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The Social Fallout: Safety Nets and Recrafting the Social Contract

with NANCY BIRDSALL

Before the spread of democratic rule in developing East Asia, governments denied citizens effective political voice and offered only limited social insurance.[1] But they pursued policies that increased household incomes and minimized or prevented the increasing inequality frequently associated with the development process. East Asia's growth lifted millions of households out of poverty and generated not only a class of the newly rich, but upwardly mobile urban middle and working classes that might be called the "striving class."

Even before the economic crisis of 1997-98, this approach to social issues was coming under pressure. Secular changes, including aging populations, urbanization, greater openness to trade and investment, and demands arising out of the democratization process in a number of countries called into question the adequacy of informal social insurance mechanisms. However, the financial crisis of 1997-98 demonstrated clearly that reliance on growth and informal mechanisms to provide social insurance had left governments badly equipped to respond to large-scale social distress. The problem was not just one of the poor, although they too were adversely affected by the crisis. The crisis struck hardest precisely

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1. A more extended version of the arguments presented here can be found in Birdsall and Haggard (2000).

at the urban ''striving class,'' thus calling into question the social mobility of the past.

The first response of governments and the international financial institutions to the social dimensions of the crisis was to relax fiscal policies that were initially too tight and to protect public spending on education, health, and other social investment programs. The second was more direct: To craft policies and programs that would protect the poor and vulnerable groups through targeted transfers and public employment, and to create or substantially upgrade social insurance for the working and middle classes.

Each of the four countries in the region instituted short-term social safety net programs: food, emergency employment, and in some cases income supplements to ensure minimum consumption levels among the poor. These efforts helped alleviate the social costs of the crisis, even if they were limited in varying degrees by the institutional weakness of the government in the social policy area, and in some cases by corruption.

But governments proved resistant to suggestions for targeted transfers and institutionalized social insurance. Their doubts stemmed in part from weaknesses in administrative capacity, particularly in the ability to target the poor, and legitimate concerns about the fiscal burden on the state and corruption.

But the nature of the response to the social fallout from the crisis also had its politics. On the one hand, conservatives both inside and outside the government harbored a deep-seated political resistance to Western models of the welfare state. They argued that such measures were not only ill-timed and expensive, but would fit poorly with long-standing cultural traditions of work, discipline, and family responsibility—traditions and values they view as central to the region's past achievements. Whatever the merits of these arguments, they also masked material concerns: that private sectors operating in increasingly competitive environments, both in international markets and at home, not be burdened with additional costs.

On the other hand, the countervailing political forces that have historically been the carriers of a widened social agenda—organized labor and social democratic parties (Esping-Anderson 1990)—have generally been weak throughout the region (Goodman, White, and Kwon 1998). The poor are rarely well-represented politically, but the configuration of political parties and interest groups did not provide strong representation for the urban ''strivers'' either. The backlash that was visible in the region was less a result of organized social resistance to reform than of the weakness of affected groups and of their lack of institutionalized, organized channels of representation.

Opportunities for national debate on social insurance and the broader social contract were greatest where such forces had managed to gain greater political voice. The conditions for this occurring were partly structural; for example, South Korea is more urbanized and industrialized than its Southeast Asian counterparts and thus better able to institute more formal social insurance mechanisms. But the conditions were also more purely political and paralleled in important ways an important condition for reform already noted in chapters 1-3. New social contracts were more likely from governments less beholden to business interests and conservative social groups and more attentive to broader publics and those most seriously exposed to the uncertainties of the market.

The Economics and Politics of Growth with Equity

Before the crisis, countries in East and Southeast Asia did have a strategy of social protection, but it was highly implicit.[2] Its central component was healthy rates of per capita GDP growth that were broadly shared through rapid expansion of employment, increasing participation in the formal labor market, and rising real wages. Even if East Asian growth was primarily the result of sheer factor accumulation, that is, high rates of savings and investment rather than growth of total factor productivity (Young 1995; Krugman 1994), households nonetheless enjoyed steady and reliable increases in real annual income.

What was behind this growth-with-equity model? First, the East Asian approach did not solely emphasize labor-intensive manufacturing for exports, although that was certainly a distinctive feature. Rather, it was a relatively balanced development model that avoided the implicit and explicit taxes on agriculture seen in other regions and addressed rural poverty through land reform (in South Korea and Taiwan) and substantial public investments in rural infrastructure and agricultural technologies.

Second, public spending on human development increased with rising GDP per capita, and was generally concentrated on programs that benefited the poor, such as primary and secondary education and basic curative and preventive healthcare. Education policy was particularly important. The combination of a greater supply of basic education with the greater demand for educated workers associated with the export-led growth strategy created a virtuous cycle: Rapid growth and good returns to education made it rational for households and individuals to invest in it. The result was a dramatic increase in average levels of schooling, and equally impressive, a rapid decline in the inequality of schooling.[3] Public

2. This discussion is based on Birdsall, Ross, and Sabot (1995), and World Bank (1993).

3. Birdsall and Londoño (1998) compare East Asia and Latin America. The coefficient of variation of schooling in East Asia declined from over 1.6 to above 0.9 between 1960 and 1990.

and private investment in education, particularly primary education, also had the effect of lowering inequality by minimizing the wage premiums scarce educated labor captured in other regions.

A third component of the growth with equity strategy was a minimal government role in providing a social safety net (Goodman, White, and Kwon 1998; Tyabji 1993). Governments invested in people but did not necessarily protect them directly against risk. Outside of some protections extended to civil servants, public-sector workers and the military (e.g., in Indonesia, South Korea, and Thailand), social insurance was generally private and informal and rested on high levels of household savings, strong traditions of family support, and private transfers (e.g., from urban workers to rural households; between generations). In some countries, notably South Korea, larger enterprises had begun to provide social insurance, but this was the exception rather than the rule.

The fourth and final component of the East Asian model was political—the prevalence of authoritarian governments that served to dampen social demands. A number of commentaries have emphasized the "shared" nature of East Asia's growth or emphasized the fact that high growth itself served to limit political pressures for formal safety net programs (Campos and Root 1996, chapter 3; World Bank 1993). But this language is subtly misleading. Such "agreements" were not achieved through democratic political processes—and indeed were not "agreements" at all. Before the democratic transitions of the 1980s and 1990s, they resulted from authoritarian or semi-democratic paternalism. Social democratic political parties were weak; labor movements were weak, repressed, or both; and interest groups and nongovernmental organizations (NGOs) had only the narrowest space in which to operate.

These political features of the Asian model had several second-order consequences for the nature of the social contract. The truncated nature of the political spectrum, limitations on interest groups, and outright repression meant that any nascent political demand for state-run social safety nets was attenuated. During periodic political or economic crises, such as the ethnic riots in Malaysia in 1970 or the oil shocks of the 1970s, governments responded to social pressures by instituting new programs. But they did so as Bismarck had over a century before: preemptively and on terms set by the government and its conservative political allies. The result was formal mechanisms that limited direct state expenditure, relied on schemes funded by business and labor, and, with the exception of Malaysia's ethnic affirmative action policies, shunned redistributive objectives.

The effect of authoritarian politics on industrial relations was also important (Deyo 1989; Frenkel 1993; Frenkel and Harrod 1995). By allowing labor markets to clear relatively freely, East Asian economies avoided the labor-market dualism visible in Latin America and Africa. This may have had positive implications for efficiency and equity, but at the cost of direct and indirect controls over the labor movement. Governments could not push wages below market-clearing levels; they could, however, guarantee that labor had little say either in the wage-setting process or in the rules governing the shop-floor. In some cases, government paternalism did introduce some rigidities. For example, in South Korea, the system of industrial relations established under Park Chung Hee made it difficult for firms to fire workers in larger enterprises, and all governments typically faced pressures from workers in state-owned enterprises. On the whole, however, labor markets in East Asia were relatively flexible.

The Limits of the Model in the 1990s

A number of secular trends posed new challenges to the implicit social policy of the high growth period, even before the onset of the crisis. First, long-term demographic changes were altering the age composition of countries in the region. Between 1995 and 2025, the share of the economically active working-age population in northeast Asia is projected to edge down from 61.6 to 59.3 percent, while the share of those over 65 will more than double from 7.2 to 17.6 percent of the population (Asian Development Bank 1998). The implication is not only slower overall rates of per capita growth, but new questions about the adequacy of the pension and health-care systems.

A second demographic trend with important implications for the social contract is the continuing process of urbanization. South Korea is the most urbanized of the group (81 percent urbanization rate in 1998), and not surprisingly has moved farthest in extending unemployment insurance to its urban workforce, although as we will see below, coverage and benefits are far from generous. Malaysia was also more than half urban: 57 percent in 1998; projected to increase to 70 percent by 2025. Urbanization rates in 1998 were only 31 percent in Thailand and 37 percent in Indonesia, in comparison with rates above 50 and even 60 percent in countries of comparable per capita income in Latin America (United Nations 1999). But by 2025, urbanization rates will increase to a still-low 36 percent in Thailand and 58 percent in Indonesia. The inexorable trend of urbanization and a relative decline in agricultural employment implies the weakening of the informal social insurance that exists as a result of mobility between the urban and rural sectors.

A third concern is rising inequality of income and wealth. The much touted "growth-with-equity" model was not in fact based on substantial reductions in inequality; in the 1970s and 1980s, Indonesia, South Korea, and Malaysia saw modest reductions but by international standards inequality in Malaysia and Thailand remained high. Rather, the characterization was based on the region's success in achieving rapid growth

Table 5.1 Gini coefficients, for selected countries of East Asia, 1978-96

High-inequality countries				Low-inequality countries			
	Malaysia	The Philippines	Thailand		Indonesia	South Korea	Taiwan
1978				**1978**	38.6		28.4
1979	51.0			**1979**			27.7
1980				**1980**	35.6	38.6	28.0
1981			43.1	**1981**	33.7		28.2
1982				**1982**		35.7	28.5
1983				**1983**			28.5
1984	48.0			**1984**	32.4		28.8
1985		46.1		**1985**		34.5	29.2
1986			47.4	**1986**			29.3
1987				**1987**	32.0		29.7
1988		45.7	47.4	**1988**		33.6	30.0
1989	48.4			**1989**			30.4
1990			48.8	**1990**	33.1		30.1
1991		45.0		**1991**			30.5
1992			51.5	**1992**			30.8
1993				**1993**	31.7	31.0	30.8
1994				**1994**			
1995	48.5			**1995**			
				1996	36.5	29.5	
Average	48.9	45.6	47.6	**Average**	34.2	33.8	29.3

Note: Ginis are based on household distributions of income per capita, except for Indonesia, where Ginis are based on hosehold distribution of expenditure per capita.

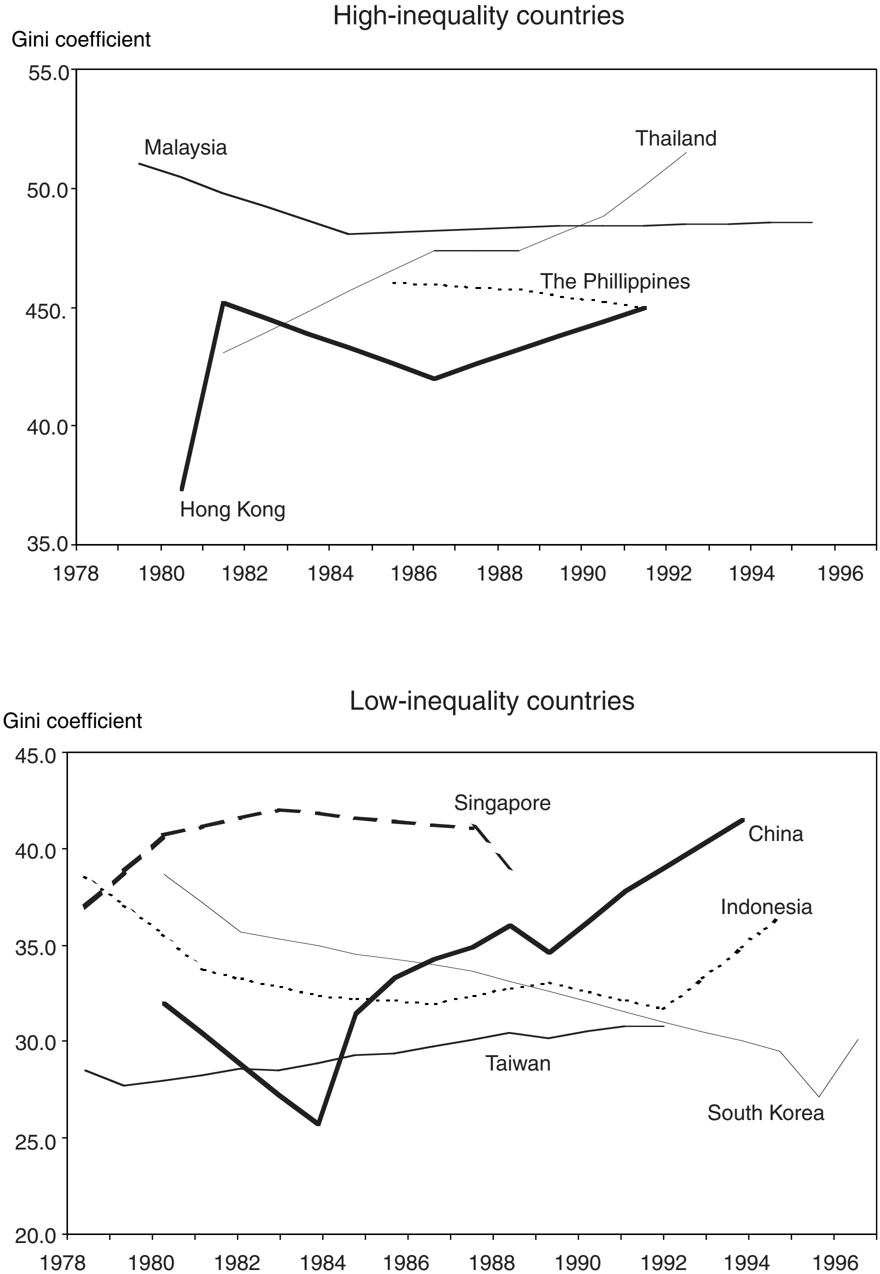
Source: Deininger and Squire (1996).

without the increases in inequality hypothesized by Kuznets (1955; Birdsall, Ross, and Sabot 1995). Yet new evidence suggests that may be changing. Even before the crisis, increases in inequality were marked in Thailand and were visible in Indonesia as well (see table 5.1 and figure 5.1). In South Korea, the Gini coefficient of inequality of urban wage income rose between 1993 and 1996 from 26.3 to 28.2, a substantial increase, though from a very low level.[4] Although East Asia in the 1980s and 1990s was much more equal than Sub-Saharan Africa and Latin America, it was no more equal than the Middle East and North Africa and less equal than South Asia or the advanced industrial states (Ahuja et al. 1997, table 3.1).

Even where inequality of income has not increased dramatically, the potential for conflict over the distribution of wealth is high. Before the crisis, booms in the stock and property markets in the 1990s generated large and visible gains for the very top of the income distribution, creating

4. Based on the data made available by Nicholas Prescott of the World Bank, calculated from the household income and expenditure survey reported monthly by the Korean National Statistical Office, which covers household and urban wage and salary workers only.

Figure 5.1 Gini coefficients in high- and low-inequality East Asian countries, 1978-96



Source: Table 5.1.

a class of the newly rich. As argued in chapter 1, the subsequent collapse revealed that some of these gains were the result of insider dealing, cronyism, and corruption. The steep losses imposed on urban workers and their households, the efforts of corporate owners and managers to secure bailouts, and the high fiscal costs of the crisis are all potential sources of political resentment.

A fourth concern is related to the process of globalization. Whatever the advantages of an outward-oriented growth strategy, continued reliance on exports coupled with increased openness to trade and investment have also produced a new set of insecurities. As the middle-income countries of the region developed, light, labor-intensive manufacturing activities are coming under pressure at home, or are shifting offshore, creating new adjustment problems. In Thailand, for example (where export growth collapsed completely in 1995-96), the demand for the skilled labor required to adjust to shifting comparative advantage is outstripping supply because of lagging secondary enrollment rates, complicating the adjustment process and contributing to that country's trend of increasing inequality.

Finally, as we have seen, the political context was also becoming more contentious. South Korea and Thailand underwent democratic transitions beginning in the late 1980s. These political transitions were not spearheaded by populist forces and typically had a quite conservative cast (Haggard and Kaufman 1995). In South Korea, the first transitional election was won by a protégé of the outgoing dictator. In Thailand, gradual democratization in the 1980s occurred under military auspices and was interrupted by a coup and brief military interregnum. Yet in both countries, political changes reinforced incentives for politicians to address social issues in some form, and encouraged mobilization of new social groups. Nor, as we have seen in chapters 2 and 3, were the nondemocratic systems of Indonesia and Malaysia immune from these pressures.

Who Got Hit?

The capital flight and devaluations with which the crisis began combined with the initial policy response of tight monetary and fiscal policy brought layoffs, declining demand for new entrants into the labor market, real wage declines, and a resultant squeeze on the informal sector.[5] Real incomes were also affected by price increases associated with devaluation,

5. We would expect that labor markets would respond differently to such shocks, depending on institutions. Labor markets characterized by wage rigidities would experience the effects primarily in the form of layoffs, while more flexible labor markets would see less unemployment but declines in real wages, potentially to very low levels. Although countries do in fact vary in the mix of these two effects, most combined both, suggesting that concerns about labor market rigidities in countries such as South Korea were, at least in the aggregate, exaggerated.

Table 5.2 Indicators of economic activity and social welfare pre- and post-crisis

	Indonesia	Thailand	Malaysia	South Korea
Annual per capita GDP growth				
1990-96	5.7	7.0	7.0	6.3
1998	−14.4	−10.8	−9.3	−6.6
Annual inflation (consumer price index)				
1990-96	8.8	5.0	4.2	6.0
1998	57.6	8.1	5.3	7.5
Annual per capita growth of private consumption				
1990-96	6.8	6.4	5.4	6.5
1998	−4.7	−15.1	−12.6	−10.2
Unemployment				
1996				
1998	4.9	1.8	2.5	2.0
	5.5	4.5	3.2	6.8
Poverty incidence				
1996				
1998	11.3	11.4	8.2	9.6
	20.3	13.0	n.a.	19.2
Percentage change	79.6	14.0		100

n.a. = not available

Source: World Bank (2000b), 116. World Bank staff estimates based on household surveys, national accounts, and labor force surveys. Poverty incidence is derived from national poverty lines, which are based on consumption in Indonesia and Korea and income for Malaysia and Thailand. Data for Korea are urban areas only. Data for Malaysia are for 1997.

particularly in Indonesia, where inflation for 1998 exceeded 50 percent. Table 5.2 shows the effect of the crisis on several indicators of aggregate economic activity and household welfare.

When the crisis hit, countries also undertook highly controversial fiscal adjustments.[6] The resulting fiscal stance, in addition to compounding the demand contraction, had the potential to directly affect those households most reliant on public spending for basic social services. In fact, as the depth of the recession became apparent, fiscal targets in the three countries with IMF programs were adjusted to allow for larger deficits (Lane et al. 1999). Malaysia's tight fiscal stance was also reversed in the summer

6. From previous plans of modest fiscal surpluses (less than 0.5 percent of GDP in Indonesia, South Korea, and Thailand), the initial IMF-supported programs called for increases in the surpluses of 2.1 percent of GDP in Thailand in the first full fiscal year of the program; 1.1 percent in Indonesia, and 0.6 percent in Korea (all including bank restructuring carrying costs) (Lane et al. 1999). In Malaysia, the government also undertook a controversial fiscal tightening in late 1997.

of 1998. In addition, fiscal spending was augmented by a relatively rapid increase in lending from the World Bank and the Asian Development Bank and major donors, including particularly Japan. The new loan packages typically included agreements by governments to maintain spending for social programs, including education, health, and emergency employment, and to encourage better allocation of such spending to the most effective programs.

Although debate about the appropriateness of the IMF's adjustment strategy is likely to continue for some time, we can now see with the benefit of hindsight that the crisis did not generate the degree of social distress initially feared. Nonetheless, for affected households the crisis was a wrenching event, calling into question the more-or-less sustained income growth and upward mobility of the recent past. How effectively did governments respond to the social dimensions of the crisis? To what extent were the new policies and programs short term, and to what extent did they constitute the core of a new social contract?

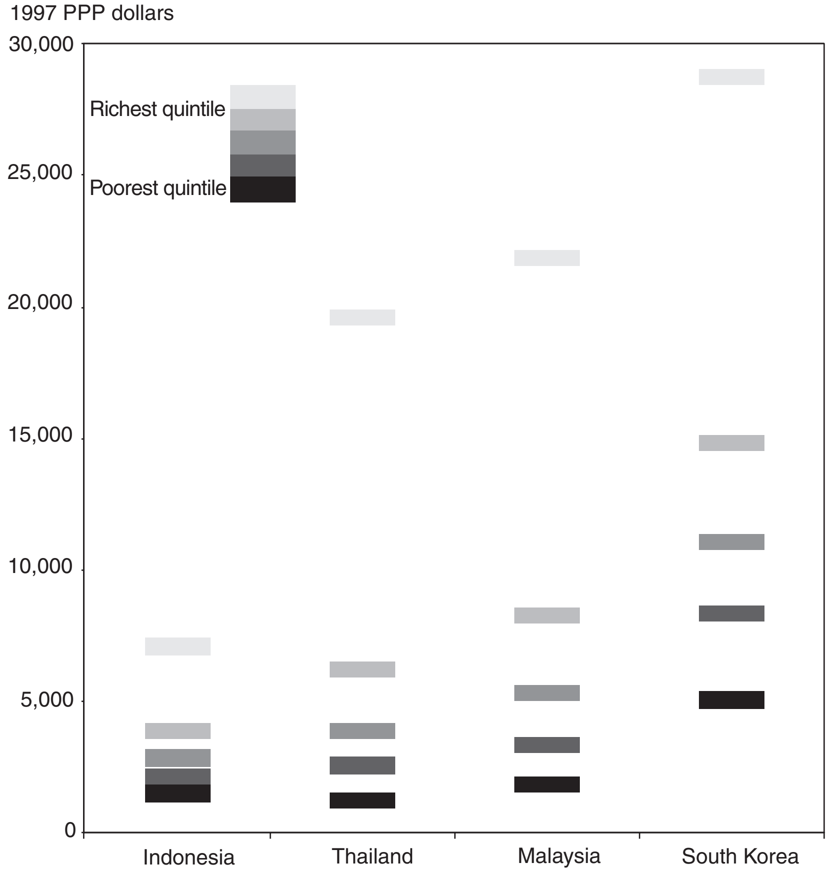
Before we can address these questions, we need to know more about who was affected. Across the four countries, the poor—and especially the urban working poor—were of course particularly vulnerable. But a much broader group, not easily distinguished at the bottom from the working poor, was also hit very hard: the class of urban strivers with reasonably good jobs or thriving small businesses but with relatively limited education and accumulated physical assets.

This group is more easily defined in terms of absolute income and education than in terms of their relative income or education status within each country. Figure 5.2 compares absolute income by quintiles of the population for Indonesia, Malaysia, South Korea, and Thailand. Note that in absolute terms, the average income per capita of the richest quintile of households in Indonesia, at about $7,000, is slightly below the average of the middle quintile in South Korea. All households except the richest in Indonesia have income per capita below $5,000; that is more or less the income level of the second poorest quintile of households in South Korea and the middle quintile in Thailand. It is around this income level, of about $5,000, that households are likely to be in the new urban striver class, although in Indonesia this group is near the top of the distribution, in Thailand in the middle, and in South Korea near the bottom.

Indonesia

The social risk of the crisis was greatest in Indonesia, because about 11 percent of the population, or about 22 million people, were living in poverty when the crisis struck. During the first half of 1998, poverty projections became highly politicized. Initial World Bank estimates suggested that poverty would rise to 17 percent (Poppele, Sumarto, and Pritchett 1999, 5-6). But government estimates in June put the number of

Figure 5.2 Average per capita income (1997 PPP dollars) by quintile: Indonesia, Malaysia, South Korea, and Thailand



PPP = purchasing power parity
Source: Pettinato (1999).

people living in poverty at 40 percent, and the international media ran stories suggesting the possibility of widespread malnutrition and even starvation (see, e.g., *Washington Post*, 1 September 1998, A1). Subsequent studies have shown convincingly that these initial projections were wildly out of line and that the World Bank estimates were surprisingly accurate (Poppele, Sumarto, and Pritchett 1999; Suryahadi et al. 1999).

Who was affected? The crisis—initially an urban one, concentrated in the formal economy—did not generate a substantial increase in aggregate unemployment. But certain sectors, particularly construction and industry, were very hard hit. Given that unemployment in such an economy is not an option, the number of self-employed expanded rapidly, as did employment in agriculture; the informal and rural sectors played the role of shock absorbers, but with an increase in underemployment.

That people were working does not mean they were necessarily doing well. Household per capita expenditures fell an alarming 33.9 percent in urban areas, in comparison with 17 percent in rural areas (Poppele, Sumarto, and Pritchett 1999, 6).[7] Increases in poverty were also more marked in urban areas.[8] When we look at the decline in median expenditures (5.0 for urban households and 1.6 for rural ones), they are much more modest, suggesting that expenditures of the better off fell most sharply.[9] In contrast to the other crisis countries, the less well educated also fared better than the educated, and by a substantial margin.[10] These findings suggest why the effects of the crisis on poverty and other key social indicators, such as school dropout rates, were somewhat less than anticipated. Many of those most seriously affected by the crisis were among the relatively well off to begin with.

Another way of capturing the highly uneven nature of the social crisis is to look at the regional picture (Poppele, Sumarto, and Pritchett 1999, 9-11; Suryahadi et al. 1999, 34-38). Those parts of Java with closer links to the formal economy—and therefore higher incomes to begin with—were the hardest hit. The effort of the government to dampen rice prices meant that farmers did not initially reap the advantages that should have accrued from their rise; in any case, many small-producer households are net consumers of rice. But the Maluccas, Sulawesi, and Sumatra have been minimally affected or have actually gained because of the effect of

7. Wage data show a similar "urban bias" in the Indonesian crisis. For rural men (22-65 years old), real daily wages decreased about 6 percent from 1997 to 1998, but urban daily wages fell by 20 percent (Beegle, Frankenburg, and Thomas 1999, 52; see also Suryahadi et al. 1999, chap. 3).

8. The urban headcount index increased from 9.7 percent in February 1996 to 15.4 percent in December 1998, while the rural headcount increased from 12.3 percent to 17.6 percent (Manuelyn-Atinc 1999).

9. Real per capita expenditures of the top quintile fell much more dramatically (from February 1996 to February 1999) than for the lower two quintiles (-23.3 percent vs. -9.2 for the first quintile, and -11.4 for the second; Suryahadi et al. 1999, 8; Poppele, Sumarto, and Pritchett 1999, 12-13), although the fall in expenditures at the very bottom of the income distribution contributed to the increase in the poverty rate (Thomas, Frankenberg, and Beegle 1999, 10, and fig. 2).

10. Other data also point to the conclusion that relatively better off households in urban areas were hard hit. Enrollment in junior secondary school in 1998 relative to 1997 fell more in urban (6.3 percent down) than rural areas (1.3 percent down); urban enrollment declines at this level were very high for girls (19 percent). Use of both public and private health care fell most among middle-income households. Spending on food rose for all households, but rose most for the poorest and, controlling for income, the best-educated (Thomas, Frankenberg, and Beegle 1999).

the depreciation on export crop earnings. Subsequently rice prices also rose, and rice was in any case protected.[11]

Thailand

Thailand shows a number of differences from Indonesia, most notably in how the poor fared (Brooker Group 1999; World Bank Thailand Office 1999a, 1999b). Unemployment doubled from just under 2 percent in 1997 to a peak of about 5 percent in May 1998, before the seasonal demand for labor lowered unemployment in August 1998 to 3.4 percent (although a year earlier, August unemployment was under 1 percent). The greatest losses in the year following the onset of the crisis were in the construction sector (-32 percent), where the boom had been concentrated, and to a much lesser degree in commerce (-3 percent) and manufacturing (-2.4 percent); by contrast, employment in the service sector grew by 5.6 percent, suggesting again the role of the informal sector in absorbing the unemployed. Small and medium-sized firms were responsible for the bulk of unemployment.

Real wages fell 6 percent from February 1997 to February 1998, with the fall greater in urban areas (8.3 percent) than in rural areas (4.7 percent). But again, differences across sectors were pronounced; for example, men working in urban construction saw real wages fall 24 percent, and women in urban manufacturing also saw larger-than-average losses. In sharp contrast to Indonesia, the declines in both employment and welfare were heavily concentrated among those whose education did not go beyond the primary level (World Bank Thailand Office 1999a, 8-9).

The role of the rural sector in the Thai crisis appears to be somewhat different than in Indonesia, because unemployment was concentrated in the rural areas of the Northeast, where poverty is also highest; of the total unemployed in February 1998, more than 40 percent were in the Northeast. However, this is probably an artifact of a significant migration out of the cities to the countryside. In general, agricultural households fared somewhat better than the average household if we compare 1996 and 1998. Urban-rural migration was later reversed when agricultural wages fell and it became apparent that rural areas offered fewer opportunities than urban ones (Brooker Group 1999, chaps. 2, 6).

Both poor rural and urban households witnessed real income declines; fully 18 percent for poor rural households and 14 percent for poor urban households. However, increases in poverty between 1996 and 1998 were relatively contained, rising from 14.9 to 16.9 percent in rural areas (but a worrisome 19.3 to 22.7 percent in the Northeast) and from 3.8 to 4.4

11. In a number of rural areas outside Java that did poorly, it is difficult to disentangle the effects of droughts and fires unrelated to the crisis.

percent in urban areas. Inequality also remained constant (World Bank Thailand Office 1999a, 12-13).

As in Indonesia, region also mattered. One of the reasons the crisis was not more severe was the differential effects of rising prices across households. Net producers of agricultural products—fully 25 percent of Thai households—saw an increase in earnings due to the effect of the El Niño drought on rice prices (World Bank Thailand Office 1999a, 10). Nonetheless, at an income level below the average and closer to our $5,000 marker, household welfare almost certainly declined, and took the form of employment and wage losses in urban sectors such as construction.

Malaysia

Of the Southeast Asian countries, Malaysia was least hard hit by the crisis (see Haflah, Johan, and Abubakar 1999; Jomo and Lee 1999). Unemployment was more modest, although the increases were large, going from 2.7 percent in 1997 to 3.9 percent in 1998, and 4.5 percent in March 1999. Nominal wages grew 4 percent in 1998—well below past trend and just a bit below the increase in the consumer price index for the year (5.3 percent). As we will show below, labor market flexibility was an important explanation for this outcome. However, a second reason for the modest effects is that many of the workers in the hardest hit sectors, most notably construction, were foreign and simply left the country; in effect, Malaysia exported a substantial part of its unemployment.

Data on retrenched workers show that 54 percent were in manufacturing (concentrated overwhelmingly in production workers), followed by 27 percent in services and 11 percent in construction (despite the fact that the construction sector contracted by nearly 25 percent in 1998). More detailed information on who was affected by the crisis is still unavailable, but what we know suggests the importance of the groups we have highlighted in Indonesia and Thailand: the urban working class as well as the poor.[12] Using Malaysia's poverty line, poverty edged up from 6.1 to 7.0 percent from 1997 to 1998 (Jomo and Lee 1999, 27). But the urban-rural income imbalance and overall income inequality may have improved slightly in 1998 in comparison with the widening gap experienced during 1996-97, again suggesting the concentration of the effects of the crisis in the urban areas.

South Korea

South Korea, the richest, most urbanized, and most industrialized of the four countries examined here presents an apparent contrast to Indonesia,

12. The mean income of urban and top 20 percent of households fell slightly in 1998, while the mean income of the bottom 40 percent of households, especially in the rural areas, remained stable owing in part to higher agricultural prices.

Malaysia, and Thailand. In fact, somewhat similar groups were at risk, but they occupied different positions in the economic and social structure.

The most striking difference with the Southeast Asian countries is the sharp rise in overall unemployment, from 2.1 percent in October 1997 to 8.7 percent in February 1999, near its peak. The loss of employment was concentrated in manufacturing (13.3 percent) and particularly construction (21.3 percent); as in the other Asian countries, agricultural and fishing picked up some of the slack (4.2 percent growth) although informal sector growth did not to the same extent (Park 1998). Contrary to the argument that the South Korean labor market showed major rigidities, rising unemployment was accompanied by sharply falling real wages, 12.5 percent from mid-1997 until the end of 1998 (Manuelyn-Atinc 1999).

Employment losses were heavily concentrated in semi-skilled workers and laborers, and initially came overwhelmingly from small and medium-sized firms, many of which relied heavily on temporary and day laborers (Park 1998). Professional, managerial, technical, and administrative workers saw no declines in employment through 1998; the numbers employed in these categories actually rose. Workers at large firms initially saw only slight declines. Data on education are also revealing; as in Thailand, those with less than secondary schooling bore the brunt of employment losses (Moon, Lee, and Yoo 1999).

In contrast to Indonesia, the fall in income in South Korea was most serious for the poorest 20 percent (-23.7 percent versus -2.5 for the top 10 percent), with corresponding consequences for poverty (Park 1998).[13] Again, this group in South Korea corresponds quite closely to similar groups affected by the crisis in the other countries, even though their relative economic status in South Korea is lower.

In sum, the financial crisis cut across broad swaths of the population in each country; its effects were by no means limited to the poor. These findings are consistent with a broader analyses of financial crises by Diwan (1999). Examining 53 financial crises from 1975 to the mid-1990s, Diwan finds that the share of labor in GDP falls sharply following a crisis—5.5 percentage points—and only partly recovers after. We have seen that in addition to the poor, the newly vulnerable included workers in the formal urban sector, particularly in construction and to a lesser extent manufacturing, and those with less than secondary education. Workers and owners of small and medium-sized enterprises were hit particularly hard.

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13. As with all countries, poverty measures are always arbitrary, but the Korean headcount measure among urban workers doubled from 3 percent in the fourth quarter of 1997 to 7.5 percent in the third quarter of 1998, and this measure excludes the unemployed (Moon, Lee, and Yoo 1999, table 4-3). More differentiated analysis suggests that the ranks of the poorest of the poor—those with incomes less than 80 percent of the poverty line—increased more rapidly than the poor as a whole or the near poor (Manuelyn-Atinc 1999).

The crisis, in short, affected precisely those emergent, transitional, weakly organized ''striving classes'' to which the growth-with-equity model had historically granted social mobility, pushing them back, at least temporarily, into the urban informal sector or the countryside. The social consequences of the crisis were partly mitigated because this group was able to draw on personal savings, rely on intrafamily transfers, shift employment, work longer hours, migrate, and reallocate expenditures to protect investments, including in human capital. In this sense, the outcome could be seen as vindicating the region's reliance on informal mechanisms and a relatively limited government role. However, it could also be interpreted as revealing the severe limitations of the formal social contract in East Asia.

The Policy Response: The Political Economy of Social Policy

If governments were not immediately aware of all the details just outlined, the social response to the crisis—including strikes, demonstrations, riots, and deeper social violence—signaled the depth of the problem. Given their lack of experience with social safety nets and the acute need for external financial support, governments turned to international financial institutions, which subsequently played a major role in the definition of the social policy agenda.

Table 5.3 summarizes the main outlines of government policy in the most seriously affected countries. In some areas, such as maintaining levels of health and education expenditure in the short run or launching public works programs, outside intervention supported governments' own inclinations and buttressed fundamental components of the growth-with-equity model. However, in varying degrees across countries and programs, ideas for a broadening of the policy response beyond temporary measures to a reconsideration of the social contract ran into institutional and political difficulties.

The problems facing the East Asian governments were in the first instance administrative. In all cases, and particularly in Indonesia, the large size of the informal and self-employed sectors posed daunting administrative problems for reaching the poor and even more so for constructing a broader system of social insurance. However, the very reliance on informal social safety nets also meant that lines of bureaucratic responsibility were not clear. Agencies with responsibilities for social issues lacked detailed information on the poor and vulnerable. Bureaucracies not only lacked the capacity to respond in a timely fashion, but were poorly positioned to act as political advocates for those affected as well. As a result, delays in responding to the social dimensions of the crisis were a common feature of all cases.

Table 5.3 Social safety net programs in East Asia during the crisis

Country	Food security	Cash transfers	Social funds	Health and education	Workfare programs	Unemployment assistance, insurance, and severance pay	Active labor market policies
Indonesia	New program of targeted cheap rice distribution		Community based programs	Back-to-School Program launched (provided scholarships for the poorest students and school grants for schools in the poorest communities) Subsidies to maintain prices of essential drugs		Existing *padat karya* programs expanded and subsequently redesigned	
Thailand		Social pensions for the elderly and cash transfers to needy families expanded	Community based programs (new)	Low-income healthcare for the poor and voluntary health insurance for the near poor expanded Scholarships and educational loan program expanded Allowing fees to be paid in installments; fee waivers; provisions for free uniforms to students School lunch program expanded	Public workfare scheme (new)	Severance payments increased New Employee Welfare Fund set up to partially finance unpaid severance claims for workers from bankrupt firms	Training for skills development for unemployed expanded Self-employment loans

(*continued next page*)

Table 5.3 Social safety net programs in East Asia during the crisis (continued)

Country	Food security	Cash transfers	Social funds	Health and education	Workfare programs	Unemployment assistance, insurance, and severance pay	Active labor market policies
Malaysia							Training for unemployed expanded
South Korea		Temporary non-contributory means-tested livelihood protection program (new) Social pension for the elderly (new)			Public workfare scheme (new)	Unemployment insurance program expanded	Active labor market programs (vocational training, wage subsidies, job placement) expanded

Source: World Bank (2000b).

Table 5.4 Aspects of social protection, 1997

Country	Unemployment insurance	Severance pay (months of salary)	Ratio of social security coverage to total employment (percent)
Indonesia	No	4	12
Thailand	No	6	16
Malaysia	No	n.a.	48
South Korea	Yes	n.a.	38

n.a. = not available
Source: Lee, E. (1998), table 3.1.

A second problem was that a number of Asian policy makers, as well as political oppositions and NGOs, were wary of the new social agenda because of the potential for leakage not to the nonpoor (always a legitimate technical concern with social welfare subsidies) but to local politicians and corruption. These concerns were present in Thailand but particularly acute in Indonesia, where controversy about corruption in antipoverty programs engulfed initial World Bank efforts.

In addition to these administrative problems, the design of social programs faced more fundamental political barriers, particularly in efforts to institutionalize more explicit forms of social insurance. Governments in Malaysia, South Korea, and Thailand expressed concern about taking on the spending and transfer programs of the Western welfare state. As tables 5.4 and 5.5 show, social insurance commitments are relatively modest in the countries in question. Malaysia's Employees' Provident Fund is the most comprehensive, but covers just under half of all employees and involves no direct government commitments.

This skepticism combined legitimate doubts about the European model with a traditionalist rhetoric that emphasized reliance on family and community and past success in harnessing work, discipline, and responsibility at the individual level. The idea of social welfare programs that included entitlements to government transfers faced strong resistance from conservative forces, who argued that such programs were costly to business and undermined the roots of past economic success.

Governments in Indonesia, South Korea, and Thailand all faced various forms of social protest. With the partial exception of South Korea, however, none of the political systems had strong parties representing the interests of those most seriously affected by the crisis in an ongoing, institutionalized way. European-style social democratic parties are alto-

Table 5.5 Compulsory contributions to social insurance schemes in Asia (percent)

		Old age, disability, death	Sickness and maternity	Work injury	Total
Indonesia	Employees	2.0 of earnings	None	None	2.0
	Employers	4.0 of payroll	3.0 percent or 6.0 of payroll[a]	.24 to 1.74 percent of payroll	7.24 to 11.74
	Government	None	None	None	0
	Total				9.24 to 13.74
Thailand[b]	Employees	1.0 of earnings	Included in 1st column	None	1
	Employers	1.0 of payroll	Included in 1st column	0.2 to 1.0 of payroll	1.2 to 2.0
	Government	1.0 of payroll	Included in 1st column	None	1
	Total				3.2 to 4.0
Malaysia	Employees	11.5 of earnings	Included in 1st column	0.5	12 percent
	Employers	12.5 of payroll	Included in 1st column	1.75 of payroll	14.25
	Government	None	Included in 1st column	None	0
	Total				25.25
South Korea	Employees	3.0 to 4.5 of earnings	1.0 to 4.0 (average) 1.64	None	4.0 to 8.5
	Employers	4.5 of payroll	1.0 to 4.0 (Average) 1.64	0.3 to 31.9[c] (Average) 1.65	7.15 to 10.15
	Government	Subsidy as needed	Subsidy as needed	Subsidy as needed	
	Total				12.68 to 18.68[d]

a. Contribution for singles is 3 percent and married 6 percent.
b. Pension benefits payable starting in 1998 with an additional 3 percent contribution by employees and 3 percent contribution by employers.
c. Varies by industry and amount of predetermined risk in that industry.
d. The ''Total'' was calculated using the average Work Injury contribution by the employer (1.68 percent).
Source: US Social Security Administration (1999).

gether absent in the region, and links between parties and civil society are generally weak. Where opposition parties did seek to exploit social issues, it was often through appeal to other political identities, such as Islam in Indonesia and Malaysia or region in Thailand (the Northeast) and South Korea (the Cholla provinces before the Kim Dae Jung presidency).

The organized groups that are historically most associated with the advance of the social agenda, namely labor, were either controlled by the government (as in Malaysia), weak (in Indonesia) or concentrated in sectors where they did not necessarily speak for the interests of those most seriously affected by the crisis (e.g., state-owned enterprises in Thailand). South Korea, again, is a partial exception. Kim Dae Jung's presidency did allow organized labor to influence the social agenda. Although divisions within the labor movement and cross-cutting pressures on the government ultimately led to the dissolution of his corporatist experiment, the partisan orientation of the Kim Dae Jung presidency and the inclusion of labor allowed a substantial broadening of the social contract in South Korea.

Indonesia

We begin again with Indonesia, where the crisis was most severe and the political problems most daunting. In January and early February 1998, the food supply seemed threatened by drought and an inability to import due to difficulties securing letters of credit. The combination of political uncertainty and the collapse of the rupiah generated panic buying, hoarding of food, and riots in a number of provinces, compounded by the initial hesitancy of the government-controlled distribution system (BULOG) in releasing adequate stocks. In early May, an ill-managed price increase in a number of basic foodstuffs—whose design was wrongly attributed to the IMF—generated another round of rioting and protest which, as we have seen, contributed to the fall of the Suharto government.

Before the fall of Suharto, the government's social policy efforts were concentrated overwhelmingly on seeking to ensure supplies of basic foodstuffs by stabilizing prices and by placing strong pressure on suppliers and middlemen. This pressure had a political dimension. Private rice distribution was largely in the hands of Chinese merchants. The anti-Chinese rhetoric that periodically tinged statements by government officials and military officers and the large-scale violence in Jakarta in May generated short-term political uncertainties in the rice markets. This pressure continued after the fall of Suharto as certain political forces, grouped around the Ministry of Cooperatives, sought to expand their role in the rice distribution system. The country faced another spike in rice prices in August and September 1998, due once again to BULOG's reluctance to play its stabilization role and perhaps to fears by large Chinese traders of further violence at the time of Habibie's Independence Day address.

The response of massive subsidization proved inefficient. Not only did the subsidy flow to all consumers regardless of income level, it also had the perverse effect of encouraging rice exports exactly as the government was fearing shortage. After the price spike in August-September, however, the international community developed a more effective relationship with

BULOG, and the more aggressive release of stocks contributed to an easing of prices.

Only after Habibie assumed the presidency and the political situation was temporarily stabilized could the government and the donor community begin to formulate a more coherent social strategy. The background to these new efforts was an important IMF policy shift toward support for a more accommodative fiscal stance. Again, a top priority was achieving food security through a targeted program of distribution of rice to poor families; this program expanded rapidly from 150,000 families to nearly 10 million by early 1999. Although considered reasonably successful, the nature of the poverty data available to the government, inertial pressures from rural districts, and the weak organization of labor and—as always—the urban poor, limited the expansion of the program to households in the cities. Only 5 percent of recipients were urban (World Bank 1999c).

The two other core government programs for alleviating the effects of the crisis were the effort to maintain education and health spending and to generate public employment. With support from external agencies, the new government quickly committed to maintaining social expenditures at past levels and even increasing them and re-allocating spending to focus on the poorest groups.[14] But the World Bank was also stung in mid-1998 by the "revelation" that some Bank-supported programs were subject to political leakage, a fact that could hardly have been surprising given the nature of the country's political system and the ongoing control of the bureaucratic apparatus by Golkar. A loan document outlining a comprehensive social safety net program approved in mid-1999 refers to "implementation delays, fund leakage, budget allocation issues, and inadequate or inappropriate design" (World Bank 1999a, ii), euphemisms for corruption and the political use of funds. Opposition groups also latched onto this critique, claiming that the World Bank and donor community were effectively supporting Habibie's efforts to extend his stay in power.

These criticisms generally fail to distinguish between those programs that worked relatively effectively given administrative constraints, those that faced serious administrative problems, and those that had more fundamental political flaws. In the first category belong the "cheap rice" program and efforts in the education area. In fiscal 1998-99, the government increased the budget for primary education by more than 55 percent, primarily to finance crisis-relief programs providing scholarships and school block grants. A massive "back to school" program provided block grants to the poorest schools and fellowships (direct transfers) to the poorest students. Although this program no doubt suffered from adminis-

14. These programs faced a number of problems in implementation, some of them administrative. Government expenditures for the first 9 months of fiscal 1998-99 on social safety net programs were only 37 percent of the annual budgeted amount (World Bank 1999c, 6).

trative problems and some leakage, it was consistent with the broadly based approach to education of the growth-with-equity model and appeared to have helped stem the dropout problem.

The political and administrative problems associated with the variety of employment generation programs—labor-intensive public works programs, demand-driven community funds, and credit schemes to small and medium-sized enterprises—were somewhat more acute. As with the rice program, a common problem was the lack of crisis-responsive geographical targeting. Provincial leaders from better off areas were resistant to efforts to redirect spending from past patterns. Many of the employment creation programs (*padat karya*) were to be carried out by ministries and agencies with no experience in running social policy, and thus little means of measuring whether or not they were effective in meeting social objectives.

However, the continuities in the political system outlined in chapter 3 also created strong incentives and opportunities for abuse. Golkar continued to exercise substantial influence over provincial, local, and community institutions; subnational elections did not take place until June 1999. After the fall of Suharto, these governments became political battlefields as the *reformasi* movement spread out from the cities to the provinces and countryside (Budiman, Hatley, and Kingsbury 1999). The range of social protest was wide, ranging from demonstrations against corrupt officials, to strikes, land seizures, and outright looting of various commodities (*Indonesia Update*, July 1998). In a political setting characterized by a weak transitional government, impending elections, and a proliferation of political challengers from both inside and outside the government, the risk that funds would be diverted to political and electoral uses or outright corruption was high. The effort to rapidly increase social spending and the emergence of strong populist pressures in the system compounded these risks. Prominent among these were calls from Minister of Cooperatives Adi Sasono to use his patronage-laden bureaucracy as the vehicle for an ethnic affirmative action program.

The government's self-assessment of earlier antipoverty efforts recognized the importance of expanding consultation beyond existing provincial and local leaders, but the transitional nature of the government made it difficult if not impossible to institutionalize such checks. The $600 million World Bank Social Safety Net Loan devised a complex governance structure that attempted to increase accountability, in part by engaging NGOs directly in monitoring disbursements in the hope of ''less misuse of funds . . . better targeting and design, and less delay'' (World Bank 1999a, iii). Even with these controls, the World Bank chose to temporarily suspend some loan disbursements before the elections of June 1999 to avoid charges by the opposition that they were indirectly supporting the government (*Asian Wall Street Journal*, 13 April 1999). Little could be done with respect to a longer-term social agenda until the new democratic government came into office in November 1999.

Thailand

In Thailand, the effort to respond to the social dimension of the crisis was similarly delayed by politics. The social consequences of the crisis were not fully apparent in the last months of the Chavalit government, but even if they had been it is doubtful that it could have responded effectively. After the Chuan government came into office, it immediately faced a variety of social pressures, particularly from the stronghold of the opposition NAP, the rural Northeast, and to a lesser extent from organized labor and other grass-roots organizations.

Before finalizing negotiations with the Asian Development Bank and World Bank for social sector loans, a variety of ad hoc efforts emerged that were driven in part by efforts of competing ministries (and their ministers) to protect budget shares.[15] By the summer of 1998, however, the overall context for the formulation and implementation of social policy had changed. Thailand completed negotiations with the Asian Development Bank for a large social loan in March, and the negotiations over the fourth letter of intent with the IMF in May codified a substantial relaxation of fiscal policy, with some of the loosening explicitly directed to social policy.[16]

Given the weakness of existing machinery for managing the social safety net, the loans generally supported or expanded existing programs rather than launching altogether new ones, and did so relatively effectively (World Bank Thailand Office 1999a, 1999b). For example, the health program expanded funding for the poor, and the education component increased a student loan program to keep children in school. The World Bank loan supported existing government programs designed to provide jobs to the poor, as well as core social services.

To what extent did the crisis generate longer-term changes in the design of the social contract? The most innovative dimension of the World Bank loan was its emphasis on decentralization and local community development through the creation of a Social Investment Fund (SIF), whose objectives were broadly in line with the new constitution's emphasis on devolu-

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15. Many of these efforts ran into serious opposition, either from management (such as repatriation of foreign workers who were important in the milling industry) and labor (such as the introduction of flexible work rules) or proved impractical (such as encouraging workers with few rural connections to return to the countryside or increasing the labor intensity of production by discouraging the use of machinery).

16. Negotiations with the World Bank were more protracted but were completed by November.

tion of power to lower levels of government.[17] Both the Asian Development Bank and World Bank loans also included decentralizing initiatives, such as shifting Ministry of Health staff to rural areas, granting universities greater autonomy, and encouraging both provincial and local governments to expand their capacity to devise projects and monitor and track the poor in their jurisdictions.

But the opportunity provided by the social funds for patronage, particularly given the coalition nature of the cabinet, made both the government and the international financial institutions (IFIs) cautious in approving projects. Less than 10 percent of all project money had been allocated by April 1999, in part because of concerns on the part of the Democrat Party that the projects would be diverted to political uses and corruption (*Bangkok Post*, 3 April 1999). Despite the constitutional changes, the development of effective local government remained a long-term project that faced resistance from within the central government bureaucracy.

The government also appeared reluctant to undertake new social insurance commitments. When the crisis hit, Thailand had a social security system that provided benefits to workers in the private sector and self-employed professionals. But the program covered only 6 million workers and its benefits were limited to sickness, childbirth, death, and disability benefits; it did not provide unemployment benefits (Sauwalak and Intaravitak 1998). The strongest safety net for urban workers has been severance pay. Under pressure from labor, the government extended the length of severance payments from 6 to 10 months, and launched a special program to provide free health care to laid-off workers and their families as well as job placement services. Not only were these benefits temporary; they were limited to workers in the formal sector.

The Chuan government was openly resistant to expanding the social security program, including a prior government commitment to the development of the pension system (*The Nation*, 5 August 1998), arguing not only that it would have high fiscal cost but that transfers raised issues of moral hazard and entitlement. In the words of one government official, "the reason behind giving them such a tiny amount of money is to create an incentive for them to look for jobs; otherwise they may want to live on social security for the rest of their lives and take advantage of others" (*Bangkok Post*, 7 June 1998).

This reluctance can be traced in part to fiscal constraints, but also to important features of Thai politics. Despite the significance of greater Bangkok in the Thai economy, the country remains largely rural. As a result, the urban-based parties such as the Democrats need to accommo-

17. The SIF would provide grant support for small scale subprojects proposed by local governments, NGOs, or community groups (which requires a 10 percent counterpart contribution) and a Regional Urban Development Fund to provide on-lending support to larger, revenue-generating projects in selected municipalities (25 percent counterpart contribution).

date rural interests, as they did, for example in devising a rural debt-forgiveness scheme and micro-lending programs that fell outside the ambit of multilateral financing. At the same time, the nature of organized labor interests reflected relatively privileged segments of the working class, such as workers in the state-owned-enterprise sector. As a result, the government has resisted calls from both the IFIs and domestic political opponents for a formal safety net. Rather, the Chuan administration has favored temporary measures, such as increased attention to education and training—which has lagged in Thailand—and various forms of local self-help.

Malaysia

The politics of social policy in Malaysia initially had less to do with an overt social reaction, as in Indonesia and Thailand, as it did with the policy debates within the government outlined in chapter 2. Anwar initially identified himself with a tough fiscal stance; the announcement of the 1998 budget in October 1997 anticipated a surplus of 2.7 percent of GNP. As the work of the National Economic Action Council unfolded in the spring of 1998, and the depth of the crisis became apparent, Anwar's position became untenable. Fiscal targets were relaxed to a 0.5 percent surplus in March 1998, and finally to a deficit of 3.7 percent.

One reason for the revised fiscal stance was to defend higher social spending. The succession of UMNO-led governments in Malaysia has had a strong record in providing education and health care, motivated in part by their pro-*bumiputra* policies. Both primary and secondary education are heavily subsidized in Malaysia, and initial cuts in the education budget for these levels were quickly restored, as was money for fellowships; as a result, the country experienced no significant problem with respect to school dropouts (World Bank 1999c, 8; Jomo and Lee 1999, 24). Health expenditure, also in the public domain, was cut in 1998 but increased in 1999, as were expenditures by ministries involved in agriculture and rural development. Roughly half of Malaysia's poor are concentrated in three states—Kelantan, Trengganu, and Sabah—that are more predominantly rural and in the first two cases highly susceptible to appeals from the PAS as well.

The distinctive features of Malaysia's approach to the social dimensions of the crisis was in its strong emphasis on maintaining labor market flexibility. One of the most important set of policies had to do with guest workers. The Malaysian government was the first in the region to announce plans to repatriate large numbers of workers: approximately 200,000 migrant workers who were likely to be laid off from the construction sector and 700,000 migrant workers whose permits would be denied renewal after expiry. The plan generated heated political debate, and was ultimately scaled back in part due to employer resistance (Haflah, Johan, and Abubakar 1999, 43-45). Nonetheless, the Home Ministry estimated that more than 200,000 illegal foreign workers returned to their home countries between January and August 1998, and this almost certainly underestimates the number returning: Approximately 80 percent of construction workers were migrants, and employment in this sector was estimated to have dropped by as much as 600,000 workers in 1998 alone (Jomo and Lee 1999, 12, 15).

Maintaining a flexible labor market was also a key policy objective with respect to domestic workers. Trade unions in Malaysia have never been particularly influential political actors, in part because of the low level of unionization (approximately 10 percent of the workforce), in part because of various legal restrictions and formal and informal government controls over their organization and activities (Navamukundun 1998). In August 1998—after the party congress of that year—the government undertook a number of labor market reforms that included closer links between wage settlements and productivity and encouraging management to use pay cuts, reduced working hours, and temporary and voluntary layoffs rather than outright retrenchment.[18] Labor—in a weak bargaining position both politically and economically—went along with these adjustments and negotiated more modest wage settlements than in previous years.

A second pillar of the government's approach was the creation of a variety of special loan funds designed to lift the income of targeted groups; a number of these initiatives were announced by Anwar at the UMNO general assembly in mid-1998. Yet the problem with such funds paralleled the problems we have seen in Indonesia and Thailand with government employment programs; the administrative capacity to move funds efficiently was lacking, substantially diminishing the programs' short-term effects.[19]

A final feature of the government's approach to the social contract was particularly strong resistance to the use of transfers, despite urging from the World Bank about the effects of the crisis on the low-income urban self-employed. Malaysia's Employees' Provident Fund is more comprehensive in its coverage than similar schemes in Indonesia, Thailand, and even South Korea, despite the fact that it is yet to be extended effectively to the self-employed and agricultural workers. But in line with the Asian

18. Worker exit was to be supported by both government and firm-level retraining and search schemes, but extremely few workers—in the hundreds—appear to have benefited from the government training program (Jomo and Lee 1999, 17).

19. In 1998, the Fund for Food Program, which provides low-interest loan to farmers and the Farmers' Association, approved only RM199 million worth of loans out of a RM700 million allocation. The Special Scheme for low- and medium-cost housing approved RM241 million out of the RM2,000 million allotted, and the Small-Scale Entrepreneur Fund approved RM882 million out of RM1,500 million approved (Haflah, Johan, and Abubakar 1999, 51).

welfare model, the fund is financed entirely by mandated contributions from employers and workers and direct transfers are minimal. Only 1 poor household in 10 receives a government transfer, and they account for only about 1 percent of the poor's gross income (World Bank 1999c, 4).

Comments made by Prime Minister Mahathir are worth citing at length, because they summarize well a resistance to certain forms of social insurance visible elsewhere in the region, including in both Thailand and South Korea. Referring to social safety nets in the form of unemployment benefits, Mahathir argued that

> this method will only wreck the economy. When the unemployed is [sic] paid an allowance, then many will choose not to work. The Government will need to allocate money for dole which can only be done through raising taxes on the employed . . . Of course the production costs for goods will increase, so will the cost of living. So each time dole is raised, taxes follow suit and the cost for manufacturing goods will only reduce our competitiveness in the world market. (*New Straits Times*, 11 June 1999)

South Korea

On coming into office, the Kim Dae Jung government faced a particular dilemma: On the one hand, the unemployment problem in South Korea was serious—the most serious of the four countries—with fewer opportunities for the rural and informal sectors to absorb displaced workers from small and medium-sized firms. On the other hand, the high degree of concentration had resulted in fairly strong and militant unions. Unions represented only 12-13 percent of wage and salary workers, only marginally higher than the unionization rate in Malaysia. But unions were dominant in large firms and public enterprises that enjoyed greater bargaining power; whereas 76 percent of workers in firms with 15,000 or more workers are unionized, only 0.9 percent are unionized in small firms with 10-29 workers. Moreover, South Korean unions operated in a newly democratic context that provided them much wider freedom of action than enjoyed by their Malaysian counterparts.

These differences in unionization had important effects on the ability of firms to lay off workers. Large-scale firms maintained long-term secure employment on a seniority-based wage and promotion system and had difficulty firing workers.[20] These factors meant that while small firms faced little resistance to layoffs and could adjust to redundancy illegally, large firms had to resort to early retirement, voluntary leave, and, where possible, wage restraint. Such measures were not likely to be adequate to encourage the corporate restructuring envisioned by the government.

20. In principle, the legal framework concerning labor adjustment was quite strict; only in the case of "emergency managerial needs" would extensive layoffs be allowed, and the supreme court had ruled that such layoffs required consultation with the unions.

Moreover, remaining labor market rigidities could act as a deterrent to foreign investment across a range of sectors.

To secure labor agreement to greater labor market flexibility, Kim Dae Jung resorted to a mechanism not used in South Korea with any success before (Kim and Lim 1999): the tripartite commission. The purpose of forming the group was related in part to legislative politics. The government called a special session of the National Assembly (the 187th) to amend existing labor legislation to allow layoffs, but the opposition in the legislature was reluctant to cooperate because of the political price; the National Assembly thus deferred to the tripartite commission.

The unions were aware from the beginning that the objective of the commission was to extract labor concessions on the issue of layoffs. Kim Dae Jung's status with labor and the promise of political as well as economic compensation allowed the government to bring representatives from both labor federations (FKTU and KCTU) to the table, in addition to the major business associations (the Federation of Korean Industry and the Korean Employers' Federation), government officials (the Ministry of Finance and Economy and the Ministry of Labor), and representatives from each of the four major parties. After weeks of intense debate, and promises from the administration that it would also extract concessions from the *chaebol* as well, a bargain was struck. In return for agreement to permit layoffs when "urgently" needed or in case of takeovers, and to allow the formation of a manpower leasing system for both specialized professions and laborers, the government made a number of political and policy concessions. These included the establishment of a W5 trillion unemployment fund, but many of the concessions to labor were political and procedural: the right for public servants to form a labor consultative body, for teachers to unionize, and the reversal of a long-standing prohibition on labor involvement in political activities. The agreement also recognized the right of labor to participate both in the policymaking process with respect to labor issues and in management decision-making. More vaguely, "all parties" would work to minimize layoffs and seek alternative solutions such as work-sharing.

As Song (1999) has pointed out, the two sides saw the agreement very differently. Management believed it had gained greater freedom to retrench, whereas labor immediately believed that the terms of the bargain were not being enforced. The first serious test of the tripartite agreement with labor came on 31 July 1998, when the Hyundai Motor Company laid off 1,538 workers for "emergency managerial reasons," becoming the first *chaebol* subsidiary to undertake extensive layoffs. The union refused to accept management's layoff plan, and as the dispute dragged on, the government decided to mediate it. After marathon talks, labor and management reached a compromise on 24 August (*Korea Herald*, 25 August 1998), which resulted in layoffs of only 277 workers (with 7- to 9-month severance payments), with another 1,261 placed on an 18-month unpaid leave.

The Hyundai Motor labor dispute was widely regarded at the time as a critical test of the tripartite agreement, and one that the government had failed. Not only had the government become involved in the dispute, but it appeared to broker a deal that signaled that large-scale layoffs were impossible (*Business Week*, 7 September 1998, 48; *Business Korea*, September 1998, 12). In fact, the government moved quickly to dispel this conclusion. In the banking sector, the government stared down financial sector workers and extracted large concessions on downsizing. In a series of confrontations in the fall and spring, the government intervened with force to break strikes (see, e.g., *Korea Herald*, 4 September 1998).

The government's policy shift was apparent to labor, and led the more independent KCTU to pull out of the second tripartite process in late February 1999 on the grounds that the government had failed to implement a number of the committee's accords. Although the KCTU's hopes for forcing the government's hand through the mounting of a general strike proved misplaced, by the spring the tripartite process had clearly broken down.

Despite the administration's stormy relations with labor, the government in fact moved quite vigorously to expand the social safety net.[21] As in other countries, some initiatives were temporary. Because the majority of workers in the country were uncovered by unemployment insurance, the government initiated a workfare program in May 1998 that supported 437,000 workers by February 1999 and was extended through the entire year by the supplementary budget of May 1999. The government also expanded its social assistance to the poor through a temporary livelihood program that added 310,000 newly poor recipients in April 1998 and increased this to 750,000 with the supplementary budget of May 1999.

But the distinctive aspect of South Korea's response to the crisis was the ability of the Kim Dae Jung government to move beyond short-term measures to address the broader social contract. We have noted above the efforts, albeit only partly successful, to remove a range of political restrictions on labor's freedom to organize and participate in politics. With assistance from the World Bank and the Asian Development Bank, the government entered into a series of commitments to expand eligibility and coverage of its unemployment insurance (Korea Labor Institute 1998). Such insurance was late in coming to South Korea; introduced only in 1995 under Kim Young Sam, it had initially covered only workers in firms of 30 or more employees. Under Kim Dae Jung, this was expanded to firms with 5 or more employees, as were mandatory contributions to

21. In 1998, the government budgeted 1.3 percent of GDP for social safety net and unemployment program spending; in 1999, the budget allocation for these programs rose by 34 percent (Moon, Lee, and Yoo 1999, 43).

training and wage subsidy schemes. The Kim Dae Jung government also initiated a reform of the pension system, and offset the low coverage and benefit levels by increasing the allocation for the noncontributory means-tested social pension.

From the perspective of the advanced industrial states, these efforts might be seen as little more than catch-up; moreover, implementation was not without difficulties. As of June 1998, for example, among the 1.5 million unemployed, only 7 percent had received unemployment benefits. The extension of benefits to day laborers, formerly set in October 1998, had not been implemented a year later due to lack of administrative capacity (Park 1999, 205). Minimum benefits are low: 70 percent of the minimum wage, which is itself just 25 percent of average earnings. As in Malaysia and Thailand, these benefit levels reflect concern with incentive effects and the risks of "welfare disease" (Park 1999, 206). Public assistance for the poor is less than 9 percent of average earnings, probably not enough to cover basic expenses.

Nonetheless, the South Korean government, headed by a democrat and outsider who appealed to and sought to incorporate labor, clearly went farther than governments in the other crisis countries. Not only did the government move quickly to provide a social safety net, but it initiated broader reforms of the social contract that expanded social insurance and improved labor's participation in both government and management decision-making.

Conclusion

The crisis made clear that the next generation of poor people could not necessarily count on unremitting growth to lift them out of poverty. However, despite the quite justified emphasis of the multilateral organizations on the poor, those vulnerable to the social fallout from financial crises constitute a much larger group that encompasses segments of the urban working and even middle classes. This group includes precisely those who are the most recent beneficiaries of the growth-with-equity model, but who are also lacking in financial, physical, and often educational assets and are not far removed from poverty.

As the crisis unfolded, both governments and the IFIs quickly acknowledged the need to deal with the social consequences of the crisis. In all cases, governments instituted a variety of temporary programs, but the speed with which they could move was limited precisely by the lack of administrative experience in providing a social safety net.

However, the problems of devising social policy are not limited to the administrative; social policy also engages broader political interests. We can see the contours of these political interests by reviewing some of the potential risks that are believed to arise in recrafting the social contract under democratic circumstances.

The first risk is that democratic politics would place demands on government that politicians would attempt to meet at the cost of fiscal and macroeconomic stability. The East Asian cases provide very little evidence for such an eventuality. Democratization has been accompanied by changes in the composition of government spending, but in no East Asian case—including, notably, Indonesia—has political reform been accompanied by an unsustainable expansion of government. The reasons for this are multiple, but include not just the crisis or the involvement of the IMF but the conservative nature of the democratic transitions and the absence of the yawning social deficits and inequalities that generate populist politics.

Rather, the risk is almost exactly the opposite: changing tax and expenditure patterns that are increasingly regressive in their structure. A sound social contract would have at its core either near-neutrality in the incidence of government or biases in favor of the structurally poor rather than the middle classes or rich; by and large, the countries in the region achieved this enviable feat in the early years of their growth.

In the aftermath of the financial crisis, however, the situation is less pretty. As we saw in chapter 1, the opening of capital markets in the 1990s led to collusion between the corporate and banking sectors in which the rich used the banks to accumulate debt-financed wealth. As was detailed in chapter 4, a substantial portion of the resulting liabilities in the form of nonperforming loans has now been assumed directly or indirectly by government. This socialized debt will ultimately be paid off by the taxpayers, as the increasing share of debt servicing in government expenditures already demonstrates. In short, the risk to a new social contract comes not from populist demands, but from the threat that the cleanup of the financial crisis involves fiscal commitments that will squeeze out social expenditures; this threat is particularly real in Indonesia, where the burden of the crisis is heaviest.

A second, related risk is that democratization will allow newly freed interest groups, and particularly labor and the "popular sector," to launch an assault on market-oriented policies. We have already seen in chapter 3 that these risks were muted by parties and movements that advanced market-oriented reforms as well as social ones. But the review in this chapter suggests again that the risks are very much the opposite, namely the weakness of countervailing political forces. Outside of some isolated sectors, labor is relatively weak in the region. Moreover, the most coherent social response to the crisis came in the country, South Korea, where labor was best organized and integrated into the policy process. South Korea's tripartite experience may not be applicable in all other settings, and it had its own limitations. Nonetheless, it did permit the government to solve a number of thorny political problems and ultimately served to advance the cause of a more coherent, comprehensive social policy. Responses to the crisis in Indonesia, Malaysia, and Thailand, by comparison, appear relatively short-term and limited by comparison.

A third, more troublesome risk stems from various forms of corruption to which the programs we have outlined might be subjected. These take a bewildering variety of forms, from the expropriation of individual retirement accounts by unscrupulous financial agents (as in Albania), to the political use of fiscal resources to benefit cronies or advance narrow electoral aims. It is important to recognize that such risks exist in any system, but they appear more egregious in nondemocratic settings where the closed, nontransparent nature of government provides ample, and in some cases virtually unlimited, opportunities for political manipulation of the budget.

A final risk is that the new democratic politics and the new social contract would do little to protect the very poor. For their own reasons, authoritarian governments in the region had incentives to pursue policies from which the poor benefited, even if that was not necessarily their initial design. Under democratic rule, however, the poor are seldom well-represented politically, and their interests may be pushed aside in the interests of business, the middle class, or even the somewhat better off strivers on whom we have placed so much emphasis.

Again, these fears appear misguided, and although it is not a foregone conclusion, the prospects for social protection of the poor seem more, rather than less secure under democratic rule, which seeks to incorporate urban middle- and working-class interests. First, political entrepreneurs do have incentives to appeal to the poor wherever they can be counted on to vote; the strong showing of Megawati in the Indonesian elections was based in no small measure on her implicit appeals to the urban disadvantaged. Second, where the poor have benefited from programs of social protection, it is often because the middle or working classes endorse program designs that in effect provide help to all who face some risk of falling into poverty under well-defined circumstances; South Korea under Kim Dae Jung provides evidence of this fact.

These findings do not address the issue of what a new social contract in Asia might actually look like; that issue, among others, is taken up in the concluding chapter.