.

Although the increase in urban employment by 1.38% is larger compared with that in rural (0.15%) in 1998, tables were turned in 1999 as rural employment increased by 4.46% while urban employment increased by only 3.07%. Moreover, rural unemployment decreased while that of urban increased. This may be due to the fact that the rural sector had recovered from the El Niño phenomenon faster than the urban sector had from the Asian crisis.

Unemployment Effect by Age, Education, and Occupational Groups. The Asian crisis caused greater youth unemployment i.e., the 15-24 age bracket of the labor force (see Table 101.2). Their labor participation also declined suggesting that they opted to drop out of the labor force for the moment, perhaps to return to school, or join the informal sector. The fact that the young age group was the one mostly affected suggests that most of the jobs lost were of temporary nature or part-time jobs. Alternatively, this suggests that the laid-off workers had very few years of tenure. It further suggests that most of the affected job classification must have been more low-paying jobs such as production workers, rather than full-time managerial tasks, as it takes some time before one reaches managerial positions.

Workers with high school diploma but have no college degrees posted the highest unemployment, followed by those with college degrees. The high unemployment among college graduates reflects the mismatch in the education and skills required by existing industries, as well as the deterioration of education in the country. Further, many college graduates in the Philippines usually end up working in relatively low paying jobs. This implies that, unlike in other countries where the unemployment spell tends to be longer for those with higher education because they have savings to sustain a prolonged job search, the unemployment spell for this group in the Philippines may have been relatively shorter barring worsening of the Asian crisis. An indication of this is that figures in 1999 show that the highest increase in employment, as the economy improved, had, in fact, come from those with college education (see Table 101.1).

By Class of Workers and Sectoral Allocation. There was a drop in own-account male workers but an increase for female, suggesting that women took into more private businesses to augment income. Wage and salary workers increased but unpaid family workers declined, probably entering the labor force as salaried workers in personal, community and social services. In April 1998, the share of wage and salary workers to total employment registered its peak since 1996 at 49.4%. Incidentally, growth in employment in the agriculture sector dropped during this period by 10.05% while the manufacturing, construction, trade and community and personal services all grew modestly with the latter taking the lead with a 9.7% growth. Thus, due to the squeeze in agriculture from El Niño, there must have been shifts in employment from agriculture to these sectors. However, in 1999, employment in agriculture as a percentage of total employment once again peaked in April. Moreover, employment in manufacturing, finance, and community and personal services likewise registered their peaks in October 1999, closing in to their pre-crisis levels in 1996.

Table 102 shows that the number of new jobs created in 1998 declined compared to that in 1997 and that these new jobs were mostly in the services sector. There was likewise a significant drop in new salaried jobs and unpaid family workers but an increase in own-account workers.

Table 101.1 Employed persons by age group and highest grade completed, in thousands

	Increment 96-97	1997	Increment 97-98	1998	Increment 98-99	1999
ALL AGE GROUPS						
Total	529	27,715	197	27,912	1,068	28,980
15-19	-110	2,716	-112	2,604	66	2,670
20-24	24	3,326	-70	3,256	32	3,288
25-34	382	7,006	-128	6,878	55	6,933
35-44	191	6,409	96	6,505	324	6,829
45-54	0	4,426	182	4,608	343	4,951
55-64	19	2,597	149	2,746	166	2,912
65&Over	23	1,233	81	1,314	82	1,396
Age Not Reported	0	2	0	2	-1	1
HIGHEST GRADE COMPLETED						
Total	529	27,715	197	27,912	1,068	28,980
No Grade Completed	10	881	-48	833	10	843
Elementary	43	11,252	-106	11,146	299	11,445
Grade 1-5	96	5,306	-73	5,233	169	5,402
Graduate	-53	5,946	-32	5,914	129	6,043
High School	150	9,238	245	9,483	427	9,910
First to Third Year	85	3,653	68	3,721	170	3,891
Graduate	65	5,585	177	5,762	257	6,019
College	308	6,274	93	6,367	322	6,689
Undergraduate	204	3,096	49	3,145	131	3,276
Graduate and Higher	104	3,178	43	3,221	193	3,414
Not Reported	17	70	13	83	10	93

Table 101.2 Unemployed persons by age group and highest grade completed, in thousands

	Increment 96-97	1997	Increment 97-98	1998	Increment 98-99	1999
ALL AGE GROUPS						
Total	94	2640	503	3,143	-41	3,102
15-19	6	640	127	767	-30	737
20-24	13	700	107	807	19	826
25-34	43	620	88	708	-2	706
35-44	-1	270	80	350	2	352
45-54	18	189	54	243	-13	230
55-64	12	133	32	165	-11	154
65&Over	1	87	19	106	-10	96
Age Not Reported	1	1	-1	0	0	0
HIGHEST GRADE COMPLETED						
Total	94	2,640	503	3,143	-41	3,102
No Grade Completed	1	56	12	68	-13	55
Elementary	34	630	136	766	-89	677
Grade 1-5	23	284	71	355	-62	293
Graduate	11	346	66	412	-28	384
High School	43	1,118	204	1,322	-6	1,316
First to Third Year	10	416	103	519	-34	485
Graduate	33	702	102	804	28	832
College	15	819	143	962	66	1,028
Undergraduate	5	486	79	565	13	578
Graduate and Higher	8	332	65	397	52	449
Not Reported	2	18	7	25	5	30

Source: Bureau of Labor and Employment Statistics, *Current Labor Statistics*.

TABLE 102 Job generation, 1997–1999

Indicator	Percent Change		Percent Change		1999
	1997	97-98	1998	98-99	
New jobs generated ('000)	528	-62.9	196	444.9	1,068
By industry ('000)					
Agriculture	-331	-15.1	-381	-281.4	691
Industry	201	-123.4	-47	6.4	-50
Services	659	-5.3	624	-31.6	427
By worker class ('000)					
Wage and salary worker	812	-73.3	217	109.2	454
Own account worker	26	346.2	116	180.2	325
Unpaid family worker	-309	560.0	-136	-313.2	290

Source: Bureau of Labor and Employment Statistics, *Current Labor Statistics*, various issues.
National Statistics Office

Reflecting the growth in employment in 1999, the number of wage and salary workers, unpaid family workers, as well as own account workers likewise increased (see Table 103). Unpaid family workers posted the highest increase in 1999. This may mean that some of those unpaid family workers who might have entered the labor force in 1998 might have returned as unpaid family workers (either in agriculture or in other family businesses) as the economy picked up in 1999.

During the crisis, most of the job shifts have been absorbed in the wholesale and retail trade, as well as in community, social, and personal services and utilities sectors. In the services sector, real wages were typically lower but workers presumably got out of unpaid family activities to join the labor force as domestic helpers to increase family income. Moreover, with the crisis, indices of compensation even fell for private service industries and wholesale and retail trade, perhaps as a result of increased labor supply.

TABLE 103 Employment by class of workers and by sector, in thousands

	Increment		Increment		Increment	
	96-97	1997	97-98	1998	98-99	1999
CLASS OF WORKER						
Wage and salary workers	812	13,461	215	13,676	456	14,132
Own-account workers	26	10,352	116	10,468	324	10,792
Unpaid family workers	-309	3,902	-134	3,768	288	4,056
SECTOR/MAJOR INDUSTRY GROUP						
All Industries	529	27,715	196	27,911	1,069	28,980
Agriculture, Fishery and Forestry	-326	11,319	-386	10,933	691	11,624
Industry						
Mining and Quarrying	16	129	-10	119	-19	100
Manufacturing	36	2,732	-16	2,716	30	2,746
Electricity, Gas and Water	14	132	10	142	2	144
Construction	132	1,636	-31	1,605	-62	1,543
Services						
Wholesale and Retail Trade	125	4,138	173	4,311	189	4,500
Transportation, Storage and Communication	111	1,741	108	1,849	94	1,943
Financing, Insurance, Real Estate and Business Services	74	688	-16	672	48	720
Community, Social and Personal Services	346	5,196	359	5,555	99	5,654
Industry Not Elsewhere Classified	2	6	0	6	2	8

Source: Bureau of Labor and Employment Statistics; National Statistics Office

Unsurprisingly, workers in agriculture, fishery, and forestry dropped in 1997 and 1998 as a result of El Niño (see Table 103). However, for the year 1999, workers in this sector increased significantly by 79%, from the 386,000 workers in 1998. In fact, while the sector posted a 3.29% average decline in employment in 1998, employment recovery in this sector began as early as July of the same year (see Table 104).¹⁰³

TABLE 104 Employment in the different sectors, 1998–1999

Sectors	Average Growth		First Signs of Recovery
	1998	1999	
Agriculture, Fishery and Forestry	-3.29	6.48	Jul-98
Mining and Quarrying	-8.06	-16.28	none yet
Manufacturing	-0.56	1.15	Jul-99
Electricity, Gas and Water	8.26	1.21	Oct-98
Construction	-1.81	-3.79	none yet
Wholesale and Retail Trade	4.2	4.38	...
Transportation, Storage and Communication	6.17	5.06	Jan-98
Financing, Insurance, Real Estate and Business Services	-2.25	7.1	Oct-98
Community, Social and Personal Services	6.93	1.79	...

... - sector not affected by the crisis.

Source: Bureau of Labor and Employment Statistics.

Another sector that experienced job contraction in 1998 but is now increasing employment is the finance, insurance and real estate sector. Data for the year 1999 show that employed persons in this sector increased by 48,000 compared to the decrease of 16,000 the previous year. Even as employment in this sector declined in 1998 with an average rate of 2.25%, by October of the same year, it already started to grow by 2.21%.

Construction employment also dropped as many infrastructures and private building construction were stalled from the increased cost of capital. Female employment in construction declined but male employment increased in 1998. This decline continued in 1999 as employment in the sector declined by an average rate of 3.79%, a plunge deeper than that of the previous year of 1.81%.

The government helped very little as far as cushioning the drop in employment was concerned. With a tight fiscal bind, the government froze hiring and thus caused a drop in government salaried workers.

By Occupation. Most of the drop in jobs in 1997 and 1998 have been for production workers, clerical workers and agricultural workers while those for professional, technical and related workers, as well as executive and managerial workers have maintained their share of the labor force.

The relative stability of professional, technical, managerial and related jobs suggests that there must have been an absorption of well qualified graduates working in professional and technical fields, or as managers and executives, from one sector to another. Alternatively, the Asian crisis did not reach a proportion in the Philippines that could affect even well-qualified workers. What it did affect was the lower end of the job-scale that tended to be paid relatively low real wages but nevertheless constituted the bulk of the labor force (see Table 105).

¹⁰³ First sign of recovery refers to the first month with positive growth preceding two consecutive growth rates.

TABLE 105 Labor force and employment by occupation, 1997–1999

	Increment		Increment		Increment	
	96-97	1997	97-98	1998	98-99	1999
Labor Force (' 000)	621	30,355	701	31,056	1,025	32,081
Major Occupation Group						
Total	529	27,715	196	27,911	1,069	28,980
Professional, Technical, and Related Workers	82	1,649	5	1,654	63	1,717
Administrative, Executive, and Managerial Workers	85	517	51	568	43	611
Clerical Workers	51	1,244	4	1,248	43	1,291
Sales Workers	71	3,921	175	4,096	177	4,273
Service Workers	283	2,745	212	2,957	47	3,004
Agriculture, Animal Husbandry, and Forestry Workers, Fishermen, and Hunters	-342	11,197	-382	10,815	706	11,521
Production and Related Workers, Transport Equipment Operators and Laborers	290	6,407	124	6,531	-3	6,528
Occupation Not Adequately Defined	9	36	6	42	-6	36

Source: National Statistics Office.

Effect on Overseas Filipino Workers (OFWs)

In the 1990s, Asia's burgeoning economies have made the region the destination of choice of more Filipino workers, eclipsing the Middle East, which had been the favorite in the 1970s. The number of OFWs in Asia increased from 9.4% in 1980 to 1984 to 42.0% in 1997 while the deployment rates to the Middle East have been declining from 69.6% in 1980 to 1984 to 39.5% in 1997.

With the financial crisis sweeping through Asia and the economic contraction in the erstwhile tiger economies, foreign workers are sure to feel the effect. This section discusses their importance in the Philippine economy and analyzes the impact of the crisis on Filipino workers abroad.

OFWs and the Economy. The overseas Filipino workers have been an important source of foreign currencies for the Philippine economy for many years now. Despite the tremendous social costs entailed in the family separation, the country is grateful for the huge foreign remittances, which these workers pump into the economy. These remittances have grown both in absolute terms and in percent of GNP, even outpacing the growth of exports. It increased rapidly in the 1990s and reached a peak of \$5.7 billion,¹⁰⁴ or the equivalent of 4.5% of GNP in 1997. Without the OFW remittances, the current account would have been much worse (see Table 106). In 1997 and 1998, the current account deficit would have reached 12% and 13% of GDP if OFW remittances were not present. Likewise, the current account deficit would have reached 9.74% of GDP in if it were not for these remittances.

¹⁰⁴ This was actually believed to have reached \$8 billion if non-official channel of remittances were taken into account.

TABLE 106 Contribution of OFWs remittances to the current account, 1991 to 1999, in million dollars

Year	Current Account	OFWs Remittances	Current Account w/o Remittances	GDP	% of Current Account w/o Remittances in GDP
1991	-869	1,500.29	-2,369.29	45,417.16	-5.22
1992	-858	2,202.38	-3,060.38	52,977.95	-5.78
1993	-3,016	2,229.58	-5,245.58	54,369.87	-9.65
1994	-2,950	2,940.27	-5,890.27	64,049.18	-9.20
1995	-3,297	3,868.38	-7,165.38	74,133.56	-9.67
1996	-3,953	4,306.64	-8,259.64	82,847.30	-9.97
1997	-4,351	5,742.84	-10,093.84	82,237.61	-12.27
1998	1,287	4,925.31	-4,440.31	65,106.53	-6.82
1999	7,188	6,794.55	393.45	76,155.00	0.52

Source: Bangko Sentral ng Pilipinas.

The OFWs also helped ease the country's unemployment problem, precisely because they were not in the country to contribute to the unemployment rate or to compete for too few jobs. If there had been no overseas outlet, the unemployment rate in the country was estimated to increase by as much as 2 percentage points (Soriano 1998) since about 10-30% of the Philippines' annual labor force entrants find work abroad. Table 106 shows that OFW deployment to the different countries has swelled to more than 700 thousand workers, with the majority going to Middle East and Asia.

However, much of OFW income is spent on consumption rather than on investments. As such, the economy cannot rely too much on increasing productive capacity through their increased remittances. A survey conducted among some 240 families of migrant workers in Pampanga (Vasquez 1992) showed that about 38% of remittance income is allocated to paying off debts while 31% is allotted to household consumer items. Around 10% go to education and only 0.8% go to savings. Return migrants surveyed indicated that 36% of their remittances were actually spent on the education of their children; 30% were spent for household needs and about 14% went to savings.

OFWs and the Crisis. The increasing number of deployed workers going to Asia make it almost certain that the OFWs will not stand unscathed by the crisis, particularly because of the increased share of Asian economies as OFW destinations in the 1990s. Data on annual departures of Filipino land-based workers during the decade show that Asian destinations have displaced the prominence of the Middle East market. From only 27% share versus the 65% share of Middle East in 1990, Asian markets' share consistently increased to 42% while Middle East' declined to 40% in 1997.¹⁰⁵

Of the Asian destinations, Hong Kong takes the bulk of the OFWs, followed by Malaysia, Taiwan, Japan, and Singapore. The affected economies of Indonesia, Korea, and Thailand capture less than 10% of the total deployed workers in Asia (see Table 107). This suggests that the drop in remittances of workers from the region may not be too serious, and the crisis' impact to migration outflows may not be as penetrating as might be expected because most Filipinos are in the relatively less affected countries.

¹⁰⁵ January-October, 1997.

TABLE 107 Deployment of OFWs by region of destination, 1975–1999

	1975-79	1980-84	1985-89	1990-95	1996	1997	1998	1999
Total OFWs	379,823	1,580,306	2,129,925	3,817,829	660,122	747,696	755,684	837,020
Landbased OFWs	211,878	1,299,086	1,766,703	2,978,517	484,653	559,227	562,384	640,331
% share to total	55.8	82.2	83.0	78.0	73.4	74.8	74.4	76.5
Africa	1.0	0.56	0.5	0.4	0.4	0.6	1.0	0.8
Americas	3.6	1.2	1.5	2.0	1.3	1.3	1.4	1.4
Asia	9.9	9.4	18.6	23.2	26.4	42.0	39.3	46.8
Europe	2.8	0.7	1.4	1.9	1.7	2.3	2.8	4.8
Middle East	37.5	69.6	59.7	44.2	33.5	39.5	40.3	44.8
Oceania	0.3	0.2	0.2	0.2	0.2	0.4	0.4	0.4
Trust Territories	0.6	0.6	1.2	1.4	0.7	0.9	1.2	1.0
Not Reported	0	0	0	4.84	0.0	0.0	0.0	0.0
Sea based OFWs	167,945	281,220	363,222	839,312	175,469	188,469	193,300	196,689
% share to total	44.21	17.78	16.99	21.98	26.6	25.2	25.6	23.5

* until August.

Source: Philippine Overseas Employment Administration.

Besides, overseas workers in the Middle East are mostly professionals, engineers, nurses, production and construction workers, as well as domestic and other service workers, while many OFWs in Asia are domestic workers, entertainers, hotel staff, and production workers (see Table 108). The last three occupations may be very vulnerable to the downswing of the economy, but domestic workers are believed to be relatively sheltered. The preponderance of Filipina domestic workers therefore assuages the concern of massive migrant return.¹⁰⁶

However, data on deployment and remittances already show that growth has slowed. Total land based overseas workers grew by less than 1% in 1998 compared to 1997 levels, largely because of a dip of about 6% in deployment in Asia and the relatively meager increase in deployment in the Middle East. Figures in 1999, however, show an increase in total deployment of foreign workers and that the share of land based overseas workers in Asia grew by a big 19.08, followed by an 11.17% growth in the share of Middle East workers. This means that more workers are being deployed in Asia once again—an indication indeed that opportunities are mounting up again in the region.

While foreign remittances remained strong with 33% growth in 1997, the amount clearly made a downturn in 1998. Foreign remittances dropped by 14% compared to the peak of \$5.7 billion in 1997, with remittances coming from all the destinations dropping except for US, Canada, and Japan (see Table 108). In 1999, however, total remittances have picked up with a growth of 38%, even higher than in 1997. Remittances from Asia did grow by 61% although this is low if compared with big inflows from Oceania (411%) and the Middle East (333%).

¹⁰⁶ This, however, can change once the Hong Kong government cracks down on the number of Filipino domestic helpers to give preference to those from mainland China.

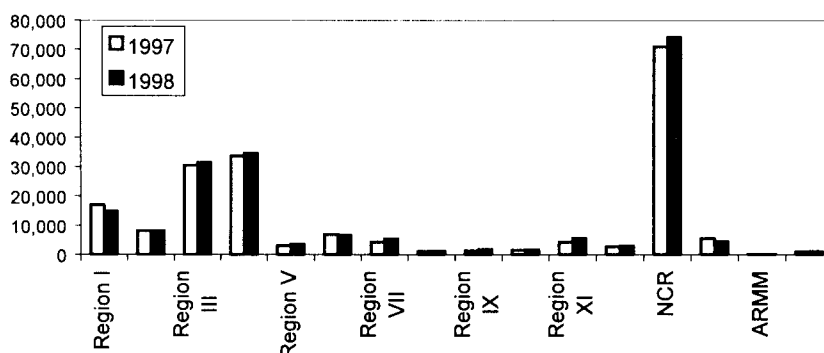
TABLE 108 OFW remittances, 1996 – 1999, in thousand dollars

Country	1996	1997	1998	1999	% change 1996-1997	% change 1997-1998	% change 1998-1999
Total	4,306,641	5,741,835	4,925,989	6,794,550	33.33	-14.22	37.93
Asia	535,959	454,791	401,419	645,566	-15.14	-11.74	60.82
Japan	114,609	131,375	107,807	273,831	14.63	-17.94	154.00
Hong Kong	221,009	189,230	171,353	176,738	-14.38	-9.45	3.14
Singapore	129,654	93,329	69,288	80,180	-28.02	-25.76	15.72
Americas	2,579,942	4,127,656	3,986,731	4,920,687	59.99	-3.41	23.43
USA	2,564,467	4,109,430	3,961,215	4,868,879	60.24	-3.61	22.91
Canada	15,475	18,226	25,010	51,053	17.78	37.22	104.13
Oceania	67,873	19,396	17,060	87,336	-71.42	-12.04	411.93
Europe	574,062	436,050	329,317	457,671	-24.04	-24.48	38.98
Germany	130,892	121,258	78,486	93,588	-7.36	-35.27	19.24
UK	278,142	205,940	130,961	83,079	-25.96	-36.41	-36.56
Middle East	39,188	25,375	60,682	263,004	139.14	-35.25	333.41
Kuwait	21,469	16,998	13,550	21,264	-20.28	-20.83	56.93
Saudi Arabia	14,515	5,723	33,433	183,304	484.19	-60.57	448.27
Africa	0	0	601	1,898	0	0	215.81
Others	509,617	678,567	129,499	418,388	-80.92	33.15	N.A.?

Meanwhile, using an assessment of degree of economic contraction in Asia and duration, and estimates of employment elasticity, Bohning (1998) estimated a cumulative loss of employment for Filipino overseas workers ranging from 46,000 to more than 100,000. If at least half of these affected workers return, 50,000 households in the Philippines would be drastically affected, the impact of which would be most felt, according to Bohning, in the poorer regions and lower strata of society. In contrast, using the Family Income and Expenditure Survey, Pasadilla (1998), shows that since more families in the middle income bracket depend on overseas remittances, and since the urban sector has a greater percentage share of foreign remittances, the impact of slower demand for foreign workers will affect the poorer group less than those in the middle group, and the urban sector more than the rural sector.¹⁰⁷ Figure 34 attests that most of the OFWs indeed come from the more urban regions like the National Capital Region, Central Luzon (Region III), Southern Tagalog (Region IV), Ilocos (Region I), and Western Visayas (Region VI).

¹⁰⁷ Pasadilla (1998) argues that since those in the middle income bracket possess higher human capital, they tend to be the ones who get the job opportunities abroad. This is partly attested by the fact that most Filipinas working overseas as domestic workers have been school teachers, or at least have college degrees. Further, since the urban areas provide better schools and necessary infrastructure support for all the overseas applications, more Filipino migrant workers have actually come from the urban sectors rather than the very poor and rural areas.

FIGURE 34
OFWs by Region, 1997-1998



Source: Philippine Overseas Employment Agency

Effects on Prices

Inflation rates reached close to 10% in 1998, but not so much due to the foreign exchange devaluation but to the supply drop caused by El Niño and La Niña. Prices of food, comprising more than 55% of the consumption basket, grew by 8.8% in 1998 as a result of the sharp cut in the production of palay, corn and other farm produce. House rentals and repairs, as well as services, comprising 14.7% and 12.28% of the total consumption expenditures, respectively, increased by 11.5% and 14.3% in 1998. These three major items—food, beverage and tobacco; services; housing and repairs—together contributed to 75% of the growth in Consumer Price Index (CPI) in 1998.

Significantly, much of the increase in housing and repairs was on rentals and its increase of 11.5% falls very much with historical annual increases. Prices of services, however, noticeably jumped by four percentage points in 1997 and another two percentage points in 1998. These were largely due to increases in educational, recreational, medical, as well as transport expenditures (see Table 109). These last items may have had a closer connection to the exchange rate depreciation.

TABLE 109 Consumer price index and its components

	1994 weights	97 growth rate	98 growth rate	99 growth rate	% contribution
CPI		5.97	9.78	6.65	
Food, Beverage and Tobacco	55.12	3.4	8.84	5.24	0.5
Clothing	3.66	6.5	8.06	6.30	0.03
Housing and Repairs	14.69	10.47	11.57	9.32	0.18
Fuel, Light and Water	5.74	9.14	6.06	6.42	0.03
Services	12.28	12.01	14.27	10.46	0.18
Miscellaneous	8.51	3.59	8.47	5.30	0.07

Source: Bangko Sentral ng Pilipinas; CEIC; National Statistics Office.

Interestingly, though statistical tests show that foreign exchange rates granger cause CPI,¹⁰⁸ the evidence in 1997 and 1998 does not quite attest to the statistical find. Of course, simply looking at the aggregate CPI, one can conclude that inflation has gone up with exchange rates. But a close look at the components of the consumption basket reveals that the exchange rates, and thus the Asian crisis, have apparently little to do with inflation showing its head once again.¹⁰⁹

III. Effect of the Asian Crisis on Income Distribution

To assess the effects of output contraction due to the Asian crisis on income distribution, this chapter makes use of the analytical framework derived from the social accounting matrix (SAM).¹¹⁰ Briefly, SAM is a systematic data classification that captures economic linkages in a general equilibrium framework and allows the computation of indirect as well as direct effects of exogenous shocks such as a fall in demand. Multiplier and impact analyses of a change in final demand, for example, allow determination of its impact on the poor.

The impact analysis in this chapter focuses on the effect of the 1997 to 1998 negative growth rates of production on several industries: Agriculture, Forestry, Fishery, and Mining, Wood and Paper Products, Chemical Products, Petroleum Refining, Non-Metallic and Metal Manufactures, Transport Equipment and Construction (see Table 110).¹¹¹ The implicit assumption is that the drop in production in these industries, except for Agriculture, Forestry, Fishery, and Mining, can be attributed to the Asian crisis.

TABLE 110 Sectors with negative growth, 1997-1998

Industries	%
Agriculture, Fishery, Forestry	-6.6
Wood and Paper Products	-0.39
Chemical Products	-0.4
Petroleum Refining	-5.7
Non-metallic and Metal Manufacturing	-4.5
Transport Equipment	-34
Construction	-3.8

Source: National Statistics Office.

¹⁰⁸ Tests of granger causality have consistently rejected the null of no granger causality at the 0.05 and 0.10 level of significance, for different sample periods and different data transformations tried.

¹⁰⁹ A study by Goldman Sachs corroborates this finding since it showed that, using variance decomposition of fluctuations in inflation, foreign exchange fluctuation has a relatively minor share to total inflation movements. What mostly affects inflation, according to the study, is the money supply. See Goldman Sachs, *Economic Research*, October 27, 1997.

¹¹⁰ Robinson (1989).

¹¹¹ This set of aggregations follows the SAM system. Thus, even if mining and quarrying posted positive growth in 1997 to 1998, SAM aggregates mining with the other resource sectors like agriculture, fishery, and forestry. Similarly, tobacco and beverage posted negative growth rates but since they are included in food manufactures, and since food manufactures chalked up a positive growth, the sectors are no longer included in those that registered decline in output.

The results show that much of the effect of the crisis fell on the middle income group, particularly the lower end of this group. It also infers that excluding the effect of the agriculture drop, most of the economic burden fell more on the urban sector.

This chapter first discusses the paper's definition of "poor" in terms of household income. Then it proceeds with the discussion of the sources of family income by income class. The results of the impact analysis are discussed next, as well as the attempt to separate the effects of El Niño from those of the financial crisis.

The Poor Defined

This study defines the poor (low-income families) as those families that have income less than P50,000, following the categorization of several other studies as well as the income groupings in the current SAM. The household income classification in the updated simplified SAM is generally described as follows:

- | | | |
|----|------------------|----------------------------|
| 1. | Under 20,000 | Low-Income Families (Poor) |
| 2. | 20,000-49,999 | Low-Income Families (Poor) |
| 3. | 50,000-249,999 | Middle-Income Families |
| 4. | 250,000 and over | High Income Families |

The middle-income class, however, is further categorized into three different income classes, namely:

- | | | |
|----|-----------------|-------------------------------|
| 1. | 50,000-99,999 | Low Middle-Income Families |
| 2. | 100,000-149,999 | Middle Middle-Income Families |
| 3. | 150,000-249,999 | High Middle-Income Families |

It is interesting to note that around 52% of the families classified as middle-income actually belong to the low middle-income class in 1997 (see Table 111).

TABLE 111 Distribution of Families by Income Class, 1997

Income Class	No. of Families	Share (%)	Cumulative Share (%)
Under 20,000	549,743	3.9	
20,000 - 29,999	1,132,664	8	11.9
30,000 - 39,999	1,473,041	10.4	22.2
40,000 - 49,999	1,438,575	10.1	32.4
50,000 - 59,999	1,163,897	8.2	40.6
60,000 - 79,999	1,828,642	12.9	53.5
80,000 - 99,999	1,285,026	9.1	62.5
100,000 - 249,999	3,926,082	27.7	90.2
250 and over	1,394,792	9.8	100
TOTAL	14,192,462	100	

Source: Family Income and Expenditure Survey (1997).

Factor Income Distribution by Income Class

The transmission of the shock on different income classes is through the effect of the change in demand (drop in industrial production) in different sources of income of different income groups. For example, if majority of low-income families depend on agricultural

income, then a shock in agricultural production would imply a drop in the income of the low-income group.

Thus, to gain a better understanding of the results of the SAM impact and multiplier analysis, it is important to understand the sources of income of the income classes. Table 112 shows, for example, that about 79% of low income families with income below P20,000 depend on entrepreneurial (or mixed) income and 38% depend particularly on entrepreneurial income from agriculture. Similarly, around 66% of the families in the P20,000-49,999 income class depend on mixed income and approximately 40% derive its income from agricultural entrepreneurial income.

Low middle-income class families (50,000-99,000) depend equally on wages and salaries and on mixed income. In particular, these families depend more on wages from the non-agricultural sector compared to the lowest income groups.

TABLE 112 Sources of income by income class

Main Source of Income	Low-Income		Middle Income			High Income
	Under 20,000 (% of families)	20,000 – 49,000 (% of families)	50,000 – 99,999 (% of families)	100,000 – 149,999 (% of families)	150,000 – 249,999 (% of families)	250,000 and above (% of families)
Number of Families	549,744	4,044,280	4,277,565	2,072,417	1,853,665	1,394,792
Wages and Salaries	21.2	34.1	50	61	60	54.7
Agricultural	13.9	15.2	8.4	1.6	0.6	0.5
Non-Agricultural	7.2	18.9	41.6	59.4	59.4	54.2
Mixed Income	78.8	65.9	50	39	40	45.3
Entrepreneurial (Agricultural)	38	39.7	22.4	6.3	6.3	2.7
Entrepreneurial (Non-Agric'l)	5.8	9.9	13.7	14.3	14.3	19.2
Other Sources	35	13.7	14	18.4	19.4	23.4

Source: Family and Income Expenditure Survey (1997).

The middle and high middle-income classes, as well as the highest income class, depend on wages and salaries for most of their income and in particular, on wages from non-agricultural activity. Between 39% to 40% of the middle and high middle-income class families and 45% of highest-income class depend on entrepreneurial income, particularly on sources other than entrepreneurial income from agriculture.

Results of the SAM Impact Analysis

The SAM impact analysis in this section determines the effect of the actual decline in the production of the industries listed in Table 109 on factor and household income.¹¹² The impact of the negative growth rates of these industries on factor and household income were

¹¹² The SAM used in this study made use of the 1994 Input-Output table, the most recent available IO table in the Philippines. We also adjusted all the average propensities making use of 1997 NIA data. We think that the result is not going to be significantly affected by the extrapolation because studies have shown that IO structures usually change only after 8 to 10 years. Thus, the structural characterization of the economy should not have changed much since 1994.

determined using the equation, $Y = (I - A)^{-1} X$, where A is the matrix of average propensities, X is the exogenous matrix and Y , the endogenous matrix.

Besides the impact analysis, this section also presents the result of a simulation on the SAM that seeks to isolate the effect of the Asian crisis from the El Niño effect. To do this, the SAM system was shocked using 2% growth in agriculture, forestry, fishery - the average growth of the agricultural sector from 1990 to 1997 - on factor and household income distribution. That is, to simulate the effects of the Asian crisis alone, it is assumed that agricultural production did not drop but rather grew at an average growth of about 2%.

The results show that much of the effect of the crisis fell on the lower end of the middle-income group (which comprise more than 30% of total households) and in general, on the middle-income group as a whole (more than half of total households). Table 113 shows that the Asian crisis (which is assumed in the 1998 industry growth rates in the final demand column of the SAM) and El Niño caused a 2.59% drop in the income of the P50,000 – 99,999 income group and a drop of 5.62% in the income of the entire middle-income class (P50,000 – 249,999). This is because the impact of the crisis was great in the non-agricultural wages and compensation of employees with an 8.8% drop (Panel A, Table 113).

TABLE 113 Simulation results: simulation shocks effects on selected SAM accounts

Selected SAM	Actual Industry	Without El Niño	% difference
A. Factor Income			
<i>Compensation of Employees</i>			
Agricultural	-1.65	-0.32	-80.5
Non-Agricultural	-8.81	-8.49	-3.69
<i>Mixed Income</i>			
Agricultural	-6.03	-1.42	-76.38
Non-Agricultural	-0.72	-0.04	-52.44
Others	-0.38	-1.19	-68.72
<i>Net Operating Surplus</i>	-10.43	-8.64	-17.13
B. Household Income			
Under 20,000	-0.22	-0.1	-54.01
20,000 - 49,000	-1.48	-1.05	-29.18
50,000 - 99,999	-2.59	-2.24	-13.41
100,000 - 149,999	-1.26	-1.19	-5.88
150,000 - 249,999	-1.77	-1.67	-5.87
250,000 and over	-1.16	-1.1	-5.55

Note: The assumed historical agricultural growth rate is 2%.

Source: Based on SAM Simultaneous Impact Table.

See appendix for the complete SAM Simultaneous Impact Table.

Of the middle-income group, the low middle-income class was most adversely affected (-2.59%) because not only was it dependent on non-agricultural wages and salaries, it also depended on agricultural entrepreneurial income. Now, both these income sources have been most hit by the combined effects of El Niño and the Asian crisis (see Table 113).

The highest-income class was likewise not spared of the effects of the Asian crisis. Assuming that the highest-income class (consisting of 4% of total households) owns the capital, the 10.4% drop in net operating surplus (interpreted in the SAM framework as returns

to capital) contributed significantly to the 1.2% decrease in income of the highest-income group. Besides, like the middle-income group, the richest families also depend greatly on non-agricultural compensation and it was already noted that this source of income declined by more than 8% in 1998.

The poorest families (3.9% of total households) were apparently the least affected by the Asian crisis with only a 0.22% drop in their income, while the other poor income group (P20,000-49,999, or 32.4% of the total number of households) also suffered a decline of roughly 1.5% of their income. This result owes itself mostly to the drop in agricultural output, which lowered entrepreneurial income from agriculture by 6% and agricultural wages by 1.7%.

Had there been no El Niño, the result would be slightly different. Assuming that the agricultural sector grew at its 1990s historical average of 2%, entrepreneurial (mixed) income from agriculture would have declined by only 1.42%, instead of 6.03%. In turn, the effect on the lower income group, particularly the P20,000-49,999 income class would have been much less at -1.05% instead of -1.48%. Because of the inter-linkages in the economy, the effect of El Niño affects all income classes, thus, without El Niño, the decrease in income of all household groups' would have been less, although the improvement is most pronounced among the lower income brackets (see Table 113). In terms of the actual effect, the low middle-income group remained the most adversely affected because of its dependence on non-agricultural wages.

From Table 114, it is likewise clear that had there been no El Niño, the impact of the crisis would be unambiguously mostly in the urban areas. But since both the El Niño phenomenon and the Asian crisis were present, the drop in both non-agricultural wages income and agricultural entrepreneurial income clearly affected both urban and rural areas. Still, combined with the adverse effect on net operating surplus which can be assumed to be urban-based, the effect of the recent events have been greater in the urban centers, as has been shown in Chapter 2.

TABLE 114 Percent of families receiving income from selected sources, urban and rural

<i>Income Source</i>	<i>Urban (% of Families)</i>	<i>Rural (% of Families)</i>
Wages and Salaries	75.8	62.5
Entrepreneurial Activities	54.9	78.0
Other Sources	98.6	100.0

Source: Family Income and Expenditure Survey (1994).

IV. Social Impact of the Economic Crisis

No economic crisis can ever fail to affect people's quality of life. The reduction in income and cuts in fiscal budgets that accompany any crisis affect all those social 'intangibles' such as health, education and housing, that are not necessarily reflected in central bank balance sheets, much less in the up- or down-trend of the stock market index. Yet, the effects on these social aspects remain long after the exchange rate or the stock markets have rebounded.

This chapter explores the actual effects of reduced income, heightened inflation and devaluation on the social indicators in the Philippines. Particularly, it evaluates the effects of the crisis on areas of health, food and nutrition, housing, women and education. As is well

known, data for most of these areas are few and not very up to date, that what would have been the best to do in order to assess the impact of the crisis on these social indicators was to carry out actual surveys. In the absence of such primary data, the paper merely attempts to extract implications from various published indicators on the most likely impact on various social groups.¹¹³

The previous chapter finds that most of the impact of the economic crisis fell more on the lower middle-income group. In the case of the social indicators, this chapter finds that most of the deterioration in the quality of life has also been more felt in the lower end of the income spectrum.

This chapter starts out with a brief discussion of the expenditure pattern of different income classes, highlighting specific spending that more directly impinge on their quality of lives. Then it tackles, in turn, the effects on education, health, food and nutrition, housing and women, presenting various variables that indicate possible consumption deterioration. For example, in the case of health and education, the number of children supplied with Vitamin A had gone down, or that the number of drop outs had increased, as a result of either fiscal budget reduction or drops in family income. This chapter moves on to discuss the existing social safety nets, government responses toward the crisis and some policy recommendations.

The Spending of the Poor

A look at the percentage distribution of income on selected expenditures reveals some interesting differences in the spending patterns of different income groups.¹¹⁴ First, the low-income group spends a very small percentage of their income on education and medical care but as income increases, a greater percentage is allocated for both. Families earning under P20,000 spend as little as 0.4% on education and 1.4% on medical care. Middle income families spend a higher percentage of 4.0% and 2.2%, respectively, while the upper income group spends as much as 5.1% on education and 2.5% on medical care (see Table 115).

TABLE 115 Expenditure pattern of different income classes, 1997

	Low Income		Middle Income		Upper Income
	Under 20,000	20,000–49,999	50,000–99,999	100,000–249,999	250,000 and over
Total (in '000 pesos)	9,467,754	147,052,001	280,245,274	501,060,772	474,851,613
% share to total					
Food	65.3	62.6	56.1	45.7	29.7
Education	0.4	1.20	2.37	4.0	5.1
Medical Care	1.4	1.53	1.77	2.2	2.5
Rent/Rental Value of Occupied Dwelling Unit	7.5	7.20	9.70	13.3	20.0

Notes: ¹ Figures were averaged from the data given by income classes 20,000-29,999, 30,000-39,999, and 40,000-49,999.

² Figures were averaged from the data given by income classes 50,000-59,999, 60,000-79,999, and 80,000-99,999.

Source: Family Income and Expenditure Survey (1997).

¹¹³ Other studies tried to analyze the social impact of the crisis using primary survey data. For instance, Reyes, et al. (1999) present a limited sample survey results of the social impact of the crisis.

¹¹⁴ In this section's discussion, the division of low-, middle-, high-income groups follow the classification used in the previous chapter.

This distribution picture suggests that while families in the upper income group try to get the best education and medical care available, the lower income group, gleaned from low share of education and medical expenditures, are not able either to attend good schools or to seek medical help. They also possibly merely rely on the government for educational and medical services, which, in most cases, are inferior to that of private institutions. In particular, people in the lower income bracket usually go to public elementary and secondary schools and public hospitals for medication. The implication is that cuts in public provisions of these goods and services due to budgetary constraint would have adverse impact on the poor population.

A different pattern is seen with food consumption. The lower the income bracket, the bigger percentage is committed to food. For example, families earning under P20,000 spend as much as 65.3% on food while families earning at least P250,000 spend only 29.7%. Since there is only a certain amount of food that a family consumes in a day or in a year, the amount that this most basic necessity can reach is only up to a certain level. Thus, it is to be expected that its share in a family's income is less as income goes up. Significantly, government food subsidies targeted towards the poor segment of the population help free up these households' income allocated for food for some other necessities like clothing and shelter.

As can be expected, the cost of living in the National Capital Region (NCR), the most urbanized region in the country, is higher compared to the other regions. This explains why for families in the same income class, the share of food and house rentals to total expenditures tend to be higher in the NCR than in other parts of the country. For example, house rental for families in the NCR earning under P20,000 take up about 13.4% while families in other urban areas in the country spend less than this.

However, families in the NCR spend less percentage of their income on education and medical services than families in other regions. There are 2 possible reasons for this. Either people in NCR are earning more or government services are more available to them and thus are cheaper. For example, families earning at least P250,000 in NCR spend 4.6% on education while families in the same income bracket in urban Western Visayas spend as much as 5.7%.

Social Impact

Much of the effects of the crisis on the social dimension have come about, no doubt, from the reduction of income through job losses. But a great chunk, particularly those that directly impinge on the poor, have also occurred through significant cuts in fiscal expenditures, as well as increases in prices. A survey by the National Statistics Office shows that 97% of families surveyed were affected most by the increased prices of commodities while only about 25% suffered from job losses or retrenchment of migrant workers (see Table 116). The former can be more directly related to the El Niño (see discussion in Chapter 2), while the latter more with the Asian crisis.

This section explores the impact of the crisis brought about by the fiscal response of budget cuts and increases in prices on the different social aspects that affect the quality of life. In particular, while prices peaked in 1998, real wages did not rise sufficiently to maintain previous consumption patterns. While nominal minimum wages were continually raised in response to the crisis, real minimum wages actually decreased. In February 1998, minimum wages in the NCR were increased by P13 from P185 to P198. In real terms however, wages actually decreased by 2.51%. Thus, with almost half of the total employed relying on wages and salaries, this reduction in real wages translates indeed to many families changing their food consumption patterns, foregoing preventive as well as curative health care, transferring

their children from private to public schools, and so on. More affected by these increases in prices are the families from the low income group, as more than 60% of their income is spent on food. Indeed, in the 1998 APIS, almost 96% of the families in the lowest 40% income stratum reported to have been affected by the increased price of food and other basic commodities. Thus, 1 in every 2 families in this income group changed their eating pattern while 3 out of 10 families increased their working hours.¹¹⁵

TABLE 116 Financial crisis problems affecting the families

	Philippines			National Capital Region		
	Total	Lowest 40%	Highest 60%	Total	Lowest 40%	Highest 60%
No. of Families Affected	13,487,569	5,495,298	7,992,270	1,851,060	760,467	1,090,594
% share						
Increased Price of Commodities	96.6	95.7	97.3	98.4	98.7	98.2
Loss of Job Within the Country	20.3	17.8	22.0	30.4	32.6	28.9
Loss of Job Due to Retrenchment of Migrant Workers	4.9	3.7	5.8	8.0	6.8	8.8
Reduced Wages	17.0	15.3	18.2	21.1	22.7	20.0
Drought or "El Niño"	62.9	76.1	53.8	36.5	35.3	37.4

Source: 1998 Annual Poverty Indicators Survey, National Statistics Office

The crisis has also led the government to tighten its belt and limit its spending. Thus, at the outbreak of the crisis, the government announced the 25% mandatory savings of all government agencies on non-personnel services. As will be discussed in the following sections, these cut in the budget greatly affected the implementation of certain programs intended for education, nutrition, housing and health.

Health. The impact of the crisis on health was most apparent in the fiscal budget reduction and increased peso values of medicines and other medical goods. With the 25% mandatory savings for all government departments at the outbreak of the crisis, the Health Department budget dropped to 4.25% of total government consumption expenditures in 1997 from 4.31% in 1996. It further declined by almost one percentage point in 1998 to 3.52%. Such million-peso reductions translated to reduced health care services and decreased medical supply. For instance, in 1996, P234 million was provided for the following services: food supplementation, weighing scales, medical and dental supplies, equipment, drugs and medicines for various diseases, toilet bowls, water for life construction and grants for primary health care. In 1998, only P55.9 million was provided for all of these.

Table 117 shows the result of a government study projecting the impact of reduced government budget for the Department of Health. Immunization targets were cut by 23%, tuberculosis patients treated were lessened by 36% and malaria diagnosis and treatment of patients were cut by 27%. These, in turn, translated to the increased number of deaths from those diseases and increased incidence of tuberculosis in the population.¹¹⁶

¹¹⁵ National Statistics Office, Annual Poverty Indicators Survey, 1998.

¹¹⁶ Though there are no available indicators yet of infant mortality, it can be inferred that the reduced immunization program can result to an increase of this social indicator. Studies (e.g., Lim 1998) have it that infant mortality is negatively related to the growth in GNP per capita. Hence, if this result were true, the economic contraction brought about by the crisis would have an adverse impact on children's health.

TABLE 117 Effect of 25% mandatory savings on health indicators

Affected Program	Immediate Effect	Social Impact
Malaria Control Program	reduce case findings and treatments by 27%	lead to 29,000 deaths
TB Control Program	not treat about 90,000 patients (36.3% of target patients)	lead to 1.8 million more people infected by tuberculosis
Schistosomiasis Control Program	reduce case findings and treatment by 26%	affected 296,000 and 4,680 patients, respectively
Expanded Program on Immunization	reduce by 23.3% immunization targets for six vaccines (Bacillus Calmette and Guerin; Oral Polio Vaccine; Diphtheria, Pertussis, Tetanus; Anti-Measles Vaccine; Tetanus Toxoid; and Hepatitis B)	
Nutritional Program	Reduce beneficiaries: 436,090 children aged 12-59 months for Vit. A 749,893 women aged 15-40 years old for iodine 166,677 pregnant women for iron	increase infant, child, and maternal mortality rates
Foreign assisted projects	reduce funding by P397.8M hire fewer consultants and personnel defer capital outlays for infrastructure projects	severely limit community health services, women's health and nutrition, safe motherhood and child survival

Source: Study conducted by the Department of Budget & Management (DBM) and the Social Development Staff (SDS) of NEDA with line agencies (1997). Included in this list were responses from the government agencies and documented by the SDS of NEDA.

Due to the devaluation, the reduced local supply of medicines and other medical supplies should also be expected since most of these medical items were not domestically produced. A look at the imports of antibiotics and first aid kits gives an indication that the crisis indeed caused a significant drop in similar medical items (see Table 118). The Foreign Trade Statistics record that even as the dollar unit value of first aid kits dropped, the peso unit values have significantly grown and thus most possibly caused the decrease in the imported quantity.

The reduction in supply of important medical items such as vaccines meant a decline in the quality of medical services. The Department of Health (DOH) estimates more than 600,000 patients may not have been diagnosed for some illness and another 3.6 million patients may not have been provided laboratory services in one way or another. It also foresaw a sharp increase in the number of patients in government medical and health facilities as people try to avoid the more expensive private hospitals. This, in turn, would take services away from the most disadvantaged groups.

Finally, a not so noticeable effect would be the tendency for families to postpone seeking medical attention as a result of a much tighter family budget. With costs of medical services increasing by more than 13% (see Table 119), a rate higher than the growth of most items in the consumers' consumption baskets, it is not difficult to imagine heads of households ignoring physical pains and discomfort just to avoid paying the medical fees.

TABLE 118 Imports of antibiotics and first aid kits

Code	First Aid Boxes & Kits	Medication Containing Other Antibiotics
	5419906	5421209
1995		
Quantity	5,337	13,256
Dollar	254,718	749,381
Cost per unit (\$)	47.73	56.53
Peso	6,606,318	18,919,523
Cost per unit (P)	1,237.83	1,427.24
1996		
Quantity	18,767	31,436
Dollar	78,420	1,301,565
Cost per unit	4.18	41.40
Peso	2,101,655	34,104,130
Cost per unit	111.99	1,084.87
1997		
Quantity	10,176	19,277
Dollar	42,024	566,177
Cost per unit	4.13	29.37
Peso	1,210,105	15,663,025
Cost per unit	118.92	812.52

Source: Foreign Trade Statistics 1995-1997.

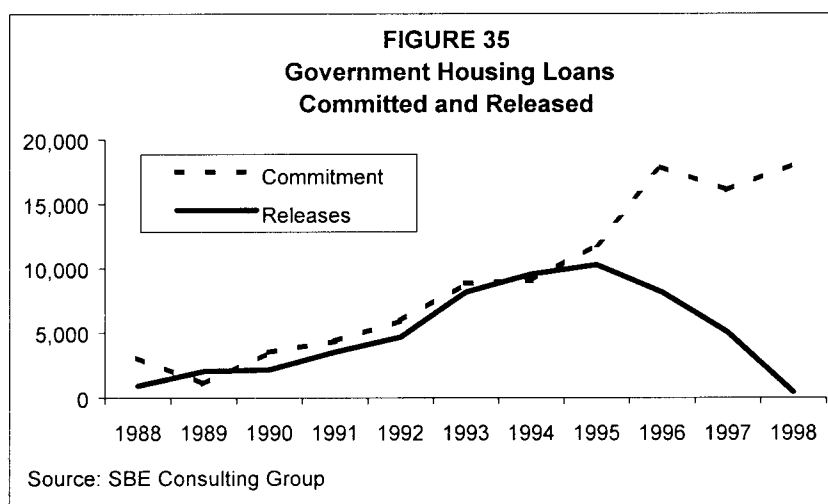
TABLE 119 Change in prices of selected items, 1995-1998

	1995	1996	1997	1998
Services				
Educational	12.13	14.96	20.37	19.10
Medical	8.22	6.74	6.74	13.60
Recreational	5.31	8.70	8.92	18.28
Food				
Fruits & Vegetables	5.44	15.41	1.87	17.38
Meat	3.88	4.28	3.94	5.69

Source: CEIC

Food and Nutrition. With lower income, rising prices and contracting fiscal budget, the crisis had affected people's food and nutrition as seen in the changes in the delivery systems and in the consumption patterns. With reduced funds, government programs had to limit their dole outs and services. For example, in 1998, the proportion of the number of children under 5 who received Vitamin A supplementation fell from 78% in 1997 to 71% in 1998 (The President's Socioeconomic Report 1998). This is quite a setback considering that the government has actively worked on uplifting the Vitamin A deficiency condition in the country.

Shelter. Shortage in funds for public housing has made it difficult for the government to reach the amount of housing loans it has promised. As of September 1998, only 52% of the committed funds was released by the pension funds for the Expanding Housing Loan Program. Moreover, by the end of 1998, the government has only provided 427 loans out of the 18,000 committed (see Figure 35).



Education. The impact of the crisis on education was seen in the reduction on spending and in the changes in enrollment patterns. Budget for the Department of Education, Culture, and Sports (DECS) as a percentage of government's consumption declined from 24.74% in 1997 to 24.18% in 1998. Given less spending capacity, educational projects were put to a halt, and construction of public schools slowed. Table 120 shows that the cut in budget translated to less classroom units and desks built, reduced provision of instructional materials, limited training of school personnel which slows institutional capability building. The backlog of teachers, classrooms, desks, textbooks and other shortages as results of mandatory savings amounting to P1.979 billion still cripple and disrupt classes even up to now.

TABLE 120 Effects of 25% mandatory savings on education

Affected Program	Immediate Effect	Social Impact
Department of Education, Culture, and Sports		
<i>DECS Projects</i>	<ul style="list-style-type: none"> — reduce new classrooms by 2,567 units — reduce new desks by 59,353 affecting 118,706 students — reduce provision of instructional materials 	— affect 158,265 elementary and secondary public school students
Special Education Program	<ul style="list-style-type: none"> — 466 students not provided Braille textbooks — reduce training of school personnel in special education 	— limit the number of gifted children enrollees (fail to meet the target of 10,000 to 20,000 enrollment)
Out-of-School Adults Program	— Disallowance of honoraria for teachers, facilitators, and project coordinators	— affect 2,000 adult learners
Non-Formal Education Projects	— reduce printing and distribution of learning materials by 60%	
Commission on Higher Education		
Faculty and staff development programs	— reduce allowance for such programs	— limit institutional capability building

Source: Study conducted by the Department of Budget and Management (DBM) and the Social Development Staff (SDS) of NEDA with line agencies (1997). Included in this list were responses from the government agencies and documented by the SDS of NEDA.

Even as a portion of the mandatory reserves was restored in the second semester of 1998, the sectoral requirements far outpaced what the government could afford to deliver. Estimated classroom shortages increased from 10,942 in 1997 to 14,615 in 1998, while the teacher shortages more than doubled from 4,764 in 1997 to 9,760 in 1998 (Table 121). The government in 1997 and 1998 provided about 50% of the teacher requirements. However, in 1999, there was absolutely no teacher provided to meet the 19,426 shortage.

TABLE 121 Teacher and classroom shortages (elementary and secondary)

Year	Enrolment	Requirements	Provided by the Government	Shortage at the end of the year	% of requirements being provided
Teachers					
1996	14,356,140	19,239	19,239	0	100
1997	14,851,489	11,674	7,000	4,674	59.96
1998	15,431,183	16,969	7,209	9,760	42.48
1999	15,573,517	19,426	0	19,426	0
2000	16,046,797	49,133	5,285	43,848	10.76
Classrooms					
1996	14,356,140	43,025	19,132	23,893	44.47
1997	14,851,489	37,567	26,625	10,942	70.87
1998	15,431,183	24,881	10,266	14,615	41.26
1999	15,573,517	29,710	8,197	21,513	27.59
2000	16,046,797	35,869	6,558	29,311	18.28
2001*	16,592,984	43,403	6,558	36,845	15.11

* projected

Source: Department of Education, Culture and Sports.

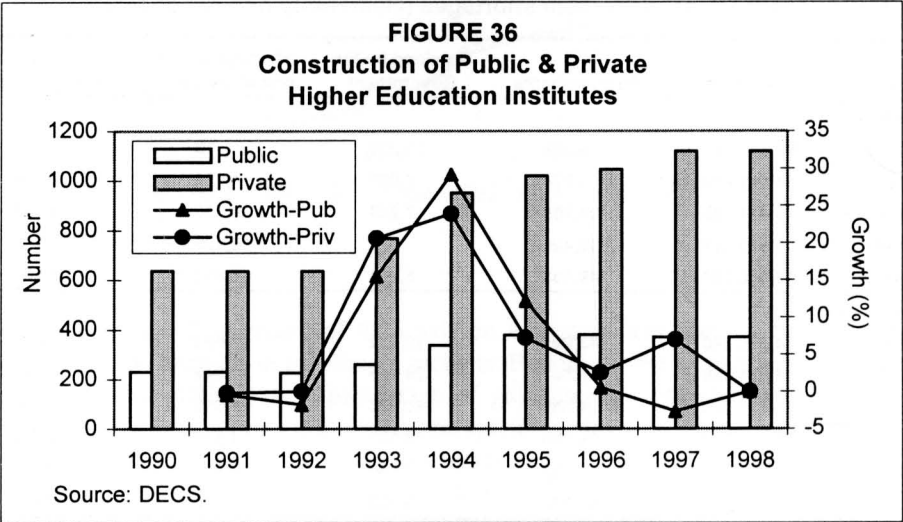
Increases in teacher and classroom shortages far outpace the rate of enrolment. In 1998, for example, enrolment grew by only 4% while teacher shortages increased by a big 109% and classroom shortages by 34%. This indeed indicates the declining capacity of the government to meet both backlog and present requirements. This is a real concern especially now that more students have been noted to have transferred from the private schools to the public schools as a result of the crisis. More so, the number of grade 1 pupils is also expected to increase as 6 year-old children are now being accepted.

Tight fiscal budget could have also caused the decrease in book appropriation and disbursement delays for book acquisitions at the Department of Education. According to the reports, less than half of the P515 million General Appropriations Act (GAA) textbook budget was made available by the Department of Budget and Management. This is similar to what happened in 1997 where the releases of funds for textbooks were also less than 50%. Along with the delays and insufficiency for budget releases for textbooks were the comparatively higher prices for these textbooks, which are now supplied to DECS by private publishers.¹¹⁷ With this, the textbook to student ratio (average for elementary and secondary levels) deteriorated from 1:3 in 1997 to 1:4 in 1998.¹¹⁸

¹¹⁷ R.A. 8047 (Book Publishing Industry Development Act which transferred the responsibility of textbook development, production and distribution from DECS to the private sector and also introduced a multiple textbook adoption policy.)

¹¹⁸ Department of Education, Culture and Sports, Annual Report. 1998

From 1994 to 1996, constructions of public colleges were growing at a faster rate than private colleges (see Figure 36). By 1997, construction rate did not only slow down for public colleges but the number had actually declined from 380 to 370. A possible reason for the foreclosures of 10 public schools was lack of funding, as often is the case.¹¹⁹ On the other hand, although private school construction was also put to a halt during the crisis period, the actual number of private schools increased from 1,045 in 1996 to 1,118 in 1997.



The crisis had also affected the enrolment patterns of different income groups. For the low income class, increased pressure on poor parents to find ways of compensating for reduced income seemed to have led some of them to take their children out of school in order to either work for additional income for the family or to take care of younger siblings as parents work longer hours. This finds support in the increased dropout rates in secondary *public* schools (see Table 122), where the low-income families usually send their children. Though the dropout rates for secondary public schools have been at an increase since 1995, the biggest percentage point-increase occurred in school year 1997-1998, as it jumped from 10.44% from 1996-1997 to 12.25% in 1997-1998.

TABLE 122 Drop out rates, 1993-1998

School Year	Elementary		Secondary	
	Public	Private	Public	Private
1993 - 1994	7.53%	2.22%	9.69%	6.44%
1994 - 1995	7.90%	2.51%	10.44%	7.07%
1995 - 1996	7.66%	2.90%	10.31%	6.49%
1996 - 1997	8.30%	4.30%	10.44%	8.38%
1997 - 1998	7.70%	3.93%	12.25%	7.00%

Source: Department of Education, Culture, and Sports.

¹¹⁹ These foreclosed schools must have been also likely local community colleges whose quality of education has been quite suspect, and thus with the reduction in budget, were the first to be cut away.

Significantly, the middle-income class did not also remain unaffected by the crisis. This is evidenced by the drop in the participation rate¹²⁰ in *private* elementary and secondary schools for 1998-1999 from 20.60% to 18.88%, in contrast to the increase in participation rate in public schools from 43.44% to 46.34% (see Table 123). Families affected by the crisis must have transferred their children from private schools to the cheaper public schools. This effect was not apparent in 1997-1998 perhaps because school arrangements have already been made prior to the crisis. But as soon as the impact of the Asian crisis started to bite through income reduction and increased prices,¹²¹ families moved their children the following year to the cheaper schools.¹²²

Most of the higher income bracket, on the contrary, seems to be the least affected as far as education is concerned. The evidence is that the drop out rate in both secondary and elementary private schools even declined in 1997 to 1998 from 4.30% to 3.93% and from 8.38% to 7%, respectively (see Table 122).

Finally, fiscal cuts in education also reduced educational innovations and training of school personnel and teachers. Majority of its budget (roughly 85%) is practically siphoned off by personnel services (or salaries) leaving very little for human capital training.

TABLE 123 Elementary and secondary participation rates, 1993-1999

School Year	Elementary		Secondary	
	Public	Private	Public	Private
1993 - 1994	78.83%	6.54%	37.41%	20.21%
1994 - 1995	80.37%	6.77%	39.04%	19.43%
1995 - 1996	84.05%	6.90%	42.14%	20.11%
1996 - 1997	87.17%	7.16%	43.30%	20.08%
1997 - 1998	87.74%	7.35%	43.44%	20.60%
1998 - 1999	88.64%	7.09%	46.34%	18.88%

Source: Department of Education Culture, and Sports.

Women in the Labor Force. While some studies predicted that women participation would go down since women tended to be the first to go during corporate cost cutting, actual participation rate of women in the labor force actually went up in 1998 from 48.3% in 1997 to 49.3%, while men's participation rate declined from 84.2% to 83.3%. This might be because as household income decreases as a result of shorter work hours or job losses, women are more pressured to augment family income by either increasing work hours, or re-joining the labor force either in the formal or informal sector.

The increase of women employed in 1998 was reflected both in the higher growth of female wage and salary workers, as well as own-account workers. There was, however, a noticeable shift of female workers from production to services industries, as reflected in the increase in employed women in wholesale/retail trade, as well as in the community, social and personal services sector. Unfortunately, these female dominated industries inked a drop in real wages as indicated in the trend of the compensation index suggesting that women had to put in more hours of work to maintain the same level of consumption. This, of course, has

¹²⁰ Number of enrollees of age group / population of age group.

¹²¹ The price of educational services increased by more than 16% in 1998, the highest increase among the items in the consumption basket.

¹²² Although earlier economic events led to the crisis, the Asian crisis is often marked to have begun in July 1997. Classes in the Philippine begin in June.

implication on the decreased quality time spent with their children at home and hence has a social repercussion.

Social Safety Nets and the Asian Crisis

There are two main institutionalized social safety nets in the country. One is the Social Security System (SSS)¹²³ for the private sector and the other is the Government Service Insurance System (GSIS) for the public sector. The problem with these two institutions is that their coverage is limited in form and in the number of people they are able to reach.

SSS granted a total of P25.2B in short and long term benefits while GSIS granted P7.7B in social security benefits, including retirement, employees' compensation and survivorship. Only a very small fraction of this will directly benefit people affected by the crisis as coverage for most people is limited to retirement.¹²⁴ Benefits such as Sickness, Disability and Hospitalization would not apply to the direct consequences of the crisis. Thus, the help that they have been able to provide for crisis-affected people are limited to loans. They responded directly to the effects of the crisis by making funds available to displaced workers. In 1998, SSS-Employees Compensation Commission (ECC), a loan window under the State Insurance Funds, made about P135 M available for livelihood needs of about 16,000 displaced workers and another P100M for other pending applications.¹²⁵ By February 1999, another P200 million was allocated for the program and about 25,815 applicants have been approved.¹²⁶ Other than this, assistance was given using the usual routes for loans. SSS, in 1998, released P9.7B as salary, educational, calamity and housing loans while GSIS, during the first 3 quarters of 1998, released P10.9B as salary and emergency loans and P1.5B as housing loans.

Additionally, the government is tapping SSS some more for other types of loans. The SSS was asked to work with the Guarantee Fund for Small and Medium Enterprises (GFSME) in providing funds for the created Enterprise Stabilization Guarantee Fund (ESGF).¹²⁷ ESGF is supposed to help small and medium enterprises experiencing liquidity problems. This poses a problem for SSS. Its funds are not even sufficient to cover unemployment or other benefits for displaced workers or even provide more comprehensive health coverage for its members.

The assistance that SSS and GSIS were able to provide was limited to a number of people. Part-time or contractual workers were often not enrolled in these programs, unless they enrolled themselves as self-employed. There are many cases when employers would get away from paying SSS by continuously hiring contractual workers, for example, as sales persons. Thus, for the most vulnerable, this pension scheme may not be an option. (In fact,

¹²³ SSS was established in 1957. SSS membership is compulsory for private employers. The benefits covered by SSS are retirement, death, disability, sickness, maternity, hospitalization, and employment injury. They offer small-scale industry loans that are export-oriented and employment generating enterprises in the rural areas. They offer cash payments for medical, surgical, and hospital expenses under their Medicare program. They offer benefits for work-related sickness, disability, and death under the Employee's Compensation Commission (ECC).

¹²⁴ Left with little options during the crisis, many people resorted to early retirement.

¹²⁵ See The President's Socioeconomic Report (1998). This is part of the Emergency Loan Program for displaced workers, approved by President Estrada on March 25, 1998. The program lends a maximum of P12,500 to members and sets an interest of 6% per year and a 1 year moratorium on loan repayment.

¹²⁶ Lamberte et al. (1999).

¹²⁷ ESGF will be implemented by the Small Business Guarantee and Finance Corporation (SBGFC). The program is supposed to guarantee up to 50% of the principal loan balance. Its finance requirement is P1 billion, P200 million of which has been set aside by SBGFC.

there has been a 1.5% decrease in the SSS membership in 1997, possibly attributed to the shutting down or downsizing of companies.)

A safety net that can directly help the people affected by the crisis is the Department of Labor and Employment's Public Employment Service Offices (PESO). This agency was set up to monitor worker layoff at local levels, provide job placements, distribute information on job vacancies and available programs for retraining, entrepreneurship and credit/livelihood assistance. Since the immediate effect of the crisis was job loss, the PESO and regional offices of DOLE were important in providing new jobs and opportunities to displaced workers. In 1998, the PESOs conducted job and livelihood fairs nationwide and placed 114,302 job applicants. Further, PESOs assisted 141,122 students through their career guidance programs.

Government Responses

The Central Bank has done adjustments to put the Philippines back to growth path (see Chapter 1, C). This is significant since social indicators improve with growth in the economy. Since many of the problems in the social sector were brought about by the reduced budget and increased costs, improved income would increase the capacity for social spending that would improve human capital.

The government has also worked on direct responses. In February 1998, the government organized the National Economic Summit (NES) in its effort to coordinate inter-sectoral cooperative responses to the crisis. The participants put together a list of proposals for various sectors (Social Pact for Empowered Economic Development II). Four clusters were formed to prioritize and concretize these proposals. One was responsible for measures on currency exchange rate problem and interest rate, headed by the Department of Finance (DOF). The other was responsible for fiscal discipline and savings, headed by the Department of Budget and Management (DBM). Still another was responsible for protecting jobs and enhancing productivity, headed by the Department of Labor and Employment (DOLE). The last was responsible for protecting the vulnerable groups, headed by the Social Reform Council (SRC) and the Department of Agrarian Reform (DAR). The Economic Monitoring and Mobilization Task Force (EMMTF) was also formed to monitor and coordinate with the 4 clusters. It would follow up on proposals, commitments and responsibilities of various agencies and sectors based on the summit and report to the Cabinet (Lim 1999).

Most proposals were routed through existing bodies such as SSS and PESO. Concretized proposals include P200M assistance to indigenous people in Mindanao. Fund was taken from the Poverty Alleviation Fund (PAF)¹²⁸ and used to help with livelihood, infrastructure and environmental protection, political stability and management efficiency. The government also responded with providing rice assistance, especially in drought-affected areas. A total of 1,385 million tons was imported to increase supply.

The government has responded also positively by providing assistance that would ultimately raise the human capital of the participants. It has provided training for 1,229 displaced workers and provided 10,774 scholarships in technical programs that would run for 1-3 years. As was earlier discussed, education is needed in raising productivity. However, the government's assistance was small scale. The number of people the government was able to help was a small fraction of the 13,487,569 families (NSO 1998) affected by the crisis.

¹²⁸ PAF was set up as part of the institutionalized anti-poverty campaign of the former Ramos Administration, Social Reform Agenda (SRA), in 1994.

Policy Recommendations

The Asian crisis highlighted the need for structural reforms in the financial and corporate sectors of the erstwhile tiger economies. But because of the adjustment pain, as such structural reforms usually impose on the population, particularly on the poor, it is important to accompany these reforms with some "sweeteners," in order to obtain democratic support for the process. One such sweetener is the use of "safety nets."

For starters, existing safety nets can be improved. The Philippines has not established extensive safety nets. Even the institutionalized safety nets, SSS and GSIS, have limited capacity, mainly due to lack of funding. Alternative source of funding should be tapped to improve the existing pension scheme, making it more universal and allowing better health care coverage.

Safety nets that would ensure food security and maintain purchasing power of vulnerable households should be further explored. There are two often-suggested safety nets, the effectiveness of each needs further study. One is food subsidy and the other is unemployment insurance. Food subsidy should specifically be targeted to the poor. Since there is a disparity between what the rich and the poor eat¹²⁹ in the Philippines, it may work. Studies show that food subsidy significantly contribute to an increase in the poor's income (Bell & Reich 1988). However, this can be very expensive for the government and would not really spur productivity.

The unemployment insurance provides immediate flexibility to the displaced worker. However, it can lead to low productivity and to a certain dependency attitude, as what has happened in countries such as the U.S. and Europe that employ this system. This system can be enhanced by tying it up with a job commitment. That is, the unemployed would be committed to do certain hours of public work in order to receive benefits. However, this set up may still be limited to low productivity. Further, the workings of an unemployment insurance may have to be designed differently in the Philippines given its extended family system and its relatively higher dependency ratio of 41%¹³⁰ (as compared to the that of the US, 34%). The main issue, nevertheless, is whether the government has the capacity to provide such support.

Admittedly, safety nets do not come without problems. Their administration tends to be plagued with inefficient bureaucracies and relatively high levels of corruption leading to beneficiaries other than the targeted group. In particular, the experience of many countries shows that the urban middle classes, rather than the low-income groups, tend to capture the benefits. One solution to this leakage in benefits is to capitalize more on the strong community ties in the country. Thus, grants to small-scale community projects and community-based organizations to provide needed services to target groups may be an effective solution.

Long-run solutions, however, must go beyond safety nets but should address the problem of low levels of human capital. High levels of human capital is important for low-income families to get better jobs, which are the best means for inclusion in society and for someone to feel productive. Also, human capital development is the best means to bridge the widening wage gap between skilled and unskilled workers that is even more highlighted by increased globalization. This problem needs to be addressed, crisis or no crisis.

¹²⁹ Except for the staple food rice, which is taken by both rich and poor families.

¹³⁰ Dependency ratio is the population ages 0-14 and 65-above over total country population.

Given globalization, open markets and vigorous competition are the best ways toward a more prosperous future. Countries need to emphasize education, skill and access to credit, improved business networks, management and marketing skills.

To a certain extent the equity effects of investment in human capital is fool-proof. While the impact of other structural reforms – take for instance, the agrarian reform program in the Philippines—on equity is open to question, there is ample evidence of the positive effect of increased expenditure on education, health as well as infrastructure in rural areas in reducing poverty and improving income distribution.

Public works and infrastructure can be developed especially in the agricultural area, where many of the people in poverty live. Currently, because of undeveloped infrastructure, transportation costs in these areas are so high. High transportation cost negatively affects productivity in the area. For example, rice imported from Thailand is even cheaper than rice transported from Mindanao to Manila.

There is also a need to develop industries that would employ more people throughout the region. This would not only increase productivity in the entire country but would also promote better income equality among the regions.

Safety nets, investment in human capital, rural infrastructure and regional development are, therefore, the keys to growth, to improving living standards and ultimately to solving huge income disparity.

Appendix A

Computing the Net External Orientation of Industries

Net external orientation is the difference between industry export share and imported input share. The measure indicates the direction of an industry's exposure to an international shock, particularly to a depreciation.

Net external orientation in the paper was computed as follows:

$$\chi_i - \alpha_i$$

Where χ_i = export share or the ratio of industry export revenues to industry shipments; and

α_i = the ratio of imported inputs to the value of production.

In turn, α_i , which provides information on the potential sensitivity of a producer to shocks experienced through the cost side, is computed as:

$$\alpha_i = \frac{\sum_j m_j p_j^i q_j^i}{VP_i}$$

Where m_j is the ratio of imports to total output of industry j which proxies the extent of foreign penetration in industry j ;

$p_j^i q_j^i$ is the value of inputs from industry j used in the production of industry i ;

VP_i is the value of total production of industry i .

The computation tried to follow as closely as possible the methodology in Campa and Goldberg (1997). However, due to data limitations in the Philippines, some adjustments had to be made.

First, all values used in the computation were taken from the 1990 60x60 Philippine input-output table. So, instead of taking export shipments value as Campa and Goldberg had done, for instance, the paper simply chose value of output because it is the data most readily available from the input-output table.

Second, instead of taking the ratio of imports to consumption to measure the extent of import penetration, m_j , the paper computed for the share of imports to total output.

Third, instead of value of production cost for VP_i , the paper used instead the value of total output.

¹³¹ The section has drawn a lot from Campa and Goldberg (1997).

Appendix B

Gross Value Added in Manufacturing by Industry Group, 1996-1999

In million pesos at constant prices

INDUSTRY/ INDUSTRY GROUP	GVA Manufacturing					Growth Rate		
	1996	1997	1998	1st 2 Qtrs. 1998	1st 2 Qtrs. 1999	96-97	97-98	1st 2 Qtrs. 98-99
CONSUMER GOODS	104,213	106,451	108,989	50,713	51,707	2.15	2.38	1.96005
Food manufactures	75,746	76,318	78,658	38,359	40,267	0.76	3.07	4.97
Beverage industries	8,256	8,961	8,930	3,423	3,473	8.54	-0.35	1.46
Tobacco manufactures	5,459	5,779	5,539	2,517	2,473	5.86	-4.15	-1.75
Footwear wearing apparel	12,036	12,356	12,818	4,905	4,035	2.66	3.74	-17.74
Furniture and fixtures	2,525	2,822	2,819	1,381	1,332	11.76	-0.11	-3.55
Leather and leather prod.	191	215	225	128	127	12.57	4.65	-7.8
INTERMEDIATE GOODS	75,463	77,602	73,312	34,544	33,821	2.83	-5.53	-2.09298
Textile manufactures	5,498	5,320	5,118	1,924	1,956	-3.24	-3.80	1.66
Wood and cork products	2,782	2,969	2,782	1,353	1,358	6.72	-6.30	.37
Paper and paper products	2,157	2,038	2,172	1,078	1,046	-5.52	6.58	-2.97
Publishing and printing	3,114	3,233	3,093	1,736	1,604	3.82	-4.33	-7.60
Rubber products	2,275	2,088	1,849	824	776	-8.22	-11.45	-5.83
Chemical & chemical prod.	13,309	14,276	14,212	5,906	6,352	7.27	-0.45	7.55
Products of petroleum & coal	39,288	39,753	37,472	18,473	19,480	1.18	-5.74	5.45
Non-metallic mineral prod.	7,040	7,925	6,614	3,250	2,624	12.57	-16.54	-19.26
CAPITAL GOODS	34,937	39,619	38,972	19,102	19,322	13.40	-1.63	1.151712
Basic metal industries	5,305	5,223	4,684	2,593	2,378	-1.55	-10.32	-8.29
Metal industries	5,061	4,841	4,232	2,206	2,914	-4.35	-12.58	32.09
Machinery except electrical	3,309	3,756	3,540	1,797	1,724	13.51	-5.75	-4.06
Electrical machinery	13,867	18,179	19,360	9,416	8,862	31.10	6.50	-5.88
Transport equipment	3,086	2,744	1,810	813	914	-11.08	-34.04	12.42
Miscellaneous manufactures	4,309	4,876	5,346	2,277	2,530	13.16	9.64	11.11
GROSS VALUE ADDED IN MANUFACTURING	214,613	223,672	221,273	104,359	106,890	4.22	-1.07	2.425282

Source: National Statistics Office.

Appendix C

Social Accounting Matrix (SAM) Framework and Analysis

1. The Social Accounting Matrix Framework

The social accounting matrix (SAM) is both a data and an analytical framework. As a data framework, Thorbecke (1985) defines the SAM as a systematic data and classification system that explicitly incorporates the various crucial transformations among variables, such as the mapping of factorial income distribution from the structure of production and the mapping of household income distribution from the factorial income distribution. The SAM is also an analytical framework because it identifies interconnections among different subsystems such as sectoral production, household incomes and expenditures, and other macroeconomic balances. As an analytical framework the SAM also specifies the interrelationships among variables within and between subsystems.

The SAM is based on the double entry bookkeeping principle in accounting. Unlike the bookkeeping principle in accounting, however, the SAM shows the balance between incomings (income) and outgoings (expenditures) of a series of accounts as a single entry in a matrix. The row and column sums should therefore balance. By showing a transaction as a single entry in a matrix, the SAM conveniently depicts how one variable relates to another.

A SAM has two major accounts. These are the endogenous and exogenous accounts. The endogenous accounts usually include factors of production, institutions, and production activities. The exogenous accounts are normally the government, rest-of- the world, and capital accounts.

2. SAM Analytical Framework

The SAM has to be converted into an analytical framework in order to make it useful for analysis and planning purposes. In order to do this, the transactions shown by the SAM are converted into a model by specifying relationships among the different variables.

The most basic relationship shown by the SAM is the balance between total income (rows) and total expenditures (columns). Total income in a particular endogenous account is equal to the transactions of that particular endogenous account with other endogenous accounts plus transactions with the exogenous accounts, that is

$$Y_i = T_{ij} + X_i , \quad (1)$$

where Y_i is total income, T_{ij} is transactions with the endogenous accounts, X_i is the transactions with the exogenous accounts. Thorbecke (1985) emphasized that X_i is the vector of exogenous injections of accounts like the capital and rest of the world accounts.

Average expenditure propensities are then specified as the ratio of the row (income) transactions to the appropriate column (expenditure) total. This is mathematically expressed as

$$a_{ij} = T_{ij} / Y_j , \quad (2)$$

where a_{ij} is the average expenditure propensity, T_{ij} is the transaction from the i th row account to the j th column account, and Y_j is the total of the j th column account.¹³²

Thus, equation 1 can now be expressed as follows:

$$Y_i = a_{ij} Y_j + X_i .$$

In compact matrix notation, the equation describing the interrelationships between the incomes and expenditures of the exogenous and endogenous accounts in the whole economy can be written as

$$Y = AY + X . \quad (3)$$

The SAM model that can then be derived from equation 3 is therefore

$$Y = (I - A)^{-1} X , \quad (4)$$

where $(I - A)^{-1}$ is the aggregate multiplier matrix or the generalized inverse.¹³³ The incremental form of the equation 4 is expressed as follows:

$$\Delta Y = (I - A)^{-1} \Delta X \quad (5)$$

3. The SAM Data Base

An updated simplified SAM was constructed based on the 1990 87 x 87 SAM of the Philippines. The 1990 87 x 87 SAM was first updated using recent data. The 1990 has the following accounts:¹³⁴

1. Wants Accounts (no. 1-7)
2. Goods and Services Accounts (no. 8-23)
3. Production Accounts (no. 24-37)
4. Generation of Income Accounts (no. 38-40)
5. Allocation of Income Accounts (no. 41-49)
6. Secondary Distribution of Income Accounts (no. 50-58)
7. Use of Income Accounts (no. 59-67)
8. Capital Accounts (no. 68-72)

¹³² Note that the principle behind the average expenditure propensity is the same as the input-output coefficient. Also note that both have the same notation, that is, a_{ij} . See Appendix Table C.1 for the average expenditure propensities for the complete table and Appendix Table B for the updated simplified SAM.

¹³³ Note the similarity between the Leontief inverse and the SAM aggregate multiplier matrix or generalized inverse. Input-output analysis and the SAM analysis have parallel concepts and operationalization. The SAM, however, is normally closed not only with respect to consumption behavior (which is normally done in semi-closed input-output analysis) but also with respect to the determination of factorial and household income distribution. Thus, the closure of the interdependent economic system is specified to a higher degree in SAM analysis. See Appendix Table C.3 for the aggregate multiplier matrix for updated simplified SAM.

¹³⁴ For a complete breakdown of the accounts, enumeration of the data sources, average expenditure propensity tables (complete and reduced versions), and the aggregate SAM multiplier matrix or generalized inverse for the updated simplified SAM, see Appendix tables.

9. Capital Formation Accounts (no. 73-75)
10. Financial Accounts (no. 76-85)
11. Rest of the World Account (Current) (no. 86)
12. Rest of the World Account (Capital) (no. 87)

In the updated simplified SAM, however, only three of these twelve accounts were endogenized. These accounts are the following:

1. Generation of Income Accounts;
2. Allocation of Income Accounts; and
3. Production Accounts.

The endogenous accounts in the updated simplified SAM represent factorial income distribution, household income distribution, and production activities. Except for the production activities, both the factorial income distribution and household income distribution were based on 1994 data.

Data for the production activities were based on the 1990 Philippine Input-Output Table, which is the most recent input-output table in the Philippines.¹³⁵ Two industries were added to the production accounts of the original 1990 SAM in order to come up with a square matrix. These industries are trade and transportation.¹³⁶

The updated simplified SAM became the basis for the derivation of the aggregate SAM multiplier matrix or generalized inverse. The aggregate SAM multiplier matrix contains the so-called accounting multipliers because they are based on average expenditure propensities.¹³⁷ The multiplier matrix shows the effect of an exogenous one peso change in demand or output of the column accounts on the income of the row accounts.

4. SAM Multiplier Analysis

The SAM multiplier analysis is based on the SAM aggregate multiplier matrix or generalized inverse. The column elements of the generalized inverse gives the effect of a peso change in the expenditures (final demand or output) of the corresponding column account.

Income-to-Income Multiplier Analysis. Aside from the usual expenditure (final demand or output)-to-income multiplier analysis, an income-to-income multiplier analysis was done to determine the effect of a change in the income of the column account on the income of the row accounts. The aggregate multiplier matrix (generalized inverse), which was the basis of the expenditure (final demand or output)-to-income multiplier analysis), was converted into an income-to-income multiplier matrix in the following manner:

$$\text{Let } Y_i = b_{ij} X_j, \quad (6)$$

where Y_i is the income of i th account, b_{ij} is the elements of the aggregate multiplier matrix, and X_j is the expenditure (final demand or output) of j th account. In incremental form, equation 5 can be expressed as follows:

¹³⁵ Note, however, that work on the 1994 Philippine Input-Output table is on its final stages. The preliminary table is not yet available to the public.

¹³⁶ In the 1990 SAM, these two industries appeared in the goods and services account. The transportation and trade accounts of the 1990 SAM detailed the transport costs and trade margins of the different industries in the economy.

¹³⁷ Note that sometimes the average expenditure propensities are sometimes converted to marginal expenditure propensities using elasticity measures.

$$\Delta Y_i = b_{ij} \Delta X_j, \quad (7)$$

which can also be expressed as $b_{ij} = \Delta Y_i / \Delta X_j$. Thus, the elements of the aggregate multiplier matrix (generalized inverse) b_{ij} can also be called as expenditure (final demand or output)-to-income multipliers.

From equation 6, the on-diagonal element of the aggregate multiplier matrix (generalized inverse) can therefore be expressed as follows:

$$b_{jj} = \Delta Y_j / \Delta X_j. \quad (8)$$

Define a multiplier matrix element b_{jj}^* as follows:

$$b_{jj}^* = b_{ij} / b_{jj}. \quad (9)$$

Equation 8 can be expanded using equations 6 and 7. Thus,

$$b_{jj}^* = \frac{\Delta Y_i / \Delta X_j}{\Delta Y_j / \Delta X_j} \quad (10)$$

The matrix multiplier element b_{jj}^* can now be expressed as

$$b_{jj}^* = \Delta Y_i / \Delta Y_j, \quad (11)$$

which can also be expressed as $\Delta Y_i = b_{jj}^* \Delta Y_j$. Thus, b_{jj}^* can be considered an income-to-income multiplier matrix.

The income-to-income multiplier matrix can be derived by simply dividing all the column elements of the aggregate multiplier matrix (generalized inverse) with their appropriate on-diagonal elements.¹³⁸

5. SAM Multiplier Analysis

The aggregate SAM multiplier matrix for the updated simplified SAM was used to conduct the SAM multiplier analysis. The multiplier analysis focused on the effects of a change in final demand or industrial output on factorial income distribution, household income distribution, and production. The industry classification of the updated simplified SAM is as follows:

1. Agriculture, Forestry, Fishery, and Mining
2. Food Manufacturing
3. Textile, Wearing Apparel, and Leather
4. Wood and Paper Products
5. Chemical Products
6. Petroleum Refining
7. Non-Metallic and Metal Manufactures

¹³⁸ See Appendix Table C.4 for the complete income-to-income multiplier matrix for the updated simplified SAM.

8. Machinery, Electrical and Non-Electrical
9. Transport Equipment
10. Other Manufactures
11. Construction
12. Electricity, Gas, and Water
13. Transportation and Communication
14. Trade
15. Financial Institutions, Real Estate, and Dwelling
16. Services

The multiplier analysis focused specifically on the effect of a drop in production in those industries that have registered negative growth rates for the period 1997-1998. These industries are Agriculture, Forestry, Fishery, and Mining; Wood and Paper Products; Chemical Products; Petroleum Refining; Non-Metallic and Metal Manufactures; Transport Equipment, and Construction.

The effect of a change in the income of unincorporated enterprises, non-profit institutions, private corporations, public corporations, and production activities on household income was also studied using the SAM income-to-income multiplier matrix. As mentioned earlier, the income-to-income multiplier matrix shows the effect of a change in income in the exogenous accounts on the income of the endogenous accounts. The transformation of the expenditure-to-income multiplier matrix into an income-to-income multiplier matrix was done by simply dividing all the column elements of the expenditure-to-income multiplier matrix by their appropriate on-diagonal elements.

Bibliography

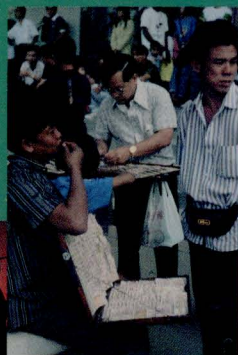
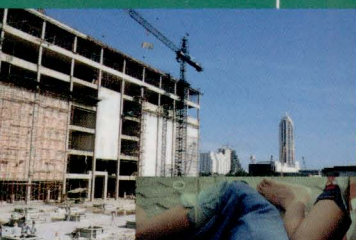
- Abbink, G.A., M.C. Braber, and S.I. Cohen. 1995. "A SAM-CGE Demonstration Model for Indonesia: Static and Dynamic Specifications and Experiments." *International Economics Journal* 9, no. 3 (Autumn): 15-33.
- Balisacan, Arsenio M. 1997. "What Do We Really Know—or Don't Know—about Economic Inequality and Poverty in the Philippines?" Joint IDE-UPSE Symposium-Workshop on *Growth, Economic Inequality, and Poverty: What Ever Happened to Mang Pandoy?* Manila: 10 December 1997.
- Bangko Sentral ng Pilipinas. 1998. *The Philippines: Staying on Course*.
_____. *Selected Philippine Economic Indicators*. various issues.
- Bell, David E., and Michael R. Reich. 1988. *Health, and Nutrition, and Economic Crises: Approaches to Policy in the Third World*. Massachusetts: Auburn House Publishing Company.
- Bohning, W.R. 1998. "The Impact of the Asian Crisis on Filipino Employment Prospects Abroad." SEAPAT Working Paper, ILO. March.
- Bureau of Labor, Employment and Statistics, various publications.
- BusinessWorld Top 1000 Corporations in the Philippines. 1998. "How Competitors Compare."
- Calvo, Guillermo, Leonardo Leiderman, and Carmen Reinhart. 1996. "Inflows of Capital to Developing Countries in the 1990s." *Journal of Economic Perspectives*. Vol 10, Number 2. Spring.
- Campa, J., and L. Goldberg. 1995. "Investment in Manufacturing, Exchange Rates and External Exposure." *Journal of International Economics* 38 (May 1995).
- _____. 1997. "The Evolving External Orientation of Manufacturing: A Profile of Four Countries." *Federal Reserve Board of New York Economic Policy Review*, July.
- Castillo, L. 1998. "The Country's Hidden Strength." *Staff Memos*. University of Asia and the Pacific (No. 21).
- Corbo, Vittorio, and Leonardo Hernandez. 1996. "Macroeconomic Adjustment to Capital Inflows: Lessons from Recent Latin American and East Asian Experience." *The World Bank Research Observer* Vol. 11. No. 1 (February).
- Department of Budget and Management. *Budget of Expenditures and Sources of Financing: Fiscal Year 1996-1998*. Philippines.
- Goldberg, L., and K. Crockett. 1998. "The Dollar and US Manufacturing." *Federal Reserve Bank of New York Current Issues* (November).
- Goldman Sachs. 1997. *Economic Research* (Oct 27).
- Krugman, Paul. 1998. "What Happened to Asia?" Downloadable from www.mit.edu/~krugman.

- Lamberte, Mario. 1994. "Managing Surges in Capital Inflows." *Journal of Philippine Development*.
- _____. 1989. "Assessment of the Problems of the Financial System: the Philippine Case." PIDS Working Paper 89-19. Manila.
- Laya, Jaime. 1981. "End of the Crisis of Confidence." *CB Review* (September). Manila.
- Lim, C., and C. Woodruff. 1998. "Managing Corporate Distress in the Philippines: Some Policy Recommendations." IMF Working Paper 98-138.
- Lim, J. 1998. Employment Effects of Globalization and the East Asian Crisis on Women: The Philippine Case. University of the Philippines. Diliman. Unpublished
- Lim, Joseph Y. 1998. "The Social Impact and Responses to the Current East Asian Economic and Financial Crisis: The Philippine Case." Country Paper prepared for the United Nations Development Programme/Regional Bureau for Asia and the Pacific. Manila, Philippines.
- National Statistical Coordination Board. *Family Income and Expenditure Survey*. Various Issues.
- Orbeta, Cristina. 1998. "Capital Flows: Challenges to Macro Management The Philippine Case." Paper presented at the ADB-World Bank Senior Policy Seminar on Managing Global Financial Integration in Asia: Emerging Lessons and Prospective Challenges, March 10-12, 1998. Manila.
- Padojinog, Winston Conrad B. 1998. "Trends and Prospects of Selected Sectors in Real Estate." Paper presented to *Waiting for Recovery in 1999?* Seminar. Manila, Philippines, September.
- Pasadilla, G. 1998. "Social Impact of the Asian Crisis in the Philippines: Preliminary Survey." Philippine Institute for Development Studies Working Paper. December.
- Pasadilla, G., and P. Ella. 1999. "Industrial Winners and Losers from the Asian Crisis." *Recent Economic Indicators*. University of Asia and the Pacific. June.
- Pernia, Ernesto M., and James C. Knowles. 1998. "Assessing the Social Impact of the Financial Crisis in Asia." *EDRC Briefing Notes*, No. 6. Asian Development Bank (November).
- Reyes, Celia M., and Edwin A. Del Valle. "Social Reform Agenda: Its Impact on Poverty Alleviation and Equity Promotion." *Development Magazine* Vol. 25. No. 6.
- Reyes, Celia. 1999. "Social Impact of the Crisis." PIDS. Unpublished.
- Robinson, S. 1989. "Multisectoral Models." In *Handbook of Development Economics*, Vol. II, ed. by H. Chenery, and T. N. Srinivasan. Elsevier Science Publishers.
- Rodlauer, M. et al. 2000. "Philippines: Toward Sustainable and Rapid Growth (Recent Developments and Agenda Ahead)." IMF Occasional Paper 187. Washington, D.C.
- Social Security System 1997 Annual Report. Manila: September 1998.
- Soriano, Ma. Teresa. 1998. "Implications of International Migration: A Focus on the Philippine Experience." *Philippine Labor Review*. January-June.
- The President's 1998 Socioeconomic Report. Manila: March 1999.

- Thorbecke, Erik 1985. "The Social Accounting Matrix and Consistency-Type Planning Models." In *Social Accounting Matrices: A Basis for Planning*. Ed. by Graham Pyatt, and Jeffrey Round. Washington, D.C.: World Bank.
- Vasquez, Noel. 1992. "Economic and Social Impact of Labor Migration." In *Philippine Labor Migration, Impact and Policy*. Battistela, G., and A. Paganoni, eds. Quezon City: Scalabrini Migration Center.
- Vivian, Jessica. 1994. "Social Safety Nets and Adjustment in Developing Countries." United Nations Research Institute for Social Development, July.
- World Bank. 1998. "Social Consequences of the East Asian Financial Crisis." September.
- _____. 1998. "The Socioeconomic Impact of the Financial Crisis in the Philippines." July.

ISBN 974-87902-3-1

Social Impacts of the Asian Economic Crisis
in Thailand, Indonesia, Malaysia and the Philippines



1996

1999



565 Ramkhamhaeng 39, Wangthonglang, Bangkok 10310 Thailand
Tel: (662)7185460; Fax: (662)7185461-2; Website: <http://www.info.tdri.or.th>