

24

**FINANCIAL CRISIS IN EAST ASIA:
“The End of the Asian Model?”**

Ajit Singh
Cambridge University
Cambridge, England

ISSUES IN DEVELOPMENT

Discussion Paper

24

**FINANCIAL CRISIS IN EAST ASIA:
“The End of the Asian Model?”**

Ajit Singh
Cambridge University
Cambridge, England

Development Policies Department
INTERNATIONAL LABOUR OFFICE GENEVA

The ILO's Development Policies Department is responsible for the formulation and implementation of an effective ILO strategy for development and technical cooperation activities. A central objective is to strengthen national capacities of developing countries in the design and implementation of policies and programmes for equitable and sustainable development. This involves the monitoring and analysis of experiences of developing countries and the preparation of policy packages for poverty alleviation and employment creation in rural and urban areas. The main results of work in progress are published in the Issues in Development Discussion Paper series. These papers disseminate the analysis and empirical information generated by ILO staff, at the Headquarters or in the field, and consultants working on development issues and are circulated in order to stimulate discussion and to elicit comments.

Contents

Preface	iv
I. INTRODUCTION	1
II. INDUSTRIALISATION AND CATCH-UP IN ASIA, 1955-1995	3
III. THE EAST ASIAN MODEL	5
IV. CAUSES OF THE CRISIS	7
V. EVIDENCE ON THE THEORIES CONCERNING THE CRISIS	9
V.1 Fundamentals	9
V.2 The Capital Supply Shock	11
V.3 Structural Factors	11
VI. THE IMF POLICY PROGRAMME AND THE EAST ASIAN CRISIS	14
VII. ECONOMIC AND SOCIAL CONSEQUENCES OF THE ADJUSTMENT PROGRAMMES	16
VII.1 Short to Medium Term Impact on Employment, Poverty and Ethnic Relations	16
VII.2 Duration and Long-Term Effects of the Crisis: Lessons from Latin America	18
VIII. ANALYTICAL CONCLUSIONS AND POLICY IMPLICATIONS	20
VIII.1 Analytical Conclusions	20
VIII.2 Policy Implications	21
VIII.3 Policy Implications for the ILO	
II	
<i>Underemployment: the more likely outcome</i>	8
4. The Crisis, Poverty, and Vulnerable Groups	10
5. Minimizing the Adverse Effects on Employment and Poverty: Some Ideas from Within	12
<i>Labour-intensive infrastructure</i>	13
<i>Targeted credit for self-employment</i>	14
<i>Targeted food distribution</i>	14
6. Concluding Remarks	16
	iii

References	17
Data Sources	18
Issues in Development Discussion Papers	19

Preface

The countries of East and South-East Asia had, till the middle of 1997, the distinction of being amongst the world's fastest growing economies. However, it is by now quite clear that the financial crisis being faced by them started from deeper economic malaise, and is leading to further economic problems. And there are important social dimensions to such problems. These social dimensions include employment, incomes and living standards of the poorer and vulnerable segments of the society. The present paper addresses these issues. It deals with the impact of the financial crisis and adjustment in Indonesia on the employment and poverty situation in the country, and presents a broad programme of action for minimizing the adverse effects on the poor. The paper was prepared as one of the background papers for the technical report for the ILO's High-Level Tripartite Meeting on Social Responses to the Financial Crisis in East and South-East Asian countries to be held in Bangkok from 22-24 April 1998.

The present paper starts by providing a brief overview of the pre-crisis situation regarding economic growth, employment, labour market and poverty in Indonesia. It points out that the financial crisis hit the Indonesian economy at a time when it was already facing dwindling exports, a slowdown in overall growth, and sharply reduced rice production leading to imports of rice and prospects of a sharp rise in food prices.

Projections made in the paper (although based on limited data) indicate that the rate of unemployment in 1998 may rise to between 7.4 and 8.8 per cent (from less than five per cent in 1996) - depending on the GDP growth that is assumed. The author, however, points out that one should not be surprised if open unemployment does not actually grow at the alarming rates mentioned above. He argues that given the structure of employment in Indonesian economy, a more likely outcome is substantially higher rates of unemployment in sectors like agriculture, trade, transport, and other informal economic activities.

The paper also argues that the present crisis is likely to affect the poverty situation directly as well as indirectly. Alongside loss of jobs and move to low-productivity work yielding lower incomes, the classic mechanism of high food inflation leading to an increase in poverty appears to be working already - thus implying the addition of a very sizeable number to the 22 million who are already below the poverty line.

The paper points out the inadequacies of actions taken or planned vis-à-vis the magnitude of the adverse effects on the employment and poverty situation and presents the outline of a two-pronged programme of emergency employment creation and safety nets for the poor. The suggested programme consists of a broad-based 'employment generation fund' and a short-term food distribution scheme carefully targeted at the poor. Going beyond the short-term, the paper emphasizes the need to understand the direction of economic restructuring that is warranted in the new environment and to formulate policies and strategies needed to augment the employment content of the new growth scenario.

It may be noted that the present paper was completed on 20 March 1998, and had to be based on information available till then.

Samir Radwan
Director
Development Policies Department

1. Introduction: The Context

In an increasingly globalizing world, management of economies is confronted with new challenges. This is being amply demonstrated by the financial and economic crisis that is being faced by a number of Asian countries, who, till recently, had the distinction of being amongst the world's fastest growing economies. The crisis which started with the devaluation of Thailand's currency in the summer of 1997 quickly spread to other countries of South East and East Asia. Although at first sight it may appear to be a financial or debt crisis, it has deeper roots in the structures of the economies, and changes in their competitiveness. After years (or in some cases, decades) of extraordinarily high growth, most countries of South East and East Asia started facing declining export growth and growth of the overall economy in the second half of 1996. In the face of mounting current account deficits, it was no longer realistic to continue with currencies pegged to the US Dollar at fixed exchange rates. As the currencies were devalued the burden of external debt (which had to be repaid in US Dollars, and no precaution had been taken against possible devaluation of the currencies) suddenly increased very substantially. Moreover, a large part of the borrowed money had gone into relatively less productive sectors (e.g., real estate) or sectors with doubtful economic viability. With declines in competitiveness, such investments were no longer capable of generating adequate returns needed for repaying the loans. The additional fact that much of this debt is short-term in nature added to the crisis. And with devaluation started capital flight on a massive scale.

Confronted with the situation outlined above, it was Thailand who first adopted an IMF-supported bailout plan. Indonesia followed suit. And after some initial hesitation, the Republic of Korea, the newest member of the club of developed countries, had to approach the IMF for help. The package offered by the IMF is the familiar one of loans associated with the conditionality of stabilization involving austerity and financial sector reforms. In Indonesia, the amount pledged was US\$43 billion and the reforms required range from cuts in subsidies and other expenditures, increases in taxes, dismantling of monopolies, to banking and financial sector reforms. All these measures are bound to have a far-reaching impact on the economy. Turmoil in the banking and financial sector has brought a number of economic activities (e.g., trade, production based on or requiring imported inputs, construction, etc.) to a virtual standstill. The short-term impact of austerity measures like budget cuts and increased taxes will be a slowdown of the economy.

It should be clear from the above that what appears to be a financial crisis started from deeper economic malaise, and is almost certain to lead to further economic problems. And there are important social dimensions to such problems. These social dimensions include employment, incomes and living standards of the poorer and vulnerable segments of the society, and social protection of the workers. The employment situation is being adversely affected in at least two ways: (i) retrenchment of workers from economic activities directly affected by the crisis (e.g., the financial sector, construction, and trade); and (ii) slowdown in growth of employment due to a slowdown in economic growth. The poverty situation may also be affected in different ways, e.g., through a direct reduction in incomes (i.e., reduction in wages or returns from self-employment), reduction in real incomes due to price increases and reduced access to services like health and education.

In order to ensure that the poor and vulnerable segments of the society do not suffer disproportionately from the adverse effects of the crisis and the associated adjustment programme, it is extremely important that appropriate measures are undertaken to minimize the negative impact on employment and incomes of the poor. It is indeed possible to implement special programmes for creating employment for the poor on an urgent basis and protect their incomes and living conditions even within the framework of an overall adjustment programme characterized by austerity.

The present paper deals with the impact of the economic crisis and adjustment in Indonesia on the employment and poverty situation in the country, and presents a broad programme of action for

minimizing the adverse effects on the poor. The paper starts by providing (in section two) a brief overview of the pre-crisis situation regarding economic growth, employment, labour market and poverty in the country. The impact on employment and poverty is analysed in sections three and four respectively. Measures and action programmes for minimizing the adverse effects on employment and poverty are suggested in section five.

2. The pre-Crisis Situation: Growth, Employment and Poverty

Indonesia has achieved remarkable success in economic development over the past decade and a half. While the GDP growth during 1980-90 was 6.1 per cent per annum, it went up to 7.6 per cent per annum during 1990-95 and 7.8 per cent in 1996. This consistently high growth has been associated with impressive diversification of the economy and strong performance of the manufacturing sector which grew at a rate of 10 per cent per annum between 1985-95 and accounted for a quarter of the nation's GDP. Indonesian exports now consist of a wide range of manufactures including textiles and apparel, wood products, and petrochemicals. The growth of merchandise exports averaged nearly 15 per cent during 1986-93, but declined thereafter. In 1996, the growth rate was 8.8 per cent.¹

Indonesia's gross investment rate went up from 24 per cent of the GDP in 1980 to 32 per cent in 1996. Domestic savings have also grown, and Indonesia continued to finance about 90 per cent of its investment domestically. In 1996, the domestic savings rate was 31 per cent of the GDP. (World Bank, 1997.)

On the employment front, the performance has been less impressive. While there has been a significant shift in the sectoral composition of employment (Table 1), the growth of employment has lagged behind that of labour force. During 1985-95, the rate of employment growth had been 2.3 per cent per annum compared to a labour force growth of 3.1 per cent. Indeed, employment growth declined from 2.8 per cent per annum during 1985-90 to 1.8 per cent during 1990-95. The rate of open unemployment jumped from 3.2 per cent in 1990 to 7.0 per cent in 1995.² The problem of unemployment is more serious in the urban areas (increased from 6.1 per cent in 1990 to 10.9 per cent in 1995) and amongst the educated (increased from 6.7 per cent in 1990 to 11.5 per cent in 1995 for those with university education). Nearly a third of the total workers suffers from underemployment (measured as working less than 35 hours per week).³ Nearly two-thirds of total employment is still accounted for by the informal sector.

¹Data presented in this paragraph are from World Bank (1997) Asian Development Bank (1997) and ILO (1996).

²The data presented above are from census and intercensal surveys. The labour force survey for 1996 shows a much lower rate of unemployment (4.89 per cent of the total economically active population in 1996 - based on data presented in the Statistical Yearbook of Indonesia 1996. But that also shows a sharp increase in the rate of unemployment from 2.6 per cent in 1986 to nearly 5 per cent in 1996.

³According to data from labour force survey 1996.

Table 1: Sectoral Composition of Employment, 1996

Sector	Number	Percentage
Agriculture	37,720,251	44.01
Mining and quarrying	774,211	0.90
Manufacturing	10,773,038	12.57
Electricity, gas and water	164,142	0.19
Construction	3,796,228	4.43
Trade, hotel and restaurants	16,102,552	18.79
Transport and communication	3,942,799	4.60
Finance, insurance, real estate and business	689,733	0.80
Public services	11,728,495	13.68
Others	10,364	0.03
Total	85,701,813	100.00

Source: BPS, Statistical Yearbook of Indonesia, 1996.

The employment situation obtaining immediately before the crisis may be summed up as follows. Approximately 4.4 million people (or nearly 5 per cent of the labour force) was already looking for jobs in 1996.⁴ Annual addition to the labour force is in the range of 2.2 to 2.3 million - depending on the source of data.⁵ In addition, the labour market is characterized by a high degree of underemployment and continued predominance of the informal sector.

In the area of poverty reduction, the performance of Indonesia has been quite impressive. In two decades during 1976-96, the incidence of absolute poverty (i.e., the percentage of population below the 'poverty line' declined from 40.08 per cent to 11.34 per cent.⁶ The benefits of growth appear to have been distributed fairly widely, and all provinces have increased income, consumption, and employment - although they have done so at different rates and starting from different levels. In terms of other aspects of the quality of life also (e.g., life expectancy, infant mortality, literacy and education) the progress has been very impressive.

As mentioned earlier, the economy of Indonesia started showing signs of strain already in 1996 when export growth slowed down to below nine per cent from an average of nearly 15 per cent during 1986-93. GDP growth started slowing down in 1997. From nearly eight per cent in 1996 growth in the first quarter of 1997 came down to less than seven per cent, and to below six per cent in the second

⁴Based on labour force survey data. Use of census and inter-censal survey data would perhaps yield a figure of approximately 6 million people.

⁵The labour force surveys yield higher figures of total workforce compared to census and inter-censal data. It is difficult to understand the reason(s) for this difference. Godfrey (1993) provides an overview of the difficulties in comparing figures obtained from different sources.

⁶Data compiled by the Central Bureau of Statistics (BPS) based on the National Socio Economic Survey of Consumption. The concept of 'poverty line' is based on the daily minimum requirement of 2,100 calories per capita plus a minimum requirement of non-food items (e.g., clothing, education, transportation, and other basic household and individual needs).

quarter.⁷ The growth rate for 1997 as a whole is now estimated at less than five per cent.⁸ A severe drought during the year adversely affected agriculture; the estimated production of rice (the staple food in Indonesia) was four per cent less than that in 1996. As a result, the country had to start import of food grains after years of self-sufficiency. The worst forest fires in more than a decade also affected agriculture (as well as tourism).

To sum up, the financial crisis hit the Indonesian economy at a time when it was already facing dwindling exports, a slowdown in overall growth, and sharply reduced rice production leading to imports of rice and prospects of a sharp increase in food prices.

3. The Crisis: What is it doing to employment?

What is happening to the employment situation in the wake of the current financial and economic crisis is difficult to assess not simply because of lack of needed data but more so because the real impact of the financial crisis on the economy is still unfolding, and it may be too early to make any prognosis even about the short-term impact. There is, for example, a good deal of uncertainty even about GDP growth. While the Government projected a growth of 4 per cent in 1998, one of the basic prescriptions of the IMF bailout package is zero growth. Financial institutions like the Union Bank of Switzerland and Credit Lyonnais are projecting a deep recession of the order of a five per cent contraction of GDP in 1998.

Even if a zero GDP growth is accepted as realistic, that would mean a sharp decline in the growth of the economy, with natural consequences for the employment situation. Indeed, the current prognosis is one of massive lay-offs and a sharp increase in the rate of unemployment. However, in the absence of hard data, much of the prognosis remains at the level of anecdotes.⁹

The impact on employment: an aggregate projection

The following steps are involved in the present projection exercise. An overall employment elasticity (of 0.2936) has been calculated for the period of 1985-95 by using the GDP and employment growth rates for the period. This figure is then used to project employment for 1997 (using the projected GDP growth of five per cent for the year and the 1996 employment figure based on labour force survey data). Labour force for 1997 is projected by applying the annual growth of 2.6 per cent to the 1996 figure obtained from the labour force survey. Projections of labour force and employment made in the above manner yields an unemployment figure of approximately 5.5 million for 1997 (or 5.94 per cent of the labour force).

Labour force for 1998 has been projected by applying the same growth figure of 2.6 per cent. The employment projection for the year is based on the employment elasticity mentioned in the previous paragraph, the projected employment for 1997, and two alternative assumptions about GDP growth for 1998 - zero growth and a five per cent contraction. With zero growth of GDP, the

⁷Based on data available in Central Bureau of Statistics, *Statistical Indicators*, December 1997. GDP growth during the first two quarters of 1997 over corresponding periods of 1996 works out to be 6.94 and 5.95 per cent respectively.

⁸While the Government's estimate is around 5 per cent, the forecast made by the UBS Global Research is 4.7 per cent.

⁹In the official circles, however, a rule of thumb is being used to estimate the likely job losses, which assumes that for every one per cent reduction in GDP growth, 400,000 jobs will be lost.

projected level of unemployment for 1998 is nearly 7.9 million¹⁰ (8.3 per cent of labour force) which represents 44 and 79 per cent more than 1997 and 1996 respectively. A five per cent contraction of GDP yields an unemployment figure of nearly 9.2 million (9.7 per cent of labour force) which is more than double the level prevailing in 1996. The projected unemployment rate for 1998 thus ranges between eight and ten per cent depending on the GDP growth assumed for the year, compared with about five per cent in 1996.

The impact on employment: a closer look using a sectoral projection model

Limitations of the aggregate projection model based on which the above projections have been made are well known. Different sectors of an economy grow or contract at different rates; and employment elasticities are also different. For example, employment elasticity of Indonesian agriculture is very low (and negative) while that of construction, trade, and services is fairly high. On the other hand, agriculture alone accounts for more employment than construction, trade and services taken together. Hence, what happens to the former is still crucial for the Indonesian economy. It is, therefore, important to make employment projections using sectoral output growth and employment elasticities. The constraint on doing so is the non-availability of reliable projections of sectoral output growth. Within Indonesia, the present author could not find any such figures.¹¹ One set of sectoral projections was, however, available from Credit Lyonnais whose overall projection for the Indonesian economy is a GDP contraction of five per cent in 1998. As an alternative to this, and in line with the within country projection of zero GDP growth, we constructed an alternative set of sectoral projections based on the following assumptions.

Agriculture will be able to recover from the adverse effects of drought in 1997 and will be able to achieve a low growth of two per cent in 1998. This should not be difficult (if normal weather prevails) in view of past records, and the fact that growth in 1997 was below one per cent. Mining and quarrying will also achieve a small growth of one per cent. Manufacturing will, however, contract by one per cent, while construction which is being most directly and adversely affected by the crisis will contract by four per cent. We assumed one per cent growth for trade as well as the service sector based on the experience in similar situations where informal economic activities in these sectors have been found to grow.¹² Given the sectoral composition of GDP,¹³ the sectoral growth rates suggested above would be roughly consistent with zero growth of total GDP.

We thus have two sets of sectoral GDP projections - one yielding a five per cent contraction of overall GDP and the other consistent with a zero growth of GDP. Sectoral employment elasticities were obtained from BAPPENAS (the national planning agency). A simple sectoral projection model was employed to make employment projections for 1997 and 1998. The results are presented in Tables 2 and 3 respectively.

¹⁰This figure is lower than Government estimates. One reason for the difference is that the assumption of 400,000 job losses per one per cent reduction in GDP growth implies a higher employment elasticity than the one estimated by us for the period 1985-95. This higher elasticity is, however, not realistic, because employment elasticity in Indonesia has been declining in recent years. (The reasons for a decline in the employment content of economic growth in Indonesia would be an interesting topic for research. But that's not the subject of the present paper.) Indeed, the figure for 1990-95 would be lower than that for 1985-95. The last remark implies that our projections (using elasticity based on 1985-95 figures) also probably produce estimates of job losses which are on the high side. Moreover, in a period of declining GDP growth or outright economic recession, normal employment elasticities, perhaps, don't apply. Hence, figures presented in this paper should be taken as indicators of the orders of magnitude, rather than anything else.

¹¹The agencies that we visited during our field visit in February could not say anything beyond the IMF prescription of zero GDP growth in 1998.

¹²The experience of the brief period of decline in growth during the early 1980s in both Malaysia and Indonesia points to such a possibility. See Amin (1993) and Harriss (1989).

¹³1996 figures - in constant prices of 1993 were: agriculture: 15 per cent; mining and quarrying: 9 per cent; manufacturing: 25 per cent; electricity, gas and water supply: 1 per cent; construction: 8 per cent; trade, hotels and restaurants: 17 per cent; transport and communication: 7 per cent; financial and business services: 9 per cent; services: 9 per cent.

Table 2: Employment Projection by Sector for 1997 and 1998
(Based on the assumption of a five per cent contraction in GDP in 1998
(in thousands)

Sectors	Employment in 1996	Employment elasticity	Projected growth of output		Projected employment	
			1997	1998	1997	1998
	(1)	(2)	(3)	(4)	(5)	(6)
Agriculture	37,720	(0.05)	0.68	1.0	37,707	37,688
Mining	774	0.63	2.56	0.5	786	789
Manufacturing	10,773	0.56	10.70	(6.0)	11,418	11,034
Construction	3,796	0.89	8.52	(4.0)	4,084	3,934
Trade, hotel and restaurants	16,103	0.73	7.87	(3.0)	17,023	16,650
Services	12,429	0.85	4.81	(6.0)	12,937	12,277
Transport and communications	3,943	0.86	8.82	(3.0)	4,242	4,133
Total	85,539				88,197	86,505
Labour force	90,110				92,452	94,856
Unemployment (no. in thousands)					4,255	8,351
Unemployment rate (%)	4.89				4.60	8.80

Notes and sources

Col. (1): Labour force survey data reported in Statistical Yearbook of Indonesia 1996. Electricity, gas and water sector has been excluded from the projection exercise because no GDP projection is available for this sector. Unemployment rate for 1996 is based on the total labour force and employment in that year.

Col. (2): Data provided by BAPPENAS.

Col. (3): Based on data for first two quarters of 1997 as reported in Economic Indicators, December 1997.

Col. (4): Data from Credit Lyonnais.

Col. (5) & (6) Estimated using the following sectoral projection model:

$$E_{ti} = E_{oi} (1 + r_{ei})^t$$

where

E_{ti} = Total employment in the t-th year for the i-th sector.

E_{oi} = Total employment in the base year for the i-th sector.

r_{ei} = rate of employment growth in the i-th sector.

$$= O_i r_{gi}$$

where

O_i = employment elasticity for the i-th sector.

r_{gi} = growth of output for the i-th sector.

Table 3: Employment Projection by Sector for 1998
(Based on the assumption of a zero growth of total GDP)
(employment figures are in thousands)

Sector	Employment elasticity	Projected growth of output, 1998	Projected employment	
			1997	1998
Agriculture	(0.05)	2.0	37,707	37,669
Mining	0.63	1.0	786	891
Manufacturing	0.56	(1.0)	11,418	11,354
Construction	0.89	(4.0)	4,084	3,934
Trade, hotel and restaurants	0.73	1.0	17,023	16,899
Services	0.85	1.0	12,937	12,827
Transport and communications	0.86	0.0	4,242	4,242
Total			88,197	87,816
Unemployment (no. in thousands)			4,255	7,040
Unemployment rate (%)			4.60	7.42

Note: See text for an elaboration of the assumptions behind the 1998 output growth projections. The projection of employment for 1998 has been made using the same projection model mentioned in the note to Table 2.

Unemployment rate is projected to increase very substantially in both the cases. In the less pessimistic scenario of zero GDP growth, the rate of unemployment is projected to rise to 7.4 per cent in 1998 compared to less than five per cent in 1996. In the more pessimistic scenario of five per cent contraction of GDP the projected unemployment for 1998 is 8.8 per cent. It should be noted that the use of the sectoral projection model yields a lower absolute number as well as rate of unemployment.¹⁴

A note of caution may be in order before we move on to other issues. The strength of the data base that has been employed to make the above projections is not known. The ground situation itself is extremely uncertain. In a situation like this, a projection exercise of the kind undertaken above should be taken as 'informed guesses' and used for illustrative purposes only. Indeed, the basic purpose of the present exercise is to go beyond anecdotes and wild guesses, and to come up with an approximate idea of the broad orders of magnitude on which needed policies and action can be based.

Although the analysis up to now has been gender-blind, the question of how women's employment is likely to be affected by the current crisis needs to be addressed. In this regard, it is important to note that the rapid growth of employment in manufacturing has created a very large number of job opportunities for women. Indeed, women have played a major role in the strong expansion of labour-intensive manufactured exports. And on the wage front, although inequalities exist, Indonesia has succeeded in reducing the gap between men and women. The gap in the field of education also has been narrowed down. And it is important to ensure that the progress mentioned above is not reversed in the wake of the current crisis.

Although official data do not provide a gender breakdown of figures on retrenchment of workers, informal responses to questions on this appear to maintain that there is no gender discrimination in deciding who to be retrenched. But the fact remains that women are employed in large numbers in a few export-oriented industries, e.g., textiles, garments and shoes. And to the extent such sectors are being adversely affected (at least temporarily) by the liquidity crisis, a large number of women do face the prospect of retrenchment if this short-term problem cannot be resolved and production does not resume quickly. Similarly, homeworkers who are linked to export-oriented sectors are also likely to face difficulties. A large number of women are also employed in agriculture and in the informal sector. To the extent these sectors face increasing pressure of underemployment and reduced incomes, women are bound to be affected.

Underemployment: the more likely outcome

As is well-known, in a country like Indonesia where a sizeable segment of the population is still poor and there is no unemployment benefit, people cannot afford to remain openly unemployed (i.e., fulfil the conditions of not working and looking for work). Indeed, underemployment - both in the sense of working less hours than is regarded as full-time employment and of working long hours with very low incomes - remains a pervasive problem in Indonesia. Underemployment rates, defined as the proportion of the workforce working less than 35 hours per week, have tended to be much higher than unemployment rates. The underemployment rate, by this definition was 41.47 per cent in 1996.¹⁵ The problem has tended to be more severe in rural than in urban areas, and particularly so in agriculture. It is also acute amongst a large section of those working in the urban informal sector.

¹⁴Also, the figure obtained by us from the same assumption of zero GDP growth - unemployment of approximately 7 million - is lower than that suggested by Government agencies. One reason for the difference is our use of a sectoral projection model which allows for different sectoral employment elasticities and weights in total employment.

¹⁵This figure is based on Labour Force Survey 1996.

The important question now is whether agriculture and the informal sector in both rural and urban areas will be able to act as the cushion to provide refuge to the potentially unemployed or whether the ranks of the unemployed are going to swell as indicated by the projection exercise reported in the earlier section. One view is that agriculture in Indonesia has undergone such a transformation and has been commercialized to such an extent that it no longer has the capacity to play the role of sponge it used to play earlier. This view also holds that many of those working in manufacturing, construction and other sectors in urban and semi-urban areas are no longer the first generation migrants, and as such, they don't have the necessary links to rural areas to enable them to return and be reabsorbed. (Hugo, 1998.)

It is indeed true that the advent of 'green revolution' has led to a certain degree of commercialization of agriculture; and many of the traditional institutions of work sharing have given way to more commercial employer-worker relationships. However, pure wage employment still accounts for a small share of total employment in agriculture (see Table 4). And self-employed with family assistance accounts for more than a third of the employment in agriculture. This together with the category of 'unpaid worker' accounted for more than two-thirds of total employment in agriculture in 1996. And these are categories which hold out the prospect of absorbing new entrants, especially family members, albeit at the cost of reduced labour productivity and returns per capita.

Table 4: Employment Status in Selected Sectors, 1996

Status	Percentage of total employment		
	Agriculture	Trade, hotel and restaurants	Transport and communications
Self-employed	16.50	41.40	47.09
Self-employed with assistance from family member or temporary employee	38.50	26.78	7.17
Employer	0.84	1.91	3.33
Employee	13.10	15.43	41.69
Unpaid worker	31.16	14.47	0.71

Source: Calculated from the labour force survey data in Statistical Yearbook of Indonesia 1996.

Similarly, more than two-thirds of total employment in the trade sector are accounted for by the self-employed and those working with family assistance. Another 14.47 per cent was in the category of 'unpaid worker' in 1996. In the transport sector also, these three categories account for more than half of total employment. Such figures indicate that much of the employment in these two sectors also are probably of informal sector type. And they certainly would face the pressure of absorbing large numbers who would either be displaced from or fail to find employment in the formal sector or in the construction sector. One should not, therefore, be surprised if open unemployment

does not actually grow at the alarming rates indicated by the projections made in the earlier section. A more likely outcome is substantially higher rates of underemployment in sectors like agriculture, trade, transport, and other informal activities (e.g., services). Since many of these activities are located in urban areas, they (except agriculture) can perform the role of sponge without requiring people to migrate on a massive scale.

4. The Crisis, Poverty, and Vulnerable Groups

As mentioned already, Indonesia has achieved remarkable success in reducing poverty during the past two decades or so. Despite this success, some 22 million people were still living below the officially defined poverty line in 1996 (see Table 5), of whom approximately two-thirds were in rural areas. In order to assess the likely impact of the present economic crisis on the poverty situation, it is necessary to understand who the poor are. Based on a recent study (Mason and Baptist, 1996), the following categories have been identified as containing the majority of poor in rural and urban areas.¹⁶

Rural		Urban	
i.	Self-employed in agriculture	i.	Self-employed in agriculture
ii.	Wage workers in agriculture	ii.	Wage workers
iii.	Self-employed in trade		agriculture
iv.	Self-employed in manufacturing		manufacturing
v.	Other wage workers:		construction
	manufacturing		services
	construction		
	services		

¹⁶It needs to be noted that not all those who are in the categories mentioned in the table belong to the poverty group. The table should be taken to mean that the majority of the poor in Indonesia are found in the categories mentioned here.

**Table 5: Percentage and Number of Population Below the Poverty Line
1976-1996**

Year	Percentage of Population Below the Poverty Line			Number of Population Below the Poverty Line (Million)		
	Urban	Rural	Urban+ Rural	Urban	Rural	Urban+ Rural
1976	38.79	40.37	40.08	10.0	44.2	54.2
1978	30.84	33.38	33.31	8.3	38.9	47.2
1980	29.04	28.42	28.56	9.5	32.8	42.3
1981	28.06	26.49	26.85	9.3	31.3	40.6
1984	23.14	21.18	21.64	9.3	25.7	35.0
1987	20.14	16.14	17.42	9.7	20.3	30.0
1990	16.75	14.33	15.08	9.4	17.8	27.2
1993	13.45	13.79	13.67	8.7	17.2	25.9
1996	9.71	12.30	11.34	7.2	15.3	22.5

Source: BPS, *Statistical Yearbook of Indonesia, 1996*.

Poverty in Indonesia remains a predominantly rural and agricultural phenomenon, the incidence of poverty being highest among self-employed and wage-earning farmers in rural areas. In the urban areas, apart from those in agriculture, wage workers in manufacturing, construction and services constitute the bulk of the poor.

The present crisis may affect the poverty situation directly as well as indirectly. The direct impact can be gauged easily from the discussion in section three on employment and underemployment. Loss of jobs or move to low-productivity work yielding lower income can easily push those who were already living close to the poverty line to a level below the line. This seems to be a distinct possibility for the millions who are likely to join the ranks of unemployed (or underemployed) during 1998. And that, in turn, would imply the addition of a very sizeable number to the 22 million who are already below the poverty line.

One indirect way in which the poverty situation is likely to be exacerbated is through a downward pressure on wages of those workers who will be lucky to retain their jobs despite the crisis. This can come through a resistance to increases in money wages (although a high rate of inflation may warrant such changes) or an outright reduction in money wages. The latter possibility cannot be ruled out, especially in the informal sector activities which will now have the dubious benefit of a substantially augmented labour supply.

Inflation is another mechanism through which the poverty situation can become aggravated; and this is especially the case if the prices of food and other essential items (which usually account for a higher share of the total expenditure of the lower income groups) increase at a higher rate compared to those of less essential or non-essential items. Inflation reduces the purchasing power of incomes; and unless money incomes (e.g., wages and salaries, returns from self-employment) increase correspondingly, consumption levels are likely to decline. This is a real possibility at the lower end of the income scale; and the result may be an increase in the number of people failing to ensure an expenditure level corresponding to the poverty line.

The above is a process which is almost certainly taking place in Indonesia as the rate of inflation has accelerated in recent months. While much of recent data on this remains at the level of anecdotes, it is possible to use some official data to indicate the process at work. Data presented in Table 6 and 7 show that the prices of foodstuffs registered double-digit increases already in 1994 and 1995 (and those rates were higher than the rate of increase in overall consumer price index). 1996 was a year of relatively low inflation, but from the last quarter of 1997 increases in the prices of food started to accelerate and exceed those of the CPI. Most recent official reports¹⁷ indicate very sharp increases in overall inflation as well as in food prices. The year-on-year figure on general inflation for February 1998 is reported to be 31.7 per cent, while in February itself the rate was 12.76 per cent. Food prices rose at a higher rate - month-to-month figure being 16.07 per cent. Thus the classic mechanism of high food inflation leading to an increase in the incidence of absolute poverty appears to be at work already. This is illustrated by the fact that the rice equivalent of the minimum wage (Rp. 5,800) came down to 4.76 kg at the end of December 1997 from 6.28 kg in January 1997.¹⁸ The sharp decline in real wages is thus evident. And with the price rise reported for February 1998, the decline must be continuing.

It also needs to be pointed out that food inflation will not have similar effects on all categories of poor. For example, those who do not have to buy food from the market (e.g., the self-employed farmers - and many of Indonesia's poor are in this category) are likely to be less affected than those (the wage workers in both rural and urban areas) who have to. Policies for assisting the poor should take such differences into account.

5. Minimizing the Adverse Effects on Employment and Poverty: Some Ideas from Within

While the short-term problems of unemployment, underemployment and poverty need to be addressed on an urgent basis, one should at the same time start looking at medium- and long-term prospects. And in doing so, it is possible to think of some positive effects of changes that are taking place in the economic environment. Very substantial devaluation of the currency is such a change which is certain to have far-reaching consequences. To the extent increases in the cost of imported inputs do not completely offset the advantages created for exportables the competitiveness of the latter in the world market may improve. And that may create favourable conditions for a renewed growth momentum in export-oriented sectors. Of course, the current liquidity crisis may make it difficult for Indonesia to benefit from such potential benefits; but they remain real possibilities once the short-term problems are overcome.

In the context of longer term growth prospects of the economy, there are several redeeming aspects which need to be noted. First, the domestic savings rate compares very favourably with other developing countries at similar levels; and the economy should be able to sustain a high level of investment on the basis of domestic savings alone. Secondly, given the size of population and the expansion in domestic market that has been made possible by the sustained growth of income during the past two decades, it should be possible for the economy to adopt the approach of 'walking on two legs' (i.e., exports and domestic market) in its efforts to come out of the current difficulties. Third, although a number of export items are heavily dependent on imported inputs, there are other items which can benefit from the new economic environment created by the massive devaluation of the currency.

¹⁷Bureau of Statistics figures quoted in The International Herald Tribune, 3 March 1998.

¹⁸These figures have been arrived at by using the average prices of medium quality rice reported in Bank Indonesia, Weekly Report, No. 2004, 23 January 1998.

What is important in the context of medium- and long-term growth prospects of the economy is to understand the kind of restructuring that would be necessary for the purpose of benefiting from the new environment. Indonesia will do well to identify a renewed path of labour intensive growth of the economy, pick up potential front-runners on such a path, and create an enabling environment for them to run fast. Such a growth path should enable the economy to take care of the problems of unemployment, underemployment, and poverty which appear to be getting serious now.

Although a precise quantification of the impact on employment and poverty of the current economic crisis and the associated adjustment programme has not been possible, it is quite clear that the situation regarding unemployment, underemployment and poverty is going to deteriorate very substantially, at least in the short term. From the point of view of equity and social justice, it is extremely important that the poor do not suffer disproportionately from such adverse effects. Therefore, it is essential to formulate and implement, on an urgent basis, direct programmes of employment creation for the poor and of protecting their incomes and living conditions.

Indonesia already has a number of programmes of direct intervention aimed at poverty alleviation. The experience in implementing such programmes including the institutional framework can be fruitfully utilized to undertake emergency measures for employment creation and providing a safety net for the poor.

In the following paragraphs, we present the outline of a two-pronged programme of emergency employment creation and safety nets for the poor. The first element of the programme would be a broad-based 'employment generation fund' which will be used to create wage employment as well as self-employment on an urgent basis. The major instrument for creating wage employment will be the use of labour-intensive methods in infrastructure construction, while targeted credit would be the instrument for self-employment. The second major element of the programme would be a short-term food distribution scheme targeted at the poor.

Labour-intensive infrastructure

A substantial part of government expenditure is usually allocated for infrastructure; and the use of labour-intensive methods can maximize the employment potential of such investment in infrastructure. In 1994/95, under the village infrastructure project¹⁹ in Java, more than five million man-days of employment were created. There is potential for employing labour-intensive methods in creating and upgrading urban infrastructure also as demonstrated by the Kampung Improvement Programme (KIP) which is a programme applied to densely populated, poor urban neighbourhoods. Such programmes have, however, been criticised on the grounds of lack of impact on poverty. Ways and means need to be found to improve the effectiveness of targeting. For example, for effective targeting, it is important that the wage paid should not be above the local market wage or the prevailing minimum wage. Similarly, although the Kampung Improvement Programme is targeted at poor neighbourhoods benefits of improvements may accrue to the non-poor also. It is necessary to ensure that it is only the poor who benefit at least from the direct employment that is generated. It will also be important to ensure that women who are eligible for participation in such programmes are not excluded.²⁰

¹⁹This is part of the Inpres Desa Tertinggal (IDT) Programme or the presidential instruction programme for villages that are left behind. IDT is in fact a kind of 'social fund' consisting of credit for self-employment and allocations for labour-intensive infrastructure.

²⁰Experience elsewhere shows that employment in such programmes is not gender-neutral. A variety of measures (including awareness raising and information campaign) may be taken to create opportunities for women to perform new, usually traditionally male, occupations, rather than limiting their task to what is perceived as socially acceptable.

Both the village infrastructure programme and the KIP have potential for substantial expansion. Indeed, the Government already initiated a crash programme of Rp. 33 billion for urban and semi-urban areas for the first three months in 1998. On the basis of a 90:10 wage: material ratio, and a wage rate of Rp. 7,500 per day, this programme is envisaged to create approximately four million person days of employment. That would imply 80 days of employment for 54,000 persons. For 1998-99, allocations of Rp. 600 billion and Rp. 500 billion have been made for labour-intensive infrastructure (in rural and urban areas) and labour-intensive forestry. The wage-material ratio recommended for these programmes is 70:30. If the daily wage rate of Rp. 7,500 is maintained, this allocation will be able to generate about 103 million person-days of employment. If, however, the minimum wage of Rp. 5,800 is applied, the employment generated can go up to 133 million person-days.²¹

Even if one assumes that such jobs are not designed to create full employment for potential job-seekers, and each of them will be given 200 days of work during the year, the total number of jobs will be between half a million and two-thirds of a million (depending on the wage rate applied. These figures represent a small proportion of the addition to unemployment (some three to four million people) - not to speak of total unemployment (of seven to eight million people) And that, in turn, indicates that the allocations made for labour-intensive works would be inadequate vis-vis the magnitude of the problem. Clearly, there is the need and also scope for augmenting allocations in this field. Also, one has to consider alternative means of job creation and providing safety nets (e.g., through targeted micro credit for self-employment, which are discussed below).

As urban areas are being particularly hit by direct job losses in construction and manufacturing, and wage labourers in these sectors constitute a substantial part of the urban poor, it would be important to pay particular attention to job creation in urban areas through labour-intensive infrastructure. However the wage rates in such projects will be crucial from the point of view of ensuring that they don't induce large-scale migration in either direction.

Targeted credit for self-employment

Indonesia has achieved considerable success over the past decade with several unsubsidised rural credit programmes. Programmes such as KUPEDDES, KURK, and BKK have managed to extend ever growing amounts of credit to relatively poor rural people on terms which are more attractive than the informal rural credit sector. Independent appraisals have concurred that these organizations have permitted significant numbers of borrowers to raise their incomes above the poverty threshold (Mosely, 1996). It has been argued that many more, even poorer borrowers, could be reached if the network of village banks could be extended, even if the interest rate on loans had to be raised.

Bank Rakyat Indonesia (BRI), for example, has an outstanding loan of some Rp. 4.5 trillion to 2.5 million borrowers. In addition to maintaining the Unit Banking System, BRI supervises about 5,300 Village Credit Units (BKDs) which provide very small loans to about 800,000 low-income people in their respective villages. The bank has a credit: deposit ratio of 1:2, and operates on a self-sustained basis. More than 60 per cent of its loans goes to rural areas. Clearly, the BRI micro-credit programme has scope for further expansion, as the current growth (10 per cent) in loans is lower than

²¹The Directorate General of Rural Community Development also gets a yearly allocation of Rp. 6.5 million per village for 65,000 villages for construction of infrastructure. With the institutional framework that this Directorate has, they could perhaps handle larger programmes of this kind.

in earlier years.²²

Micro and small enterprises, especially those not requiring imported inputs, have not yet been hit by the current financial and economic crisis. Indeed, there is a stronger case for promoting their growth at this critical juncture. And micro-credit can play an important role in that regard. Programmes like that of BRI should, therefore, receive special encouragement for expansion.

Targeted food distribution

As mentioned earlier, the poverty situation is being exacerbated by the high rates of price increases for food and other essential items. Inflation is causing additional hardship to the poor in a situation where unemployment and underemployment are on the rise. It is, therefore, essential to find a way of protecting the poor from the adverse effects of such high rates of inflation. One way could be to introduce a targeted scheme of distributing, at subsidised rates, basic food (e.g., rice) and a few selected essential items (e.g., kerosine) during the period of high inflation. Although such an idea may run counter to the prescription of eliminating all subsidies,²³ this has the potential of providing a safety net to the poor and assisting them to tide over the difficult period. If the idea is acceptable in principle, the budgetary implications can be worked out quite easily, and a way can also be found to raise resources for implementing the programme.²⁴ What is important is to ensure very careful and strict targeting of the programme in planning as well as implementation, and to underscore its temporary nature so that it can be phased out once things return to normal.²⁵

In addition to targeted sale of essential items suggested above, the Government may also consider participating in open market operations as a means of stabilizing the prices of food and other essentials. This can be quite effective without putting additional burden on the exchequer.

²²Micro-credit for self-employment has the added advantage that women can benefit from them more easily compared to employment in infrastructure construction. It is, however, essential to ensure that this is so in practice.

²³Some flexibility in this regard appears to be desirable, considering the potential severity of the impact on the poor.

²⁴In a society like that of Indonesia where assistance to the poor is deeply rooted in the traditional culture and institutions, it may not be difficult to mobilize resources for such a programme through specific contributions/taxes from the upper income groups.

²⁵One way of making a food distribution programme 'self-targeting' could be to select items with adequate nutritional value but not corresponding to the normal taste and preference of the people - so that the subsidized items will be bought only by the very poor in a situation of real desperation.

Table: 6 **Consumer Price Index (1998-89 = 100)**

Year/Month	Food		CPI	
	Index	Changes (%)	Index	Changes (%)
1992	130.19	6.01	135.08	4.94
1993	136.81	5.11	148.83	9.77
1994	156.97	13.94	163.17	9.24
1995	179.14	13.32	177.83	8.64
1996	189.99	6.12	189.62	6.47
1997				
July	198.96	1.10	195.77	0.66
August	201.05	1.05	197.50	0.88
September	204.89	1.91	200.04	1.29
October	212.29	3.61	204.02	1.99
November	220.06	3.66	207.38	1.65
December	227.88	3.55	211.62	2.04

Sources: (i) Bank Indonesia, Indonesian Financial Statistics, December 1997.
(ii) -, Weekly Report, No. 2004, 23 January 1998.

Table: 7 **Average Prices of Medium Quality Rice, 1991-97**

Year	Price (Rp/kg)	Percentage change over previous year
1991	557.42	
1992	604.31	8.41
1993	592.95	(1.88)
1994	659.32	11.19
1995	768.76	16.60
1996	879.55	14.41
1997	1,088.89	23.80
1996 December	918.81	
1997 December	1,218.00	32.56

Source: Bank Indonesia, Weekly Report No. 2004, 23 January 1998, Jakarta.

6. Concluding Remarks

The present paper has provided only broad outlines of possible emergency employment creation and safety net programmes for those who are being adversely affected by the current economic crisis (especially the poorer people). It has also provided an indication of the likely benefits when the economy starts its recovery. The details of such suggested programmes will need to be worked out.

On the proposed employment generation fund, the realistic size of the fund, the number of jobs that can be generated, the institutional framework for operating the fund, the time frame, etc. will need to be worked out. Similarly, for the targeted food distribution scheme, the size of the target group, the items to be distributed, the budgetary implications, and ways of generating the needed funds will have to be worked out. On the medium and longer term employment outlook, in-depth analytical work needs to be undertaken to understand the direction of economic restructuring that is now warranted, the employment outcomes of such restructuring, and policies needed to augment the employment content of the new growth scenario. A comprehensive exercise on employment and poverty is thus called for.

References

- Amin, A.T.M. Nurul (1933): 'The Urban Informal Sector in Indonesia: through the economic recession and recovery'. ARTEP Working Papers, ILO, New Delhi.
- Booth, Anne (1997): 'Poverty in Indonesia'. SAAT Working Papers, ILO-SAAT, New Delhi.
- Godfrey, Martin (1993): Labour market Monitoring and Employment Policy in a Developing Economy: A Study of Indonesia. ILO-ARTEP, New Delhi.
- Hugo, Graeme (1998): 'Some comments on the Employment Consequences of the Currency Crisis in Indonesia'. Unpublished manuscript, ILO Office, Jakarta.
- Harriss, J. (1989): 'Labour Absorption in Small-Scale Private Sector Services'. ILO-Economic Planning Unit, Malaysian Human Resource Development Plan Project, 1989.
- ILO-SEAPAT (1996): 'Targeted Programmes for Special Groups and Combatting Social Exclusion in Indonesia'. ILO-SEAPAT, Manila.
- Mason, Andrew D. and J. Baptist (1996): 'How Important are labour Markets to the Welfare of the Poor in Indonesia? The World Bank.

Data Sources

BPS (Biru Pusat Statistik): Statistical Yearbook of Indonesia 1966.

BPS: Labour Force Situation in Indonesia, 1996.

BAPPENAS: REPELITA VI: Indonesia's Sixth Five-year Development Plan (1994/95-1998/99).

Bank Indonesia: Weekly Report No. 2004, 23 January 1998.

S, Indonesian Financial Statistics, December 1997.

World Bank (1997): World development Report 1997.

Asian Development Bank (1997): Asian Development Outlook, 1997 and 1998.

International Labour Office (1996): World Employment 1996/97.

Unpublished data from:

- various government agencies in Indonesia
- Credit Lyonnais
- UBS Global Research.

Issues in Development Discussion Papers

1. Paul Streeten: *The political economy of fighting poverty* (March 1995)
2. Guy C.Z. Mhone: *The impact of structural adjustment on the urban informal sector in Zimbabwe* (March 1995)
3. S.D. Barwa: *Structural adjustment programmes and the urban informal sector in Ghana* (June/July 1995)
4. Roger Plant: *La función de las organizaciones de trabajadores en el desarrollo económico y social: Estudio de caso del Convenio núm. 141 de la OIT en México y Filipinas* (1995)
5. Roger Plant: *Rebuilding civil society: Rural workers' organizations in Guatemala* (1995)
6. Alain de Janvry and Elisabeth Sadoulet: *Poverty, equity and social welfare in Latin America: Determinants of change over growth spells* (October 1995)
7. Ashwani Saith: *Reflections on South Asian prospects in East Asian perspective* (October 1995)
8. Michael Lipton: *Successes in anti-poverty* (1995)
9. S. Tilakaratna: *Credit schemes for the rural poor: Some conclusions and lessons from practice* (1996)
10. Amelita King Dejardin: *Public works programmes, a strategy for poverty alleviation: The gender dimension* (1996)
11. Carol Graham: *Gender issues in poverty alleviation: Recent experiences with demand-based programmes in Latin America, Africa and Eastern Europe* (1996)
12. Mayra Buvinic: *Promoting employment among the urban poor in Latin America and the Caribbean: A gender analysis* (1996)
13. Keith Griffin: *The macroeconomic framework and development strategy in Uzbekistan* (1996)
14. Azizur Rahman Khan: *The transition of Uzbekistan's agriculture to a market economy* (1996)
15. Hélène Harasty: *Transition and the labour market in Uzbekistan* (1996)
16. Keith Griffin: *Macroeconomic reform and employment: an investment-led strategy of structural adjustment in sub-Saharan Africa* (1996)
17. Azizur Rahman Khan: *Reversing the Decline of Output and productive employment in rural and sub-Saharan Africa* (1997)
18. Mireille Razafindrakoto et François Roubaud: *L'approche à haute intensité de main-d'oeuvre (HIMO): Une opportunité pour Madagascar. Essai de cadrage macro-économique* (1997)

19. Arjan de Haan and Julie Koch Laier: *Employment and Poverty Monitoring* (1997)
20. Saskia Sassen: *Informalization in advanced market economies* (1997)
21. Manuela Tomei: *El Fondo de Solidaridad e Inversión Social (FOSIS) de Chile* (1997)
22. Azizur Rahman Khan: *Poverty in China in the Period of Globalization: New Evidence on Trend and Pattern* (1998)
23. Rizwanul Islam: *Indonesia: Economic Crisis, Adjustment, Employment and Poverty* (1998).

How to obtain documents

- Priced items published by the ILO:
ILO Publications,
International labour Office,
CH-1211 Geneva 22, Switzerland.
A complete catalogue is available on request.

- Books published on behalf of the ILO by commercial publishing houses:
Publisher in question or your local bookseller.

- Working papers and all other documents may be requested directly from the Documentalist,
Development Policies Department, International Labour Office, CH-1211 Geneva 22,
Switzerland.