Four Case Studies: Malaysia, the Philippines, Indonesia and Thailand[4]

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The Financial Crisis and Economic and Financial Responses

If the broad features of the crisis generally conform to the description given above, it is also the case that each economy experienced the crisis in different ways. How the crisis affected an economy was dependent on the pre-crisis relationship between domestic economic and financial policies and external factors.

In the case of Thailand, the *de facto* devaluation of the baht in July 1997 brought to an end a decade of growth. By October 1977, the baht had depreciated by 50 per cent. This led to reluctance on the part of exporters and investors to hold baht and to a massive capital outflow. In recent months (March and April 1988), some stability has returned to exchange rates as a result of a high interest rate policy. The export-promoting effect of devaluation has frequently been undermined by problems faced by exporters in gaining access to credits, problems exacerbated by high interest rates and tight credit controls.

Insolvency has hit the financial sector due to a lack of confidence in institutions, high debt-equity ratios and a dependence on foreign borrowing. A raft of measures has been directed at the financial sector in order to overcome these difficulties. Much effort is being put into establishing financial institutions on a firm and transparent basis whilst also attempting to consolidate a stable exchange rate, and reverse the current account deficit and debt servicing and liquidity problems. The international financial institutions have been supporting these efforts, with a bailout totalling US$17.2 billion.

Limskul's paper identifies a number of key features of the Thai crisis including:

- rapid economic growth, resulting in an investment-saving gap associated with rapid and large inflows of foreign investment, inflows consequent on international realignments of currencies in the 1985 Plaza Accord;
- a deterioration of the current account (a gap of 8.8 per cent of GDP in 1996); and
- policies which failed to respond to economic signals, and regional and international economic trends.

Implicit in this analysis is a perspective similar to that of Goldstein (*op cit.*). Careful analysis of the Thai growth model and its associated institutions has shown that, for a considerable period prior to July 1997, the model was unsustainable on a permanent basis and that a major adjustment was inevitable.

The way forward for Thailand has been charted in conjunction with the IMF. Drastic reform of the financial system, an austerity programme and tight monetary control using a high interest-rate approach combine to form the basis of the policy approach. Private consumption, investment and production have been adversely affected by this package. Capital outflow has not been halted, leading to further domestic liquidity difficulties. As a result, some relaxation of the high interest rate and the tight liquidity policies is being considered in order to promote export earnings. In institutional terms, alongside financial sector restructuring, corporates face new bankruptcy and foreclosure legislation, as part of a legal reform package. Also, privatization is being pursued in the public sector.

In Malaysia, GDP growth had averaged nearly 9 per cent annually for a decade, with inflation averaging under 4 per cent annually over the same period. The savings rate was high (around 33 per cent of GNP 1990–1995). The exchange rate for the ringgit was stable against the US dollar. Foreign capital flows

4 These case studies are drawn from papers by Kitti Limskul (Thailand), Kim-Lian Yap (Malaysia), Aris Ananta and colleagues (Indonesia), and Cayetano Paderanga Jr. (Philippines), particularly prepared for the APEC HRD Working Group Task Force.

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into the economy were strong against a background of stable economic indicators and political certainty.

By the end of December 1997, the ringgit had depreciated by 35 per cent against the US dollar; and stock market values had fallen by 45 per cent since June. GDP growth fell from a projected 8.5 per cent to 6.9 per cent in the final 1997 quarter, with a GDP growth projection for 1998 of around 3 per cent. Export growth is seen to be the answer to the impact of declining domestic demand on growth levels. The financial and construction sectors were particularly badly hit by the 1997 reversal in economic fortunes. The current account deficit is projected to be an acceptable 1 per cent of GNP in 1998. Inflation is expected to double to between 7 and 8 per cent in 1998, but price controls on basic commodities will, it is hoped, dampen any inflationary effects.

The policy settings adopted by the Malaysian government to deal with the crisis have been driven by the National Economic Action Council (NEAC), a representative stakeholder initiative. Specific policies include a reduction in state expenditure, the deferment of project expenditure (other than those allowing potentially significant export earnings), export and tourism promotion, and encouragement of local content usage in production. Malaysian business compliance costs are being attacked. Prudential standards in financial institutions are being tightened. Funds raised in capital markets are to be subject to more stringent requirements and priority is to be given to lending for productive and export-orientated operations.

In the Philippines, the pre-conditions for the crisis were to be seen in the exuberant expansion of domestic credits in 1994 (by 50 per cent) and 1995 (by 40 per cent). Confidence in the economy and an inflow of foreign capital promoted a cheap credit regime. Foreign capital became an option on the basis of apparently stable exchange rates. This exuberance led to banking institutions becoming overstretched and, because of foreign exposure, susceptible to external shocks. By early 1997, a note of caution was sounded about levels of foreign obligation, and some constraints were imposed on domestic credits.

When the crisis hit the Philippines, paralysis was induced in almost all sectors of the economy. Confidence in the economy fell as uncertainty rose in the face of a depreciating peso. Operations with unhedged foreign obligations were adversely affected by this depreciation. Consequent liquidity pressures on financial institutions led to a credit crunch, upward pressure on interest rates, further reductions in business confidence and a consequent downwards spiral in economic activity. Inflation rose due to both external and domestic pressures.

Government responded to the downturn with measures to re-establish economic equilibrium and increase confidence in economic fundamentals. The focus of policy was to maintain control over three areas: fiscal policy, the balance of payments and the savings-investment gap. Higher interest rates were used to make domestic assets more desirable and to restrict liquidity. Austerity measures were introduced particularly in terms of state sector expenditures. Export promotion was fostered to respond to the balance of payments issue, as were policy adjustments in respect of the capital account.

Indonesia's annual growth was regularly 6.5 per cent or higher for nearly 30 years prior to the 1997 crisis. Cheap capital combined with cheap skilled labour provided an attractive environment to overseas capital. In recent years, a shift was developing from labour-intensive to more capital-intensive, higher-skilled production, promising further growth and improved export performance.

When the crisis hit, the rupiah fell from 2,400 per USD (July 1997) to 17,000 per USD in January 1998. By April 1998, it had recovered to 8,000 per USD. The crisis led to a drop in domestic demand, falling investment levels, foreign capital flight and the exodus of important layers of skilled labour. Price increases reflect the important contribution of foreign content to domestic production. The IMF-designed adjustment policy carries with it the reduction of subsidies to staple commodities, exacerbating social unrest and contributing to recent civil unrest. Growth is expected to be negative in 1998, by as much as 5 per cent.

The response to the crisis in Indonesia has been focused on the debate around the IMF austerity plan. The plan, first agreed to in January 1998, is a comprehensive reform of Indonesia's economic order. Subsidies are to be reduced or abolished; trade and manufacturing monopolies are to be prohibited; non-performing state enterprises are to lose government financial support; privatization is to be promoted; the financial sector is to be reformed and prudently regulated; central bank independence is to be increased; and state expenditure is to be made more accountable and transparent. After the January agreement, little stability emerged due to policy slippage, resulting in further currency pressures, rising inflation and further deterioration of economic conditions. In April 1998, the January measures were complemented by further reforms that were designed to induce stability, which was an expectation that was given some support by changing political circumstances.

The aim has been to stabilize the financial sector whilst balancing policies applied to this end against policies designed to reassert export growth as the long-term way forward out of the crisis.

Two points stand out, in considering these accounts of the crisis. First, there is a to-be-expected uniformity of policy prescriptions to deal with the crisis. In all cases, the aim has been to stabilize the financial sector whilst balancing policies applied to this end against policies designed to reassert export growth as the long-term way forward out of the crisis. Second, the intensity of the crisis varies between economies. The depth and urgency of the crisis declines as one moves from Indonesia to the Philippines via Thailand and Malaysia. This suggests that the mixture of institutional structures and policy settings that were in place when the crisis hit, and their adaptation in response to the crisis, are important factors in understanding the crisis.

Labour Market Impacts[5]

A concern about the impact of retrenchment on unemployment and underemployment dominates all case studies of the crisis. In the case of Thailand, non-agricultural employment fell from 16,516 million to 16,016 million between 1997 and 1998 (in a total labour force in 1998 of some 33 million). National statistics suggest that unemployment grew from 1.9 per cent to 3 per cent in the same period. New entrants to the labour market face particular difficulties in the current environment. Another survey paints an even bleaker picture. Manufacturing is badly hit (24 per cent unemployment in the fourth 1997 quarter), as is the service sector (46 per cent unemployed in the same quarter). What is even more concerning for Thai employment levels is the implication that the impact of the credit crunch will be tougher than IMF predictions and that, therefore, any upturn out of the crisis will be delayed beyond 1999. Yet another survey, this time of layoffs in the last two quarters of 1997, suggests that up to 29 per cent of staff in place in the surveyed firms at the beginning of the crisis were laid off by the end of 1997. Other measures of the employment impact of the crisis in Thailand bear out this depressing picture.

In Malaysia, retrenchment has taken place but the picture is more promising than in Thailand. Some 8,000 workers were retrenched

5 Taking its lead from the commissioned case studies, this paper focuses on the labour market impacts of the crisis. For a broader discussion of the impacts, and for an extended discussion of policy options, see ILO, *The Social Impact of the Asian Financial Crisis*, 1998.

Malaysia is also facing a substantial increase in demand for tertiary education places as a result of the rising cost of overseas education due to a depreciated ringgit.

The measure of poverty has increased from 22.5 million (11 per cent of the total population) in 1996 to over 100 million in mid-1997, a figure likely to have been much increased by the impact of the crisis.

in 1996; the figure rose to 19,000 in 1997; in the period from January to April 1998, 26,500 workers lost their jobs (in a labour force of some 8.6 million). The jobless rate, according to Yap's paper, is not alarming and pre-existing skill shortages have allowed the market to reallocate some retrenched labour in enterprises facing labour shortages. Employment growth is projected to be about 1 per cent in 1998. Employment levels are expected to fall in all sectors except those involved in exports. Construction and tourism will face particular problems. Agriculture still exhibits labour shortages. As in Thailand, new entrants into the labour market face particular problems at present. Malaysia is also facing a substantial increase in demand for tertiary education places as a result of the rising cost of overseas education due to a depreciated ringgit. Rising inflation, as already noted, is likely to have an adverse impact on real wage and income levels. This should be seen, argues Yap, against the background of above-productivity-growth wage settlements in the period prior to the crisis.

In the Philippines, unemployment growth follows both the downturn of the economy and the adjustment polices enacted. In the former case, retrenchment follows reduced outputs; in the latter, structural adjustment to fundamentals such as the exchange rate has threatened previously viable enterprises.

In the year to end January 1998, employment grew by 1.3 per cent as the labour force grew by over 2 per cent (to 30.2 million). Over the same period, the unemployment rate grew from 7.7 per cent to 8.4 per cent. Official underemployment rates remained stable (21.1 per cent and 21.7 per cent). Employment growth was positive over this period in industry and services but was declining in agriculture.

In Indonesia, Ananta et al propose that the impact of the crisis on employment cannot be measured accurately. They suggest that mid-1988 unemployment may run at between 1.3 million (2 per cent) and 8.20 million (12.5 per cent), depending on the scenario constructed. However, they also suggest that a better measure of the impact of the crisis is the percentage of the population living below a poverty line. On this basis, the measure of poverty has increased from 22.5 million (11 per cent of the total population) in 1996 to over 100 million in mid-1997, a figure likely to have been much increased by the impact of the crisis.

In terms of the effects on employment, the impact gradient declines from Indonesia to the Philippines via Thailand and Malaysia, again reflecting the differential impact of the crisis on different economies. It is reasonable to argue that the wider social impacts of the crisis also broadly follow the same gradient.

The Indonesian case study also provides a helpful discussion of the crisis' impact on migrant labour.[6] Two important arguments stand out in this analysis. First, the attempt by unemployed and unskilled Indonesian labour to find work in neighbouring economies will not only cause economic and political difficulties for those economies but will also be complemented by further outflows from Indonesia of business people and skilled labour, both vital to any long-term recovery. The second issue, which is identified as the most pressing one arising from the crisis, is that of the security of Indonesian workers already overseas. Already subject to difficult and often discriminatory regimes in destination economies, these workers may well find their position made worse by the impact of the crisis.

6 This summary does not do justice to the detailed analysis of the issues provided in the case study, which warrants closer study in its complete form.

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Labour Market Responses

In Thailand, a range of responses to retrenchment and the wider social impacts of the crisis has been introduced. These include:

- repatriation of undocumented foreign labourers;
- the creation of a Centre for Assistance to Laid-off Workers (with ADB assistance to the tune of US$300 million);
- a proposed US$480 million programme in the areas of labour, health and education (targeted at the unemployed, especially in hard-hit regions) focusing on job-creation in infrastructure projects and tourism;
- a Regional Urban Development Fund and a Social Investment Fund (the former for regional infrastructure projects; the latter for local authority and community-based projects; together totalling US$185 million);
- counter measures against layoffs and unemployment, including short-run measures (for example, labour market information provision, cooperation with employers on the allocation of severance payments and matters, provision of training referrals, and work in the area of retraining) and long-term measures (including the development of private provision for training, focused training provision for industrial technicians —for which a demand exists—training for some service sectors, and rural job creation);
- other layoff measures (including measures to avoid layoffs: for example, changed working arrangements and early retirement; stakeholder involvement in management of changed working environments);
- mitigation of the effects of unemployment, including funding to allow people to move into new areas of economic endeavour, and the promotion of rural employment and of Thais working overseas, and support for employment creation in industry.

The goals of the Thai response package are:

- the generation of rural employment (some 320,000 jobs anticipated in the first nine months of the activity);
- the substitution of 300,000 foreign workers by Thai labour;
- the maintenance of at least 500,000 employed in industry;
- the export of 210,000 Thai workers;
- the implementation of His Majesty the King's model of balanced rural development (expected to create opportunities for 20,000 unemployed); and
- other measures to create a further 21,000 job opportunities for new entrants in the labour market and for the unemployed educated.

In all, the proposed measures are designed to create 1.137 million direct jobs and a further 900,000 indirect employment opportunities.

Amendments are also proposed to the framework of management and labour relations which, it is suggested, build on the developing perception of mutual interest between the parties as a result of the crisis.

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In Malaysia, measures have focused on employment creation and labour market improvements, which foster increased productivity, and sectoral and spatial mobility. Measures include:

- encouragement of export-sector investment to create employment opportunities;
- allowing government-sponsored students to remain overseas and seek employment there (a clear reversal of policy);
- sectoral monitoring and government-sector cooperation to identify employment possibilities;
- reviewing legislation in order to encourage more flexible employment practices (for example, in relation to part-time employment, flexible work, pay cuts and working time rearrangements);
- retraining retrenched workers via initiatives of the Human Resource Development Fund;
- continuing the expansion of skill-training establishments, including mechanisms for private sector access to public training establishments;
- creating a graduate entrepreneur scheme;

In the Philippines, a response emerged around the National Employment Conference in February 1998.

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- expanding the intakes of tertiary institutions, including the promotion of the establishment of private tertiary operations by overseas providers, and by large corporates; and
- longer-term assessments of the HRD implications of the crisis.

In the Philippines, a response emerged around the National Employment Conference in February 1998. Its task was to review and update the Comprehensive Employment Strategy Programme, particularly in relation to the short-term employment effects of the crisis. This was followed by a National Economic Summit, also in February, which focused on four areas of action:

- currency exchange and interest rates;
- fiscal discipline and savings;
- protecting jobs and enhancing productivity; and
- protecting the vulnerable groups.

In turn, the Department of Labour and Employment initiated a package of responses, including:

- *the job-watch programme*: this involves the monitoring of job loss and creation. The information is used in part to inform the second element of the package, that is;
- *the job-linking process*: this includes provision for training and retraining grants, support for displaced overseas workers, training opportunities for rural workers and other employment-related measures;
- *job loss prevention*: a proactive approach to the safeguarding of existing employment and the minimization of job losses by facilitating employer-employee dialogue. Also included are the Work Improvement in Small Enterprises (WISE) approach, designed to improve productivity and job conditions on simple and low-cost bases, and the Industrious, Systematic, Time-conscious, Innovative and Value for Work Productivity Awareness Programme (ISTIV), a total productivity improvement measure.

When compared, there is much in common that unites the responses of the economies to the labour market impacts of the crisis. Common themes are:

- the search for integrated strategies;
- information gathering and analysis in the labour market;[7]
- short-term relief measures to tide the retrenched workers over the immediate impact of job loss;
- support for retrenched workers in terms of retraining;
- cooperation between the stakeholders to create a shared perspective on appropriate labour market responses;
- a search for improved working arrangements, coupled with a focus on productivity improvement and flexible work practices; and
- particular support for the exporting sectors.

Equally, there are responses that are specific to one economy. The Thai response includes the explicit "U-turn" to the agricultural sector, on the face of it involving a reversal of post-war thinking about the direction in which labour moves in a modernizing economy. The Malaysian response includes the interesting ideas of exporting graduate skills (also found for non-graduates in the Thai model) and, as well, the expansion of tertiary options as a productive way forward to deal with reduced job opportunities.

A provisional conclusion to be drawn from this brief overview of labour market responses to the crisis is that, a priori, there is little in the various packages that might be seen to contradict the focus on export-led growth and competitiveness that has marked these

7 See also the Labour Market Information Group report to the Jakarta Experts' Meeting, April 1998.

economies in recent years. Rather, there seems to be a recognition that short-term adjustment measures should help to recreate the model of export success, which faltered in mid-1997. This recognition has particular significance for any APEC inputs into the short-term amelioration of the impact of the crisis.