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Economic Crisis, Employment and Social Protection - The Case of Southeast Asia -

Wolfgang Scholz

The financial crisis revealed that the Southeast Asian development model had a serious design fault in not bolstering it by social protection. Labour flexibility is no substitute for this omission as proven by growing unemployment rates in the region. Introducing social protection as an integrated part of market economies has gained new attention. It is realised that through the lack of well functioning social protection systems the crisis countries have unnecessary problems to cope with the growing social tensions. Three countries are being confronted with dramatically increasing unemployment rates; in income terms they are thrown back in time by about five to ten years. Now that the Southeast Asian experiment has proven its faults it is time to prepare seriously for the uncertainties of the future. In doing so governments can take advantage from European experience. The broad variety and long-standing experience of European social protection systems could be a valuable source of information for all those looking for solutions in Southeast Asia. Despite much criticism, Europe has managed its recurring economic problems quite successfully - in which the wide social protection system has probably played a more prominent role than usually acknowledged.

East Asia has over the past two decades often been treated as a development model for other regions of the world, especially for Europe, which - since the mid seventies - is struggling with growing unemployment. By contrast, East Asia was a job machine which many observers related, inter alia, to its declared high labour flexibility and also to its low or practically non-existent formal social protection, both contributing to low labour cost of production. While over simplifying, the argument was: Europe must increase labour flexibility and reduce social protection. The result would be higher growth and, thus, growing employment levels.

The Asian financial crisis, which is presently gradually turning into the fourth world wide economic crisis of the last quarter of this century, reveals that practically none of these arguments was true. High flexibility of labour and non-existence of social protection systems could not prevent unemployment and poverty in the region from increasing dramatically in the course of 1998.[1] Obviously, business and labour had no chance to parallel the flexibility and velocity of international financial capital flows and to mitigate their impacts on the real economy. According to World Bank estimates Southeast Asia suffered an outflow of over US$100 billion during the last

1 Of course, in a strict scientific sense, serious economists have probably never argued that labour flexibility and no social protection were sufficient conditions to guarantee economic and employment growth. But these conditions were declared necessary and, thus, the labour market debate quickly focused on these.

months of 1997 - roughly 10% of the gross domestic product of the region. "Few economies could withstand a shock of this magnitude."[2] Interestingly enough, much of this capital (together with capital from other emerging capital markets previously considered "promising", such as Turkey, Southern Africa and Russia) seems to have been channelled (back) to safe havens in the US and in Europe. The fact, that Europe has the most advanced social protection systems was obviously not regarded an obstacle.

In the course of this crisis, to the surprise of many social policy makers, the notion "social protection" seemed suddenly be sung in a more friendly tune, even by market liberal hard-liners who were for years in clear opposition to, or simply never thought of introducing or expanding social protection systems, especially when they had or were meant to have strong elements of income redistribution. While, over pre-crisis periods, social protection (apart from mere individual savings schemes which supplied monies to the developing capital markets) was often considered an obstacle to economic growth and employment, it is now realised that through the lack of well functioning and redistributive social protection systems the governments of the affected countries were left unable to cope with the quickly growing social problems. It became obvious that the lack of social protection systems also meant lack of administrative instruments that, if they had existed, could have been used effectively to channel monies and to alleviate the increasing income problems of high numbers of private households. Lack of social protection became overnight synonymous with lack of social stability, the emerging social unrest contributing even more to the flight of international and national financial capital.

Suddenly, the Asian economic model's apologists seem to realise that they might have made a serious mistake before its launching. They forgot to supply their success model with a solid and sound system of social protection in order to make it robust for difficult times. Without such necessary supplements, the East Asian model had no chance to pass its first elk test![3] It would have been a miracle, if it had! Lacking social stabilisers the model flipped over and now the mess has to be cleaned up. Amongst the proposed instruments to do this work, the introduction of social protection systems (or the introduction of further sub-systems) are of growing importance. All crisis struck countries, especially Thailand and South Korea, are already intensively working on the introduction of such systems.

Are the apologists to be blamed for their failure? Are governments to be blamed for being (too) late in becoming active? The answer is equally yes and no.

Yes, because the same mistakes were made in Europe more than a century ago; yet the Europeans later learned from their mistakes and introduced their broadly based social protection systems. This valuable experience could have been advantageously

2 Joseph Stiglitz, Chief Economist of the World Bank; Road to Recovery. Restoring growth in the region could be a long and difficult process. In: Asiaweek, July 17, 1998 (World Bank web page: www.worldbank.org).

3 To all those not familiar with European car testing: The elk test is a technique invented by Swedish ingeneers to test the road performance of cars in case of a sudden, unexpected obstacle (the elk) occuring in front of the driver. It became recently famous when the new model of a major European car producer spectacularly failed the test.

used during the sparkling growth period in Asia. But, not surprising, the success was also accompanied by some elements of hubris which made the European model look old fashioned and not especially attractive.

And no, because the basic wisdom that market economies are in principal unstable had lost a lot of its relevance for decision makers around the world. The long growth period in Asia and the lasting and still good growth performance of the US fostered belief that a new age of everlasting steady and stable economic growth may have had begun. Why should not the apologists of the Asian development model join the growing chorus? Furthermore, it has to be acknowledged that the Asian performance over 20 years was excellent:

In 1975 roughly six out of ten East Asians lived on less than a dollar a day. By 1995 it was down to roughly two out of ten.[4]

Indonesia, South Korea and Thailand, the three countries which are presently suffering most, enjoyed almost steady high economic growth rates in the order of 7% to 9% over the past years. They managed to increase employment permanently such that the continuous labour market pressure stemming from the growing population at working age, especially in the younger ages, could be easily absorbed and unemployment could be kept low. In all three countries, the measured unemployment rate[5] varied in the 1990s between 2% to 5%, annually.

This was a formidable achievement of the Asian economic development model, especially when compared to other developing regions of the world.

But the festival is over now. After a long and presumably never ending period of growth, the economic activity in the three countries started suddenly to slow down, not gradually but rapidly. At the beginning of this process, governments - in conjunction with international and national observers - seemed to hope for a soft landing in 1998, i.e. either zero or only slightly negative growth. Should they not have been fully aware of the interdependencies between the financial and the real sectors of their economies? Meanwhile it is more than obvious that all three of the countries and probably some of their neighbours, like Malaysia and Laos, will undergo severe economic recessions. At present, it is expected that Thailand's GDP will fall by as much as 7% this year, South Korea's by 8% and Indonesia's by even more than 15%.[6] These figures imply that by the end of 1998, the GDP in Thailand and Korea will probably be more than 10% lower and in Indonesia about 25% to 30% lower than in the same quarter of 1997.[7] For all these countries recovery is postponed at least for another one or two years, and probably longer.

Under these conditions unemployment will rise to levels previously unknown. The Thai society was used to measured unemployment levels in the order of 0.5 to 1 million; now unemployment will increase to clearly over 3 million persons (unemployment rate in 1998 of around 11%). South Korea counted over the past

4 Joseph Stiglitz, loc. cit.

5 In broad terms, all countries measure unemployment on the basis of internationally acknowledged ILO conventions / recommendations.

6 The Economist. July 11th 1998, p. 59.

7 Calculations ILO Social Security Department.

years usually around 0.5 million unemployed; these will in 1998 grow to an average of 2.5 million (unemployment rate of around 11.5%), implying about 3 million by the end of the year. The labour statistics of Indonesia, with a population of 200 million the world's 4th biggest country, showed usually between 3 and 5 million unemployed; in 1998 the number of statistically measured unemployed persons could well be around 20 million (unemployment rate of around 25%) if labour market participation rates do not change.[8]

It should be noted that many of the growing number of private households whose breadwinners become unemployed may for some time be able to live off savings that were accumulated during better times. Yet, once these reserves are depleted, it is only a question of time when the world will see growing social unrest in the region again. This will add to the reduced labour market access of next year's school leavers. Any resulting violence would probably concentrate in the urban areas because traditional social structures and urban relations with the rural sector have to some extent been destroyed over the past high growth period; thus, especially former workers in the formal sector will suffer exclusion from wider family support.

All three countries are presently shattered by massive economic and labour market shocks. In other words, what - over two decades - seemed to be the economic success model for the rest of the world is now in danger of being extinguished within a short period of two or three years. The crisis severely jeopardises the hard-won results of East Asia's record, which, as the World Bank observes, was reflected in better living standards for hundreds of millions of Asians, giving them longer life expectancy, better health and education, and providing millions of others the chance to rescue themselves from poverty. Obviously, "tens of millions of people have been dragged back into poverty by the current crisis."[9] The Indonesian government now estimates that 40% of the population - 80 million people ! - are living below the poverty line. "Mass hunger is a real fear."[10]

Model calculations indicate that it will take Thailand and South Korea at least three to five years in order to regain the pre-crisis levels of income and employment which would by no means imply an equal reduction of unemployment (because of continued supply side pressure on the labour market). To achieve only such a "moderate goal" the economic growth performance would still have to be excellent. Indonesia will likely have to wait a decade or more before it might recover to pre-crisis levels.

What has to be done? Of course, the financial sectors of the region have to be brought to international standards. This has been stressed in numerous articles, conferences and political announcements. But also, the introduction of sound social protection systems and / or the improvement of existing schemes has to be pursued. Now that the party is over it is time to come back to earth and prepare seriously for the uncertainties of the future.

8 Calculations ILO Social Security Department.

9 Joseph Stiglitz, loc. cit.

10 The Economist. July 11th 1998, p. 60.

In their efforts to do so governments can start from already existing national social protection elements but also from international experience. Also, they will have to accept that relying on a capital based, market economy type of development model at the same time means opting for a certain limited range of possible designs of social protection systems.

For example, South Korea can no longer rely on the concept of a partitioned labour market and the idea of life-long job guarantee in the same company (for only a part, though significant, of its labour force) and on severance payments as the major element of retirement income for a broad range of employees. Also seen as an implication of the IMF rescue package, the government has started focusing on the elaboration of an active labour market policy framework to be accompanied by low level benefits provided through the unemployment insurance. The pension system will have to be reformed so that it provides meaningful income replacement at and after retirement.

Thailand has to realise, that it can no longer, under the conditions of a market economy, solely rely on traditional family structures to absorb recurring labour market shake outs. It needs an unemployment insurance or equivalent scheme. Regrettably, such an insurance could at the earliest be implemented by the beginning of the year 2001. This was the result of a feasibility study, recently carried out by the ILO, which showed that - taking into account the administrative problems arising from the introduction of family benefits and of a pension insurance in January 1999 as well as the lead time required for new legislation - the operation of an additional scheme would not be feasible before 2001.

And Indonesia has yet to embark on the idea of substantial social protection systems at all. The introduction of provident funds, or derivatives thereof, as the major social protection system for workers has to be recognised as a mistake and be written off for the time being. Given inflation of around 80% in 1998 the members of these funds are these days painfully experiencing the sudden devaluation of possibly long periods of individual payments. Especially when unemployed and in need of support through their fund, workers now realise that their contributions have virtually been expropriated by the crisis.

Apart from their own national experience, governments might wish to take advantage of international experience. In doing so, it might be worth while looking also to Europe. This is, of course, not to argue in favour of copying the so-called European model - simply because such a model does not exist. What exists in Europe is a wide variety of different types of social protection schemes that have over many decades been shaped by economic and political ups and downs. The reality of European social protection systems could be a valuable source of information for all those looking for possible solutions in Southeast Asia. As it stands, Europe could provide "vertical" information on the existing different structures of schemes realised as well as "horizontal" information on the development of existing schemes under changing economic and political conditions.

One might object to an approach of expanding social protection in Southeast Asia by arguing that also the former planned Eastern European economies could not be safeguarded from almost collapsing although they had integrated social protection systems covering 100% of their populations; nor, so it seems in many cases, did such systems support economic recovery - why then should it be helpful for the East-Asian economies to introduce such systems? For two reasons: First, the social protection systems of Eastern Europe existing then were not adapted to the inherent conditions of market economies as (a) they relied on the "everlasting" existence of companies / conglomerates (no bankruptcies allowed) and (b) they did not foresee unemployment (no unemployment insurance programs). Only a properly functioning program of income support to the unemployed can effectively dampen the temporary negative income effects, and render politically sustainable, clear cut sectoral restructuring measures on company level. Although full of imperfections, the existence and practice of legal, institutional and administrative social protection instruments in Eastern Europe has probably contributed significantly to an amelioration of the serious and growing income problems of by far the majority of private households during the ongoing transition process. Second, the appropriate comparator is not Eastern but Western Europe. Despite much criticism, this part of the world has so far managed its recurring economic problems quite successfully. In doing so, the wide social protection system has probably played a much more prominent role than is acknowledged by many.

The present economic and social conditions of Europe and Southeast Asia may be very different. But important elements of the European social protection approaches are applicable to any type of capital based market economy. To find out these elements and adjust them to the Southeast Asian countries would be worth the effort and may even be helpful for Europe. After Asia has shown Europeans how to build better cars, cameras and computers - why not show them how to improve their social protection systems?