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## Globalisation, Economic Crisis and Labour Market Policy: Lessons from East Asia

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# Globalisation, Economic Crisis and Labour Market Policy: Lessons from East Asia<sup>\*</sup>

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## INTRODUCTION

The need for market-oriented reforms was central to the 'Washington consensus' which emerged in the wake of disappointing development performance in Latin America and success of the export-oriented East Asian countries from the 1980s. This applied equally to labour markets as to international trade, and national product and capital markets, although labour markets were not central a central focus of the reform advocates.

More recently, however, labour market standards and regulation have been given more attention in the international and domestic policy discussions. Critics of market-oriented reforms have pointed to the backwash effects of globalisation, in particular the impact penetration of exports from low wage countries on employment and wages in developed countries. Attention has been drawn to the gap between regulated standards in First and Third World countries. Further, the deficiencies in social protection and safety nets for workers under conditions of economic instability in poor countries have been highlighted in the analysis of the impact of the East Asian economic crisis.

This paper surveys the main issues raised in these debates. We ask whether a new consensus is now emerging which gives much higher priority to the regulation of labour markets as a means of protecting workers both from exogenous shocks and the social costs of rapid economic growth. Alternatively, is the new 'neo-institutionalist' approach, that seeks to protect workers directly, often through application of international standards, misplaced? Is there evidence of a need for a paradigm shift, or merely a shift in emphasis, or does the data vindicate the Washington consensus in relation to labour markets after all?

The paper is divided into two major sections. The first deals with the globalisation and labour standards debate with special reference to developing East Asia and the second with the labour market impact and policy response to the East Asian crisis.<sup>1</sup> In the treatment of the globalisation debate, we also draw attention to both early and more recent discussions of labour market policies in LDCs. The second section examines labour market adjustment in selected countries during the crisis and both active and

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<sup>\*</sup> This is a revised version of a discussion paper presented at a Workshop on Trade and Labour Markets at the East-West Center, Honolulu, January 15-16 2001

<sup>1</sup> This survey does not attempt to cover the huge labour market transition issues in China and other former command economies in the region. The focus is on developing East Asia (including the now high income economies of Singapore and Hong Kong, as well as South Korea and Taiwan).

passive labour market programs as part of a broader ‘social safety net’ approach aimed at minimizing the social costs of the crisis.

## II. LABOUR STANDARDS, GLOBALISATION AND WORKER WELFARE: NEOCLASSICISTS VERSUS NEO-INSTITUTIONALISTS

As in other areas of policy, there have been major swings in ‘mainstream’ economic positions on labour market regulation and reform in developing countries over the past 30 years. Based on the experience of the 1960s and 1970s, the emphasis in policy reform was on deregulation of labour markets in the broader context of programs of structural adjustment and trade liberalisation. By the 1990s, however, international and national policy makers talked much more of labour ‘standards’ and ‘social safety nets’, as many began to question the benefits of globalisation. The seeming helplessness of workers faced with shrinking job opportunities in the wake of the East Asian financial crisis added to the new scepticism of market solutions.

Not surprisingly, many of the advocates of a more interventionist approach have paid scant attention to the earlier debates on the role of labour markets in economic performance, employment and welfare. I will first briefly review some of these arguments, given that many of them are as relevant now as they were 10-20 years ago.

### **Arguments in Favour of Deregulated Labour Markets**

Although there was relatively little evidence from micro studies, support for competitive and deregulated labour markets emerged with the growing ‘Washington’ consensus regarding the gains from export orientation and pro-market reforms from the early 1980s. For example, several prominent authors pointed to the potential gains from less intervention by governments in labour markets, especially in the context of on-going trade reforms in the early years of the decade.<sup>2</sup> They drew attention to the increasingly apparent success of the new industrialising economies (NIEs) of Asia, in particular. High levels of labour mobility, flexible wages and employment were viewed as major factors supporting rapid economic growth in the NIEs.

In contrast, ‘neo-institutionalists’ advocated an international agenda of promoting government and trade union intervention in labour markets through setting and raising standards, as a prerequisite to improving labour welfare (Piore, 1984; 1990; Golub, 1997). They questioned the negative impact of minimum labour standards on employment, pointed to gains in productivity from higher wages and better working conditions, and argued that an increased wage share in national income would stimulate aggregate demand. The International Labour Organisation (ILO) was at the forefront in promoting this approach. It is important to recognise, however, that the ILO relied on voluntary compliance to basic standards through ratification of basic conventions and

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<sup>2</sup> Squire (1981) Krueger (1981) and Fields (1985). It should be noted, however, that Squire in particular (1981: 128) pointed out that the removal of minimum wage distortions, alone, in the modern sector may have relatively little impact on employment and incomes in traditional sectors.

their supervision through tripartite channels (Leary, 1996). The organisation did not advocate trade sanctions for violations of standards although, implicitly, labour market institutions in developed countries, especially in Europe, were viewed as models for less developed countries.

What were the main areas of contention? Much of the criticism of labour market regulation dealt with the impact of minimum wages on employment, especially through Harris-Todaro processes leading to high urban unemployment in response to minimum wages and expected incomes (Todaro, 1976; Fields and Wan, 1989). Minimum wages were also questioned in relation to structural effects of higher than equilibrium wages on technology and labour demand (Sen, 1975; Krueger, 1981). However, there were two other main areas of concern. The first related to the impact of payroll taxes on employment and the second to job security regulations.

- Basic microeconomic theory tells us that payroll taxes raise the cost of labour and reduce employment, except under conditions of monopsony or when labour demand is inelastic. Following the European experience, these taxes became widespread in developing countries, and particularly in Latin America, especially given limited capacity for revenue generation from more conventional sources (Marquez, 1999).
- Several areas of job security and severance pay regulation limited employer discretion and hence increased labour costs (Fallon and Lucas, 1991). These included controls over the employment of casual workers and employees on short term contracts, restrictions to employers' discretion to dismiss workers and severance pay regulations which made separation costly.<sup>3</sup>

Minimum wages and both sets of regulations were considered particularly pernicious in developing countries with large, low productivity rural sectors, as in much of Asia. In dualistic labour market models, employment growth in the modern sector played a critical role in raising labour productivity and welfare. Since regulation and associated higher labour costs were largely limited to the modern sector in such economies, this meant a slower shift of workers into higher productivity sectors.<sup>4</sup>

The economic disruption and macroeconomic instability associated with populist labour regimes in Chile and Argentina convinced many policy makers that strong industry and national union movements could do major harm to development efforts through their impact on labour regulation and employment growth. This contrasted with the development success of the 'labour repression' models which featured limited labour market intervention in the NIEs in the 1960s and 1970s.

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<sup>3</sup> Workers on short term contracts were commonly denied benefits provided to regular workers in addition to lacking job security. Complicated and drawn out industrial relations or legal procedures frequently had to be followed in the case of dismissal of individual workers (or mass retrenchment) and severance pay was generally tied to years of service, thus discouraging labour turnover.

<sup>4</sup> In the open-economy model, these gains were especially compromised if the modern sector also tended to be relatively labour-intensive and export-oriented.

It is important to recognise that three fundamental judgements regarding the development process in East Asia underpinned these views:

- rapid employment generation in the modern sector was the fundamental mechanism for improvement of household welfare and poverty eradication in developing countries
- most workers in agriculture, small scale industry and the informal sector were excluded from labour protection legislation or labour union negotiated agreements
- implicitly, it was believed that improvements in the material conditions of the poor in less developed countries (LDCs) were of higher priority than affirmation of certain individual and collective rights such as trade union freedoms

A basic presumption, therefore, was that labour standards were **endogenous** to the development process (Maskus, 1999: 13). As living standards rose and a higher proportion of workers found wage jobs in the modern sector, there would be increasing demand for greater security of employment and remuneration, and preservation of certain basic standards, as social goods. Higher incomes meant, moreover, both individuals and society could pay for such benefits and, importantly, society was well placed to manage them in an equitable and efficient manner.<sup>5</sup>

### **Globalisation and the Labour Standards Debate**

By the 1990s there was increased interest in labour market regulation as a means of protecting workers from the harmful effects of structural change and unforeseen exogenous shocks. Paradoxically, this new attention to labour standards was bolstered by increasing fears regarding the impact of globalisation on wages, employment and labour standards of unskilled workers in **developed** rather than developing countries. Both organised labour and welfare groups in DCs began to blame unfair competition from abroad for increased NIE and other developing country import penetration into the USA and EU during the 1980s. In the East Asian context, Korea and Taiwan were an early focus of lobbying in the USA and Europe. Attention then turned to Indonesia with regard to GSP (Generalized System of Preference) special trade access and later to China, especially after the latter country emerged as a major player in labour-intensive manufacturing exports in the 1990s.

Low labour costs were viewed as one critical factor giving developing countries a competitive edge.<sup>6</sup> At the same time, increased mobility between DCs and LDCs and the IT revolution increased awareness of the gap in living standards and in labour rights between groups of countries. This led to more strident calls for action for recognition and implementaton of 'universal' standards. Non-government organisations in both

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<sup>5</sup> Limited administrative and legal capacity to implement legislation efficiently and equitably (especially when faced with public sector corruption) has been one of the main concerns regarding extension of labour protection arrangements, such as unemployment benefits and severance pay systems. Another has been a concern that systems involving significant public subsidies are not viable in during periods of frequent economic downturn.

<sup>6</sup> The other important factor was environmental conditions (Anderson, 1996).

developed and developing countries, and political alliances of NGOs, supported by first world unionists, accused LDCs of ‘social dumping’ and began to lobby for a ‘social clause’ in international trading agreements through the WTO.

Insertion of a social clause into international trading agreements was initially rejected at the Singapore Ministerial meeting of the WTO in December 1996, largely because it was opposed by many developing countries as a protectionist ploy in the DCs.<sup>7</sup> Nevertheless, the strength of opposition to perceived backwash effects of globalisation – in which unfair LDC labour standards were viewed as one component – became increasingly obvious when the 1999 Seattle WTO meeting ended prematurely under extreme pressure from populist lobby groups largely within the USA.

Thus, catchwords such as ‘a race to the bottom’ were coined in an endeavour to promote the notion that DC worker standards being eroded by the much worse labour conditions in LDCs. Increasingly pleas were being made for ‘harmonization of labour standards’ to fit in with the framework used in international trade agendas at the WTO and other international bodies (Lee, 1997).

What abuses of labour standards were regarded as particularly threatening to first world employment and wages and a transgression of fundamental human rights? As noted above, ‘core’ labour standards were of most concern to the ILO, US and European government agencies and NGOs. Two groups of these received most attention in the international media: the (exploitative) employment of child labour, and labour rights: freedom of association (the right to organise trade unions), collective bargaining and the right to strike. Employment of child labour became a key issue in international forums in the 1990s. The EU and US government funded action and research major programs through the ILO and other agencies, notwithstanding the small proportion of children engaged in export sectors and the relatively small contribution of child labour to total output.<sup>8</sup> Consumer action and NGO activists that focused on labour standards in multinational companies such as Nike and Reebok, especially focused on this issue.

What was the response of international and labour economists to these proposals? Several renowned economists rejected many of the arguments employed by opponents of globalisation, and especially the imposition of a social clause in WTO trade agreements, as illogical, impractical and self serving.<sup>9</sup> It was argued that domestic labour market conditions and productivity levels largely determined wages and labour standards in countries at very different stages of development.<sup>10</sup> Bhagwati (1995: 754) sums up the variety of objections to a single standards approach:

“Indeed, the reality is that diversity of labour practices and standards is widespread in practice and reflects, not necessarily venality and wickedness, but

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<sup>7</sup> The Singapore meeting affirmed the role of the ILO as the appropriate body for monitoring international labour standards, resulting in much needed moral and financial boost for the flagging organisation.

<sup>8</sup> The US Department of Labor estimated, for example, less than five per cent of working children in LDCs were engaged in export sectors.

<sup>9</sup> See especially Bhagwati (1994), Freeman (1995), Srinivasan (1995), Fields (1995) and Anderson (1996).

<sup>10</sup> Writing for a largely developed country audience Freeman (1995) asked provocatively in the title to a paper: “Are Your Wages Set in Beijing”?



rather diversity of cultural values, economic conditions and analytical beliefs and theories concerning the economic (and therefore moral) consequences of specific labour standards.”

Thus, it is the gap between unit labour costs (wages relative to productivity valued at international prices) not wages which determine the level of international competitiveness. Golub (1997: 12-14), finds for example, that because productivity levels are very low especially in labour-intensive industries in LDCs, the gap between DC and LDC unit labour cost was relatively small. In several East Asian cases (Malaysia and the Philippines) LDC unit labour costs exceeded those in USA in 1994 largely because of low productivity relative to wage costs in these countries. Social clauses in trade were viewed as potentially harmful to those most in need of jobs in competitive labour-intensive industries in East Asia where these jobs had been at the heart of welfare improvement and poverty decline.

It was also argued that standards tied to trade would lead to endless disputes and would be open to manipulation by interest groups in first world countries. The vested interests of companies and workers finding it difficult to compete in DCs were seen to lie behind many of apparent humanitarian concerns regarding third world standards.

Nevertheless, although there is no consensus, a number of concessions were made by mainstream economists in response to arguments for introduction of labour standards. Some agreed that a distinction should be made in national approaches to standards which reflected ‘fundamental’ human rights and those that were based on employment conditions (economic rights).<sup>11</sup> The former might at least include ‘core’ labour standards while among the latter hours of work and the level of wages were especially important.<sup>12</sup> A consensus did emerge, however, that the WTO was not an appropriate body for implementation of standards, although this notion is still fiercely resisted by some sections of the NGO community. The ILO was viewed as the proper international body to monitor and advise on standards and their implementation. In addition, however, there has been a growing awareness that voluntary regulation through consumer action and ‘product labeling’ are more effective forms of action and, as with eco-labeling, have proved effective for a number of specific industries.<sup>13</sup>

Critics of the ‘export-oriented’ model of development such as Rodrik (1996), on the other hand, advocated a more targeted approach on the behalf of governments. He suggested

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<sup>11</sup> There are basic difficulties in defining fundamental human rights: even for child labour. For example, distinctions have been made between governments and individuals on what is an appropriate age to work and what might constitute ‘exploitative’ conditions of work (as reflected in the ILO convention on child labour). Similarly, perceptions of what constitutes discrimination varies enormously between societies (Srinivasan, 1996 cited in Maskus, 1998).

<sup>12</sup> Surprisingly, health and safety have not been a key issue on the policy agenda of the those urging tougher action on LDC labour standards, given that basic regulation in these fields is relatively simple (and supported by substantial ILO research and training) and likely to have only a minor impact on wage costs.

<sup>13</sup> One innovative suggestion is the ‘ratchetting labour standards’. In this case, best practice standards are identified in national contexts and are promoted widely by trade unions, NGOs and other bodies to support improvements in lagging firms and industries (Sabel, O’Rourke and Fong, 2000)

the imposition of “social safeguard tariffs” against practices which could be shown to be morally unacceptable to a majority of citizens in importing countries.

### **Mainstream Reassessment of the Effects of Labour Regulation**

At the same time as vigorous debate flourished over labour standards and trade, there was also a softening of attitudes within the economics profession regarding the hitherto widely accepted standpoint that enforced labour standards were harmful to employment and labour welfare in LDCs. Several factors were important in moderating the opposition to labour market regulation in developing countries.

- One of the fundamental propositions of neoclassical economic analysis, the assumption that minimum wages contributed to unemployment, was challenged by research on the impact of minimum wages in the USA and Great Britain (Card and Krueger, 1995). While these results could not be expected to be generalised to very different labour market conditions in developing countries, they did suggest that there was much more to the subject than mere quantity adjustments based on demand and supply elasticities.
- Second, research suggested no clear link between labour market regulation and economic performance at a national level. Influential labour economist Richard Freeman in research for the World Bank, found “surprisingly” that there appeared to be little support for the view that labour market regulation inhibited macroeconomic performance (Freeman, 1993:139-40). Freeman’s findings suggested several possibilities, in addition to the standard explanation of low supply and demand elasticities. Either the regulations were not binding or, alternatively, levels of compliance were too low.

Subsequent research suggested that both the level of minimum wages were set too far below average wages and compliance levels were also low. In a review of the literature, Squire and Suthiwart-Narueput, (1997) found that minimum wages were set so low in some developing countries (especially those experiencing high rates of inflation) that they were not binding for most modern sector firms. Where they were binding, usually in smaller establishments, compliance was typically low and compliance costs high.<sup>14</sup> In addition, rigid LDC labour markets did not appear to contribute to substantial rises in unemployment during crises: the main adjustment was in wages, especially in high inflation environments, as labour market regulations turned out to be ‘paper tigers’ when put to the test (Freeman, 1993:140).

Similarly, Maskus (1999:39) reporting on research conducted by Rama (1995?), concludes that “much ambiguity exists” in the econometric linkages between

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<sup>14</sup> Squire and Suthiwart-Narueput (1997: 140) report on studies showing that non-compliance was on average much higher among small firms than in larger scale enterprises. For example, in Mexico the proportion of small compared with larger firms which paid average wages well below the minimum was 24% as against 6% and Columbia 71% versus 27%. In addition, enforcement mechanisms tended to be weak and sanctions relatively light. See also Nayyar (1995) for East Asian experience and Manning (1998: Chapter 8) for a discussion of these issues in the Indonesian case.

ratification of ILO conventions and indices of labour market rigidity, on the one hand, and economic performance on the other. Further, he cites Rama's conclusions that that ".inefficient government employment and high unionization rates were the most likely explanations of poor performance.." especially under conditions of limited product market competition. As with Freeman's research, the study did not vindicate the views of either the labour market 'neoclassical' or 'neo-institutionalists' who supported greater intervention in labour markets.<sup>15</sup>

A major World Bank study of labour markets in both highly regulated and less regulated labour markets during structural adjustment episodes in Latin America, Africa and Asia provided some support for these findings. The studies suggested that real wages were flexible in both more and less regulated markets (Horton, Kanbur and Mazumdar, 1994). Although several regulations (such as wage indexation and job security legislation) limited both price and quantity response in some Latin American countries, the main difference in labour market response between the two groups of countries related more to macroeconomic policies. In particular, the management of the real exchange rate and associated trends in unit labour costs were more fundamental to labour market adjustment than the presence or absence of labour market regulation in the modern sector.<sup>16</sup>

- Third, it was generally agreed that the elasticity of labour demand was low in regulated economic environments and where other markets were constrained. Labour market reform was likely to convey few gains to workers under such conditions. Like liberalisation of capital markets, there is a logic in a definite sequencing of reforms: first product market and then labour market reforms.

Thus, the main findings of the research on trade liberalisation and structural adjustment episodes in the 1970s and was that product market distortions were the main obstacles to employment and wage growth (Krueger, 1981; Horton, Kanbur and Mazumdar, 1994). Others have argued that workers and employers were prepared to collude in dividing rents under monopolistic or less than perfectly competitive product market conditions: employment was constrained but wages were relatively high in protected sectors (Rama and Tabellini, 1998)? While this applied mainly to Latin America and the former socialist countries, it was also significant in countries like Indonesia where vested interests played a major role in protected segments of manufacturing and services (Manning, 1998). Similarly, reform of non-competitive public enterprises where employees are guaranteed job security and often above market clearing wages, is important for promoting productivity and more efficient labour markets, as well as for a more competitive economy in general.

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<sup>15</sup> Similarly, Rodrik (1996) found little evidence for a relationship between labour standards and international trade or investment flows.

<sup>16</sup> Mazumdar (1993) showed this most clearly in his study of Malaysian and South Korean labour market response to endogenous and exogenous shocks in both countries in the 1980s. Unemployment rates rose in both countries although much less than in several Latin American countries undergoing structural adjustment. Price and wage adjustment as a result of substantial devaluations ensured that output and employment recovered quickly in both countries.

In sum, although labour market regulation was still regarded with suspicion in policy circles, by the late 1990s more economists were less concerned about their impact on employment and welfare than had been the case in the past. Social protection and so called 'safety nets' were viewed as providing greater protection at least for workers in the modern sector. It was argued that their distortionary effects were limited for a variety of reasons: regulations were not binding; inadequate coverage, poor supervision and inadequate sanctions; distortions in other markets were still widespread; and macroeconomic policy, rather than regulation, was the major constraint to output and employment growth during structural adjustment.

### III. THE EAST ASIAN CRISIS AND SOCIAL SAFETY NETS FOR LABOUR

Anticipated social costs of the East Asian financial and economic crisis in 1997 contributed to a further questioning of too heavy reliance on globalisation and export-orientated growth for the welfare of workers and their families, and for poverty reduction.

Why was the response to the East Asian crisis important in the context of the labour market regulation debate? For several decades the region had been held up by the World Bank and many international economists as a model to the developing world. Market-oriented reform combined with conservative, pro-export macroeconomic policy were the hallmarks of economic success. Although mainstream economists did not view their role as central to development performance, especially in light of the above-mentioned research, labour market flexibility was regarded as one key element supporting rapid economic growth and structural adjustment (World Bank, 1993: 258-73).

This situation contrasted with several countries in Latin America where a range of labour regulations and strong labour unions contributed to slow labour market adjustment following economic shocks and subsequent macroeconomic reform. Even though there was often low compliance and minimum wages were not always binding in Latin American countries, regulations which limited employment flexibility and discouraged employment, coupled with active unions, contrasted with much of East Asia. Edwards and Lustig (1997: 2) in lamenting extensive labour market regulation in Latin America pointed out that : “..East Asian economic success largely resulted from a significant degree of labor market flexibility that has allowed small and medium-sized firms to adapt rapidly to new market conditions, remain competitive internationally and take advantage of technological advances.”<sup>17</sup>

In East Asia, not only was economic growth rapid but most indicators of labour market performance were positive. Real wages had begun to rise rapidly in most countries in the region by the early 1990s, unemployment rates were low and poverty decline had been dramatic throughout the region (Atinc and Walton; 1998; Manning, 1999;). But, as critics of the flexible labour market environment had pointed out, there were few institutional safeguards in place to soften the impact of the large decline in labour demand which occurred in several countries in the region in 1997-98. Only South Korea

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<sup>17</sup> See also Krueger (1981), Mazumdar (1993), World Bank (1993 and 1995), and Fields (1994) for similar viewpoints.

had any sort of national unemployment (employment) insurance scheme and this was relatively new and hence coverage and funds were limited (Lee, 1998; OECD, 1999; World Bank, 2000a). In other countries severance pay systems and social security extended only to the modern sector. Although vocational training programs and labour market information programs were of some importance in all countries severely affected by the crisis (Korea, Malaysia, Thailand and Indonesia), they were not designed to cope with large numbers of displaced workers.

Similarly work fare programs had been important in the region, but had either been phased out or were now intended to serve purposes other than providing a cushion against macroeconomic shocks: seasonal fluctuations in labour demand, development of rural and urban infrastructure and poverty alleviation.<sup>18</sup> In short, the challenge was how would labour markets mechanisms and institutions which had served the countries well during the long period of expansion deal with an unprecedented fall in output, investment and associated labour demand.

Early signs were not encouraging. There were reports of large scale layoffs in 1997 and early 1998 and within a year unemployment rates had doubled in Thailand and Hong Kong China and tripled to a record 8 per cent in Korea (Lee, 1998: 40). In Indonesia it was projected by government and international agencies that unemployment might rise more than double in the first full year of the crisis (1998), and rise even higher in the following year (ILO, 1998).

There was a sense of impending disaster that permeated the international community during the first years of the East Asian crisis. International and national agencies in turn responded with a wide variety of support programs. 'Social Safety Nets' rarely referred to in the context of East Asian development became a new catchword in the lexicon of development. Devising social protection programs, including those that protect labour, began to play a more prominent role in World Bank operations and research of international agencies such as the World Bank and the Asian Development Bank. Welfare agencies like the ILO and UNICEF received a new lease of life. The new ADB policy agenda was adjusted to include poverty reduction as a major goal of lending projects.

Fiscal stringency and a tight monetary policy first advocated by the IMF gave way to a recognition of the need for fiscal stimulus. All countries worst hit by the crisis had revised their budgets to allow for a significant deficit in GDP for the first time in a decade (Lee, 1998: 53).<sup>19</sup> In both Thailand and Korea social expenditures accounted for a significant proportion of the deficit financing.<sup>20</sup> Much of this new spending was allocated directly to households through support for spending on health and education.

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<sup>18</sup> For example, Indonesia's *padat karya* program which had been an important component of rural public works spending for the poor in crisis years several decades earlier was discontinued in 1994, partly because it was judged no longer appropriate in the rapidly urbanizing economy.

<sup>19</sup> Increased public spending was supported by substantial foreign support, especially from the Japanese government under the Miyazawa initiative announced in the second half of 1998.

<sup>20</sup> Planned social spending also rose significantly in Indonesia although implementation was hampered by political instability and administrative inertia.

Direct support for labour market programs was greatest in Korea, followed by Thailand and Indonesia among the three worst affected economies.<sup>21</sup>

In Korea, the list of programs was impressive. In addition to substantial expansion of the Employment Insurance Program (in terms of both duration and extent of coverage), they included: vocational training, job placement and information, job protection, and public works programs. Overall programs to assist displaced workers accounted for two per cent of GDP, a far higher share had been allocated to such programs than ever before (OECD, 1999: 139). Similar programs on a more limited scale were introduced in Thailand: supplementary support for existing job creation programs, rural industrial employment (including extension of the social security coverage from 6-12 months for unemployed workers) and increased spending on infrastructure projects including the training of some 100,000 workers.

How did labour markets adjust to the crises and support programs to assist displaced workers and the unemployed? Three conclusions emerge from more recent studies of the crisis economies: labour markets were highly flexible, active employment programs had a limited impact and passive labour market policies had even less labour market impact, especially in poorer countries in the region.<sup>22</sup> I deal with each of these briefly.

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<sup>21</sup> Indonesia differed from the other crisis countries in the high rates of inflation fueled by expansionary monetary policy and a massive depreciation of the currency fueled by political instability Johnson (1998).

<sup>22</sup> This section focuses on labour market issues on Korea, Thailand and Indonesia. For further discussion, see especially OECD (1999), Kim, Dae-Il (1999), Kim, Dong-Heon (1999), World Bank (2000) and Manning (2000b).

## Flexible Labour Markets.

Although there were significant differences between countries, labour markets were remarkably flexible in adjusting to the crisis. Several important developments can be noted<sup>23</sup>:

- Unemployment rates increased relatively little (as in case of Thailand and Indonesia) or rose and then fell quite quickly (as in Korea) (Table 1).
- Although employment fell in most industries in the first year of the crisis, it began to expand quite quickly in tradable goods industries, which were now much more profitable as a result of exchange rate adjustments (Table 2). This adjustment was much more rapid than experienced in Latin American labour markets during periods of structural adjustment in the 1980s and attests to the benefits of much deeper market oriented reforms than in the crisis economies.<sup>24</sup> The adjustment should be seen against a backdrop of declining tradable goods employment in Korea and Thailand in the decade before the crisis, and only a modest expansion in Indonesia.
- With regard to specific sectors, manufacturing employment had returned to close to pre-crisis levels in all countries by 1999, only 1-2 years after the crisis. Surprisingly, employment in the tradable agricultural sector, which had contracted in all countries during the boom years of the early 1990s, actually expanded quite rapidly in the first year of the crisis in Indonesia and fell much less than it had in the previous six years in Thailand. Seemingly unlike several Latin American countries, agriculture provided a temporary refuge for workers displaced from the modern sector. So did small scale industry which expanded in export-oriented industries such as furniture, and in import substitution industries such as food processing (Sandee, Andadari and Sri Sulandri, 2000).
- Wage adjustments were substantial (Table 3). Real wages fell from the onset of the crisis in all countries. However as labour demand picked up in export-oriented industries, they stabilised quite quickly (by the first quarter of 1998 in Thailand and Korea) although they continued to fall through 1998 as inflation gathered pace during the political crisis in Indonesia. By early 1999, wage recovery had already begun in Korea and by the end of 1999, average real wages had already recovered to levels above pre-crisis levels. A recovery was also visible in the other two countries in 1999, although real wages (after adjusting for inflation) still remained below pre-crisis levels, especially in Indonesia.
- How did these trends in real wages affect unit labour costs? As might be anticipated from substantial depreciations in the exchange rate, they declined in all countries over the crisis period 1996-99, thus contributing to an increase in international competitiveness, in contrast to rising unit labour costs in the pre-crisis period (Table 4).

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<sup>23</sup> Much of the discussion in this section is based on an empirical analysis of adjustment processes in Korea, Thailand and Indonesia presented in Manning (2000a).

<sup>24</sup> Compare, for example, with case of Mexico (Lustig, 1998: 70) in the period 1983-88, or Argentina and Brazil during the 1980s (Horton, Kanbur and Mazumdar, 1994).

Nevertheless, there were important differences between countries in the response to the crisis. In the more developed economy of Korea, modern sector retrenchments were quickly reflected in high rates of unemployment. In contrast, in the less advanced economies (for example, Thailand and Indonesia), many of the displaced workers sought employment in the informal sector where work sharing arrangements were common. Despite the crisis, many producers were able to adapt production and take on workers in new activities, shifting away from less profitable non-tradable goods, or from tradables that were overly dependent on imports.<sup>25</sup>

In sum, labour market flexibility acted as an important source of social protection, partly in the absence of other formal sector forms of support in all countries, and especially in Thailand and Indonesia. Nevertheless, it was also clear that many workers suffered loss of jobs and income during the crisis, and this raised the more fundamental question regarding the adequacy of social safety nets for workers as a more permanent form of protection in East Asia. Before dealing with this issue, however, I turn first to labour market programs adopted during the crisis.

### **Active Labour Market Programs for Employment Generation.**

In general, ALMPs can be divided into three groups: those aimed at improving the quality of labour supply, those aimed at raising labour demand and targeted especially to the unemployed (including displaced workers) and those aimed at improving the matching of employees and jobs. From the outset it is important to note that ALMPs have never been large in most East Asian crisis economies. This can be attributed to the rapid expansion of employment, and low rates of unemployment, associated with sustained rapid economic growth and effective macroeconomic management and stabilisation programs in times of crisis.

As noted, this lack of interest in ALMPs changed dramatically with the economic crisis. Although there are have been few systematic evaluations of programs in the region, evidence to date suggests several preliminary conclusions. First, the effects were quite small in the poorer countries in the region. For example, Lee (1998: 55) estimated that less than 10% of all unemployed or displaced workers in Thailand and Indonesia could expect to benefit from programs offering direct labour market support. For example, less than half a million unemployed and displaced workers were affected directly by direct spending on government programs in Indonesia in a year when some 7-8 million people shifted back into agriculture as a result of the economic crisis. However, the figure was much higher in Korea where expanded government programs were estimated to have benefited well over half of the unemployed, although there were major questions regarding the sustainability of these programs.<sup>26</sup>

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<sup>25</sup> For example, small scale manufacturing flourished in several industries in Indonesia, including furniture and garments in key produced locations on Java (Manning, 2000b).

<sup>26</sup> Relatively expensive vocational training programs were extended to cover an estimated 25 per cent of all unemployed in Korea and some 1.3 million unemployed received some form of assistance out of a total of approximately 1.5 million unemployed in that year.



Turning to specific types of program, *on the labour supply* side increased unemployed meant greater pressure for expansion of vocational training.<sup>27</sup> In Korea, for example, vocational training programs expanded dramatically as a result of the crisis, and both Thailand and Indonesia special short-term programs (approximately three months) were set up to help the unemployed.<sup>28</sup> Programs allowed for greater private sector participation and developed innovative approaches for the region, such as linking activities to the employment insurance program and providing vouchers in Korea. In Indonesia they involved NGOs in management of the scheme and gave some emphasis to training for self employment.

Nevertheless, the programs suffered from a number of problems. Perhaps the most important were the old problem of matching the skill focus of the training programs with job opportunities (especially since many graduates sought work in the depressed modern sector). Training programs were also poorly coordinated in several countries.<sup>29</sup>

On the *labour demand side*, public works programs were expanded quite dramatically and provided a fiscal stimulus to both urban and rural areas. However, Betcherman et al. note (p. 28) that problems arose with targeting because wages were set too high.<sup>30</sup> Under considerable political pressure, government officers rushed in new programs which were often poorly designed and implemented, or had indeed been considered of low priority in the pre-crisis period. Wage subsidies, on the other hand, seem to have worked better, although they were limited to Malaysia and Korea. In Malaysia, moral suasion on the part of the government combined with wage subsidies is reported to have contributed to fewer layoffs. In Korea one establishment study suggested that around 20 per cent more workers remained in jobs as a result of wage subsidies given to firms that kept employees on their payroll, although not necessarily in active employment.

In the informal sector, micro credit programs were also expanded. In Malaysia, a program was adopted to help some 12,000 traders and small businesses whereas in Indonesia there was a proliferation of programs of support for cooperatives, many of them administered through NGOs. The focus of the latter programs were tainted, however, as largely politically motivated, and although creating spending power in rural areas, probably did little to foster enterprise development.

Finally, with respect to improvement of *job search activities*, linking job seekers with employers, were also expanded in most of the crisis countries. Public employment

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<sup>27</sup> This section draws heavily on Betcherman, Das, Luinstra and Ogawa (2000) who in turn have summarised the findings of papers given on labour market adjustment in the crisis economies (Indonesia, Thailand, Malaysia and Korea) at a workshop hosted by the Japanese Labour Institute in Tokyo in October 1999.

<sup>28</sup> In the Indonesian case, the program (P3T) was limited to 'educated' manpower with at least an upper secondary education.

<sup>29</sup> Betcherman et al. (p.26) mention one extreme example of 19 different Indonesian government departments involved in 815 different vocational training programs! Needless to say government officials were eager to be involved in new projects owing to the proliferation of 'crisis related' activities.

<sup>30</sup> For example, in the case of Indonesia, where minimum wages levels differed substantially across regions, early programs in 1998 set wages at the highest level paid in Jakarta (Rp. 7500) even in regions such as Central Java where official minimum wages were around 30% lower.

services existed prior to the crisis in all countries, although the large number of government centres was still small in relation to the total work force. Since these services were generally not linked to unemployment insurance (except in Korea), the incentive for companies to register vacancies and for job seekers to use the public employment services has always been limited. In the case of Korea, the fact that unemployed needed to register with the exchanges in order to obtain benefits meant that companies could draw on a larger pool of job seekers and hence had more incentive to register job vacancies.

Nevertheless, new information technology and private sector involvement has probably helped improve the efficiency of employment services, although skill deficiencies in operating new systems was a constraint (Betcherman et al., p. 25).

What was the likely overall impact of the new active labour market programs? As noted, their aggregate labour market impact was relatively small. In addition, many suffered from similar problems noted in a recent survey of ALMPs in Europe: design was critical to success and modest, carefully targeted programs with clear objectives worked best (Dar and Zsannatos, 1999). On all these counts, the hastily devised programs in East Asia scored badly. This is not necessarily an indictment of the programs per se, as to the specific form they took, often because of lack of care in program formulation.

As in the OECD, youth training schemes were probably least cost effective. But in contrast to the experience in the OECD, wage subsidies were more successful in the crisis countries where government administration was relatively efficient (and clean), owing to the strong influence of the government in offering both incentives for compliance and threatening sanctions on those firms unwilling to participate.

#### **‘Passive’ Labour Market Programs .**

In Indonesia, Thailand and Malaysia, two major schemes for worker social security were already in place when the crisis broke: (i) provident funds covering pensions, disability and worker health, and (ii) severance payments related to years of service with the firm.<sup>31</sup> Provident funds require both employer and employee contributions in relatively equal amounts, normally to be withdrawn as a lump sum at retirement age of 55 (see Cox-Edwards and Manning, 2000; 12).<sup>32</sup> As noted, Korea, on the other hand, combined similar but much wider social security coverage with an (un)employment insurance system funded by the government, employees and employers. All the crisis countries except Malaysia had a regulated system of minimum wages set by the government, which varied by region in Indonesia and Thailand.

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<sup>31</sup> Severance pay was set according to years of service. However, even though there were some restrictions over dismissals in Indonesia, job security has not been a major issue in the region, in contrast to India and Latin American countries.

<sup>32</sup> Coverage extended to an approximate 15% of the employed population in Indonesia and Thailand and a much higher 48% in the case of Malaysia (Lee, 1998: 52). While contributions were mandated for all firms with 10 or more employees in Thailand and Indonesia, in practice payments coverage was heavily biased in favor of larger establishments with 100 employees or more.

Although information is fragmentary, it is possible to draw attention to several effects of the crisis. Except in Korea, formal mechanisms of support such as minimum wages and severance pay played a minor role, even among wage workers, in supporting labour standards in the poorer crisis economies. Official minimum wages played virtually no role in stemming the substantial decline in average real wages in any of the crisis countries. The level at which wages were set were not binding employers in the modern sector who were worst hit by the crisis (especially in the case of Korea) or enforcement mechanisms were weak or officials turned a blind eye to an emerging gap between official minimum and actual wages.

In the case severance pay, studies have found that few displaced workers gained any severance pay especially in the frequent case of bankruptcy, and most of those that did were in larger and often foreign establishments in Indonesia and Thailand, (SMERU, 2000; World Bank, 2000a).<sup>33</sup> The experience of the crisis suggests that prevailing systems in these countries based on years of service and financed by employers may not be the best systems, both at times of sharp falls in labour demand or in more normal periods.

Severance payments defined as multiple of prevailing salaries at the moment of separation, as in much of East Asia, are not defined contribution programs.<sup>34</sup> Workers in the same job have to be compensated differently because of different tenures. As a result, management conflicts arise which adversely affect the working environment. New systems can be designed whereby all workers (through their employers) are required to establish a 'job termination account' which are accessible at the time of dismissal, or even voluntary separation. Problems arising from different payments according to seniority can thus be avoided if severance payments are defined by law in terms of explicit contributions towards such a fund. In effect, severance payments become a forced savings program. The exact amount at the disposal of each individual worker in case of employment termination (quits or dismissals) will be directly determined by the funds accumulated in his/her account.

Protection mechanisms through the employment insurance scheme only worked slightly better in Korea than severance pay systems in other countries, although they were more closely linked to training programs and job search activities than many traditional unemployment insurance programs. Three problems in particular are worth mentioning. First, a high proportion of the unemployed could not gain access to several programs, including and many wage workers who did not qualify for coverage.<sup>35</sup> Further, coverage is expected to expand slowly. The Korean Labor Institute has projected that a significant

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<sup>33</sup> A World Bank (2000a: 41) assessment of the social impact in Thailand found that over 90 per cent of employees in establishments with 1-9 workers, and over 70 percent in firms with 10-99 workers, received no severance pay during the first year of the crisis, in contrast to slightly over half of all employees in larger establishments.

<sup>34</sup> For a fuller exposition see Cox-Edwards and Manning (1999).

<sup>35</sup> The ratio of benefit recipients to the total number of unemployed was only 13 per cent in June 1999 (Kim, Dong-Heon, 1999: 34-35). Workers in small and self-employed enterprises, were particularly badly affected since they did not qualify for unemployment benefits but at the same time were not poor enough to be eligible for livelihood support programs.

share of workers (nearly 10 million) would be eligible to receive unemployment insurance only by the year 2002.

A second problem was the escalating cost of the programs. EIS contributions on the part of employers doubled in 1998-99 from one to two per cent of the payroll (including employment fund contributions, vocational training levies and payments to job security and wage claims programs).<sup>36</sup> Third, implementation of many programs depended in part on cooperation between employers and employees. In Korea as in other countries, there was a major attempt to set up structures to encourage social dialogue on a tripartite basis (involving the government, labour organisations and employers) but the institutional basis for such cooperation was weak after long periods of control of the labour movement.

In sum, while labour market programs, both active and passive, appear to have played some part as social safety nets during the East Asian economic crisis, it would seem that the flexibility of labour markets (and associated commodity markets) played the major role in helping economies get back on their feet. Labour markets adjustment to changes in relative prices and incentives were supported by social sector spending in health and education in critical in supporting adjustments among the poor (World Bank, 2000b).

#### IV. CONCLUSIONS

Returning to the questions posed at the beginning of the paper, we conclude that there are no grounds for a paradigm shift regarding the role of labour standards and social safety nets pertaining to labour, either as instruments of social policy or as an effective mechanism to redress 'unfair' competition in the world trading system. Beyond several cases, relatively unimportant in the overall context of the world trade, labour costs have not been depressed by the absence of 'internationally acceptable' labour standards. Rather they are low because of low productivity associated with underdevelopment. Insofar as labour standards have improved, the process has been endogenous to the development process in countries like Korea that are in the process of a development transition. Improved standards in the initially small modern sector spread more widely as low productivity pockets of the economy disappeared. At the same time demands for greater security, sometimes at the expense of income, coupled with the disappearance of traditional coping mechanisms, assumed a greater role in social preferences.

The experience of the Asian economic crisis does not lead to a reassessment of this position regarding labour standards in poorer countries. I have argued that the presence, or absence, of passive labour standards such as minimum wages or job security legislation (including severance pay regulations) had only a minor bearing on labour market outcomes: both from efficiency and welfare perspectives. Similarly, active labour market programs can be important in softening the impact of economic crisis but they need to be carefully designed and targeted. Traditional mechanisms of adjustment

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<sup>36</sup> It is projected that contributions by both employers and employees, or government subsidies, would have to increase significantly if the benefit schemes were to remain financially viable in the future.

through access to jobs in the informal sector and agriculture, work sharing and multiple jobs were the critical factors in enabling workers and their families to adjust to the crisis.

In upper middle income countries such as Korea, unemployment insurance did play an important role in cushioning the social effects of the crisis. But the fundamental lesson from labour market experience during the crisis throughout the region was that flexible product markets and prices, complemented by accommodating labour markets, were critical for recovery in employment and wages. The East Asian economies had already made substantial progress towards greater international openness and flexible prices when they faced an international crisis in 1997, in contrast to their Latin American counterparts that had experienced similar crises almost two decades earlier. In Latin America, failure to reform was **part of** the crises of the 1980s, and labour market regulation became increasingly a central part of the problem once trade and other market reforms had been initiated (Edwards and Lustig, 1997).

This in no way suggests that it is sufficient to rely entirely on competitive product, capital and labour markets for protecting labour welfare. There has been a necessary correction of the earlier rather simplistic characterisation of labour market regulations as distortionary under most conditions. Thus, one can draw several lessons from national and international experience with regulated labour standards. First, to be effective, for the most part they need to be part of the national political and social agenda and not imposed on the basis of externally imposed international standards. Second, insofar as international action with respect to labour standards is relevant, it should focus on several core standards related to rights rather than conditions of employment. Third, international action with regard to core labour standards should be channeled through expert organisations such as the ILO which focus on voluntary participation backed by moral suasion and technical support, or through consumer and related organisations acting in a private capacity.

Devising both active and passive labour standards and safety nets that are consistent with employment expansion in the modern sector is one important priority in contexts where the transfer of labour from low productivity, traditional sectors is the major challenge for poverty alleviation. LDCs are fortunate in being able to draw on the experience of DCs in labour protection, especially in the areas of unemployment insurance, job security and vocational training.<sup>37</sup>

In the discussion of social safety nets, we have drawn attention to two kinds of policies. Active labour market programs are for the most part poverty-targeted, emergency, programs. They are not necessarily focussed on the unemployed, since unemployment is not the most important characteristic of the poor even during a crisis, these programs are considered effective mechanisms to reach out households severely affected by income loss. In general, flexible approaches and a large degree of local autonomy in the disbursement of funds characterise effective poverty targeting and/or emergency employment programs.

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<sup>37</sup> See Cox-Edwards and Manning (2000) for a discussion of some of these issues in the context of the East Asian crisis.

The second set of policies, passive labour market programs, includes all permanent-type labor market interventions focussed on dismissals and/or the unemployed. Labor market interventions can address the risk of income loss associated to formal employment not only in a recession but also during the normal operation of a growing economy. For instance, in most developing countries, including the countries discussed in the context of the East Asian economic crisis, there is legislation in place that regulates severance payments in case of dismissal or layoffs.

How can these programs be reformed as a permanent feature of the social security network to deal more adequately with periodic economic downturns? It can be argued that it is important to build on existing laws and institutions than devise completely new one. For example, given the long tradition of severance payments, it makes political sense to try to improve upon the existing systems rather than to add an unemployment insurance program, at least until countries reach a relatively advanced standard of living such as in Korea. But given the failure of the severance payment systems for many workers during the crisis, there are strong arguments for reforming these systems in the direction of individual accounts to which employers and employees contribute.

Implicit in the discussion in this paper has been the assumption that systems cannot be willy-nilly transferred across national boundaries without taking into account stage of development, pre-existing labour market structures and institutions, and the socio-political environment. I have also assumed that one must take into account dualism as a fundamental feature of labour markets in most LDCs. While it is accepted that implementation of labour policies in the modern sector will be constrained by levels of productivity and earnings in traditional sectors, the application of different standards will, and should, apply to the modern sector where productivity is often much higher. As Sen (2000: 120) notes, there is no need to “level down” conditions of workers in the modern sector to meet those of less fortunate workers in the informal sector and agriculture. A fundamental rule of thumb should be, however, that these standards are not in conflict with productivity or employment growth in the modern sector.

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TABLE 1: LABOUR FORCE PARTICIPATION AND  
UNEMPLOYMENT RATES, KOREA, THAILAND AND INDONESIA,  
1996-1999 (%)

	1996	1997	1998	1999
<b>Korea</b>				
Labour force participation <sup>1</sup>	62.0	62.2	60.7	60.5
Unemployment rate	2.0	2.6	7.3	6.7
<b>Thailand</b>				
Labour force participation <sup>1</sup>	69.3	69.2	68.1	67.8
Unemployment rate	1.6	1.6	4.3	4.4
<b>Indonesia</b>				
Labour force participation <sup>1</sup>	66.9	66.3	67.0	67.2
Unemployment rate	4.9	4.7	5.5	6.4

**Note:** Korea: average of four quarters; Thailand average for February(slack) and August (busy) seasons. Indonesia annual survey (August).

1 Labour force participation rates

Sources: ILO Yearbook of Labour Statistics, various years; Thailand NSO, National Labour Force Survey, August and February Round ; Indonesia: CBS, National Labour Force Survey, 1996-1999. Korea, Korea Labour Institute, Quarterly Labour Review, various numbers.

TABLE 2: EMPLOYMENT DYNAMICS IN TRADABLE AND NON-TRADABLE INDUSTRIES, KOREA , THAILAND AND INDONESIA, 1990-1999

	Share 1996 (%)	Growth (% p.a.)		<i>Index (1996=100)</i>			
		1990-96	1996-99	1996	1997	1998	1999
<b>Korea</b>							
Tradables	45	-2.3	-5.8	100	96	89	90
Non Tradables	55	5.3	-0.2	100	104	100	102
<b>Thailand</b>							
Tradables	74	-1.8	-0.2	100	101	99	99
Non Tradables	26	6.5	-1.2	100	99	95	96
<b>Indonesia</b>							
Tradables	66	-0.5	2.1	100	97	105	106
Non Tradables	100	6.1	1.8	100	107	104	106

Notes: Growth rate for Indonesia 1990-1996 includes East Timor, Ages 10 and above; All other data excludes East Timor, ages 15 and above. Growth rate for Thailand 1990-1996 for August round of the Labour Force Survey, all other data average of August and February rounds. Korea data annual average. In each country, tradable goods include agriculture, mining and manufacturing and non-tradables all other sectors.

Sources: See Table 1.

TABLE 3: GROWTH OF AVERAGE *REAL* WAGES IN MANUFACTURING AND ALL SECTORS, KOREA, THAILAND AND INDONESIA, 1991-1999<sup>1</sup>

	Growth (% p.a.)		<i>Index (1996=100)</i>			
	1991-96	1996-99	1996	1997	1998	1999
<b>Korea<sup>2</sup></b>						
Manufacturing	6.9	1.2	100	101	91	104
<i>All Sectors</i>	6.7	4.1	100	107	107	113
<b>Thailand</b>						
Manufacturing	7.8	1.2	100	108	103	104
<i>All Sectors</i>	7.0	1.4	100	106	105	104
<b>Indonesia</b>						
Manufacturing	6.9	-8.3	100	106	66	78
<i>All Sectors</i>	6.4	-6.1	100	104	69	83

1 All nominal average wages deflated by the CPI in each country.

2 Data for regular employees, to third quarter 1999. For 1991-1996 data are taken from NSO, *Major Statistics of the Korean Economy* (monthly). For 1996-1999 data are taken from the Korean Labor Institute, *Quarterly Labor Review*, 12(4), page 8.

Source: Source: Indonesia. CBS, *National Labour Force Surveys*, 1991-1999. Thailand, NSO, *Labour Force Survey*, February and August (average of two rounds), various years. Korea. NSO, *Major Statistics of the Korean Economy* (monthly) and The Korean Labor Institute, *Quarterly Labor Review*, 12(4), page 8.