AFTER THE CRISIS:
THE SOCIAL CONTRACT AND THE MIDDLE CLASS IN EAST ASIA

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PREFACE

The Carnegie Economic Reform Network (CERN) is a distinguished group of approximately twenty-five ministerial-level economic policy practitioners from around the world who have played key roles in advancing market-oriented reforms in their countries. Members of the group come from Asia, Africa, Latin America, the Middle East, Eastern Europe, and Russia. Their common goal is the promotion of economic change under challenging political circumstances. The network was created in 1997 by the Carnegie Endowment for International Peace to capture the exceptional range of experience of the members, as political players as well as technocrats, and to impart lessons about the critical political component of successful reform efforts. Three conferences have been convened by CERN to address current economic issues: economic reform in Latin America (held in Miami in 1998), the reform of labor markets and pension systems in Eastern Europe (in Moscow in 1998), and the politics of the economic crisis in Asia (in Bangkok in June 1999).

It was in Bangkok that a lively discussion about the social contract in East Asia took place and the idea for this monograph arose. The conference—the first of CERN in Asia—was planned and prepared in the waning days of the East Asian financial crisis. It brought together CERN members with a select group of Asian public officials, scholars, and members of the Asian policy community. Much of the agenda had to do with the direction and scope of economic policy in consolidating and accelerating the post-crisis recovery, given the political constraints and the changing political dynamics in the region. One issue was how politics and the balance of power would affect the speed and nature of corporate and financial restructuring. The second was how the crisis itself and the social and political fallout of the crisis had and would affect the future direction of social policy in Asia. The second issue, which beforehand had seemed less controversial, turned out to excite more concern and—on the part of the Asian participants—some skepticism. This monograph explores the background for that skepticism, its implications for the way in which the immediate social consequences of the crisis were addressed, and the political prospects for a new turn in the evolution of the social contract in post-crisis Asia.

One of the objectives of CERN is to bring together good politics and good economics. This monograph is a modest contribution to that larger endeavor. At the least, it brought together an economist (Nancy Birdsall) and a political scientist (Stephan Haggard) and reflects what we taught each other. But it reflects much more what we learned at the Bangkok conference from our colleagues who have struggled with the practical politics of designing and implementing economic and social reform. We are grateful to all the CERN members who contributed to that discussion, and in particular to our Thai member and host, Anand Panyarachan, whose wisdom on the social issues was so clearly forged in the real world of making policy in his own country.

The authors are grateful to Daniel Morrow, who collaborated in the preparation of the conference where these issues first converged; to Linda Low of the National University of Singapore; to Tamar Manuelyan-Atinc, Emmanuel Jiménez, Richard Newfarmer, Jill Armstrong, Ijaz Nabi, and the late Nicholas Prescott of the World Bank, all of whom generously shared their information and their views; to Marygold Severn-Walsh and Shu Fan for extensive and unstinting research and help; and to Mary Downs and Sherry Pettie for copy editing and production assistance.

1 INTRODUCTION

The Asian financial crisis put in bold relief two big differences between the Asian and the Western economies. One has been hotly contested, while the other has been virtually ignored.

The first is the difference signaled by the label “crony capitalism”—the notion that the Asian model of conservative state-managed capitalism was too reliant on close ties among government, business, and banks, and that it was lacking in transparency and was thus prone to moral hazard and vulnerable to crisis. This model of course cannot be held altogether culpable; it had produced high growth in the past and at least two other factors—regional contagion and financial panic—also contributed to the crisis. Nonetheless, the crisis did reveal important structural weaknesses, and financial and corporate restructuring are now viewed as central to the region’s long-term growth.

The second big difference between Asian and Western economies—and the one we focus on in this report—is the nature of the social contract. The Western contract is an agreement between citizens and their governments and has arisen out of a long and sometimes contentious democratic process. It varies across countries in its extent, yet in general it provides for policies and programs to protect citizens from the vicissitudes of an impersonal market economy. The social safety net that is a part of this contract provides insurance against personal circumstances, such as old age, infirmity, or bad luck in the job market, as well as against nationwide economic downturns, when many people suffer wage and job losses. In Western economies, the contract has evolved over time, and has been shaped and insured by certain underlying rights, including membership in political groups, the right to collective bargaining in the workplace, and the vote.

When the crisis hit the economies of East Asia—notably in Thailand, Indonesia, Korea, and Malaysia—most of these countries had little if any formal social safety net and only a weak semblance of the political arrangements that might sustain and monitor the management of collectively agreed safety net programs. The governments of these countries offered limited social insurance and denied citizens effective political voice. The social contract was only implicit that governments guarantee growth that would be rapid and broadly shared via widespread employment opportunities and virtually constant wage gains. The crisis showed that growth was not inexorable and that many people were vulnerable to economic bad times. Yet in the aftermath of the crisis, despite a number of short-term programs to alleviate the social costs, very little has been done to develop a more explicit social contract.

While the governments of East Asia have been heavily involved in economic matters, they have remained reluctant to expand the social safety net. In light of the crisis, this is odd. For one thing, the international community, including the International Monetary Fund (IMF) and the World Bank, has been as vocal and as supportive financially of safety net programs as of corporate and financial restructuring. Indeed, the World Bank in particular tried hard to use the crisis to catalyze movement toward a less “Asian” and more “Western” style social contract. In addition, as we will show below, it was not only the poor who were hit by the crisis, but a larger group—an emergent urban middle class that we call the "strivers"—who might be expected to command more political presence and to press now for a more explicit social contract.

With the crisis now more or less averted, the social consequences have lost their political urgency, both internationally and domestically. But there are costs to the current neglect. The obvious one is that without a more explicit safety net reflecting healthy political agreements on the costs and tradeoffs, the next shock will find *both* the poor and the emergent middle class again vulnerable. Combined with other sources of tension, this could easily generate another round of political and social explosions that seemed imminent in 1998 and 1999. More damaging would be the backlash stemming from the unchanneled political demands of the new urban strivers. Populist fiscal indiscipline does not seem a likely risk in East Asia. But a reversion to insider politics, delayed corporate and financial restructuring, increasing recourse to inefficient market policies, and even the erosion of democratic politics, are risks.

So what went wrong? Why, despite the crisis and a slew of sensible programs meant to address the social consequences, has there been so little progress on an indigenous and sustainable social contract in Asia? And what might be done to get onto a sensible path?

This report presents the outlines of a future social contract for East Asian countries that is both more explicit and more democratic. While it is concerned with the poor, its primary focus is on the political logic of developing and expanding programs that address the new risks faced by the urban strivers. A broader social contract will be necessary to sustain and strengthen democratic processes in Asia, but at the same time, the development of those democratic processes—via the strengthening of political parties and of civil society—will also ensure an explicit social contract. In the first section, we offer an explanation for why no social safety net was developed. Before the crisis, there were years of rapid and widely shared growth, which produced limited pressures for an explicit and broad social safety net. Despite growing pressures on the urban strivers in the 1990s, with urbanization and rising income and wealth inequality, there was really no political constituency for a broader social contract nor were there effective political channels through which incipient constituencies might have directed demands for safety net programs.

In the second section, we discuss the effects of the crisis on various groups and the efforts of governments to minimize the social costs of the crisis. We show that the crisis hit the urban strivers as well as the poor, and thus created a potentially more active constituency for social protection. But the policy and program response to the crisis was not particularly receptive to the needs of the urban strivers. What governments offered instead turned out to be a grab-bag of programs reflecting a standoff between the business community and a conservative state reluctant to institute or expand social insurance on the one hand, and the determined but apolitical efforts of the international community to protect the poor on the other. International pressure was backed by balance-of-payments support from the IMF, the World Bank, and the Asian Development Bank (ADB) that was carefully linked to governments' commitments to social programs. But the response of governments was minimal, cautious, and slow, it failed to reach some hard-hit groups, and it promised more on paper than it could in reality deliver. Institutional and administrative constraints were a major obstacle, but so was the political reality—there was no effective internal constituency lobbying for the extensive programs proposed by the international community.

Finally, taking into account historical and political realities, we conclude with some principles for a new, Asian version of a social contract that is more likely to be politically acceptable as well as sustainable. Safety net programs that are built into a social contract must reflect the outcome of a political bargain, since they are costly and are financed by taxpayers. The first stages of a safety net in the West were typically so-called encompassing programs that appealed primarily to the working and emergent middle classes and were closely linked to individual work effort and responsibility. (It should be noted that in Korea and Malaysia, limited programs of unemployment and assistance to the elderly financed by individual contributions already existed before the crisis.) The urban strivers represent a critical group: In the event of any future financial crises, they risk downward mobility, yet if programs are developed that assist in, or maintain, their upward mobility, they become the foundation for a new middle class, and as such, they have the potential to carry significant political weight. Programs addressing their insecurities can build on and reinforce this group's participation in public life, while providing the institutional and political foundation for a safety net that eventually (and even immediately) also protects the very poor. In this sense, the very democratic processes necessary to create a new explicit contract will be strengthened.

2 HISTORY AND POLITICS SHAPE SOCIAL PROGRAMS

THE HISTORY OF A MISSING SAFETY NET IN EAST ASIA

Prior to the crisis, countries in East and Southeast Asia with a few exceptions noted below had no publicly financed formal social safety net. Instead they relied on a three-part package: broadly shared growth, high and effective public spending on education and health, and a strong informal safety net consisting of family support and private transfers.

Growth was not only high but was also broadly shared, the result of rapid employment growth, an increasing participation in the formal labor force (especially of women before marriage), and rising real wages. Fiscal and monetary discipline generated macroeconomic stability, while reasonable access to credit—sometimes subsidized—contributed to high levels of investment. In addition, competitive exchange rates contributed to rapid growth of labor-intensive manufactured exports. Moreover, healthy income growth in rural areas was ensured through land reform (in Korea and Taiwan), and through substantial public investments in rural infrastructure and agricultural technologies, as well as by the absence of the implicit and explicit taxes on agriculture typical in other developing regions (World Bank 1993).

In the three decades before the crisis, as GDP rose, public spending on human development also rose rapidly. While social expenditures were generally concentrated on programs that benefited the poor, such as primary and secondary education and basic curative and preventive health care, there was no explicit emphasis on targeting the poor. The approach was instead universal or "encompassing" (Nelson 1999) with an emphasis not on social protection but on human capital investment. Education policy was particularly important. The combination of a greater supply of basic education with the greater demand for educated workers associated with the export-led growth strategy created a virtuous cycle: Rapid growth and good returns to education made it rational for households and individuals to invest in education (Birdsall, Ross, and Sabot 1995). The result was a dramatic increase in average levels of schooling, and equally impressive, a rapid decline in the inequality of schooling.[1] Public and private investment in education, particularly primary education, also had the effect of lowering inequality by minimizing the wage premiums that scarce educated labor captured in other regions.

Meanwhile, an informal safety net was based on high levels of household savings and strong traditions of family support and private transfers (such as from urban workers to rural households and between generations); in Korea's large firms it was based on the apparent insurance of lifetime employment. With high growth, households or individuals that fell on hard times could rely on family and community support. Economy-wide crises in which family savings would be insufficient and fellow family members could not easily help were infrequent and short-lived.

NEW PRESSURES IN THE 1990s

Strains in this approach were becoming obvious already a decade ago. Slow but constant increases in the proportion of the aged population (in northeast Asia that proportion will grow from 7.2 percent of the population in 1995 to 17.6 percent in 2025) and large expected increases in urbanization rates throughout the region in the next 25 years are beginning to undermine the informal family- and community-based safety net. More obvious in the 1990s, the foundation of rapid and shared growth, or the export model, was fraying. Taiwan, Korea, Hong Kong, and Singapore were becoming relatively high-wage countries surrounded by lower-wage competitors entering the export game. There was a sharp decline in the previously rapid growth rate of exports in Korea, Thailand, and Malaysia in the second half of the 1990s, and a mild decline in Indonesia (Ranis and Stewart 1998: Table 1). That these declines were associated with exchange rate problems as China entered the market does not obviate the general point that there were increasing risks to the long history of steadily rising employment and wage levels. Similarly, more-open capital accounts, whatever their merits or deficiencies (a discussion we need not reproduce here), were generating obvious vulnerabilities for the so-called miracle economies.

Another source of strain came from rising income and wealth inequality, a new phenomenon for most countries of the region. The portrait of East Asia as a region of shared or equitable growth had never been based on substantial reductions in inequality. In the 1970s and 1980s, Indonesia, Korea, Malaysia, and the Philippines saw modest reductions in inequality, but by international standards the level of inequality in Malaysia, the Philippines, and Thailand was high. In fact, the record was based on the region's success in achieving rapid growth without the increases in inequality that had been hypothesized by Kuznets (1955). Even before the crisis, increases in inequality were becoming marked in Thailand and Hong Kong, as well as in China, and were visible in Indonesia and Malaysia (Table 1 and Figure 1).[2] In Korea, the Gini coefficient of inequality of urban wage income rose substantially between 1993 and 1996 (from 26.3 to 28.2), a big increase, although from a very low level.[3] With the crisis, even where income inequality had not increased, the potential for conflict over the distribution of income

TABLE 1. GINI COEFFICIENTS FOR SELECTED COUNTRIES OF EAST ASIA, 1978–1998[a]

High Inequality Countries

Year	Malaysia	Hong Kong	Philippines	Thailand
1979	51.0			
1980		37.3		
1981		45.2		43.1
1982				
1983				
1984	48.0			
1985			46.1	
1986		42.0		47.4
1987				
1988			45.7	47.4
1989	48.4			
1990				48.8
1991		45.0	45.0	
1992				51.5
1993				
1994				
1995	48.5			
1996				
Average	49.1	42.4	45.6	47.6

Low Inequality Countries

Year	China	Indonesia	Korea	Singapore	Taiwan
1978		38.6		37.0	28.4
1979					27.7
1980	32.0	35.6	38.6	40.7	28.0
1981		33.7			28.2
1982	28.8		35.7		28.5
1983	27.2			42.0	28.5
1984	25.7	32.4			28.8
1985	31.4		34.5		29.2
1986	33.3				29.3
1987	34.3	32.0			29.7
1988	34.9		33.6	41.0	30.0
1989	36.0			39.0	30.4
1990	34.6	33.1			30.1
1991	36.2				30.5
1992	37.8				30.8
1993		31.7	31.0		30.8
1994					
1995	41.5				
1996		36.5	29.5		
1997			27.1[b]		
1998			30.1[b]		
Average	33.4	34.2	32.5	39.9	29.3

Notes:

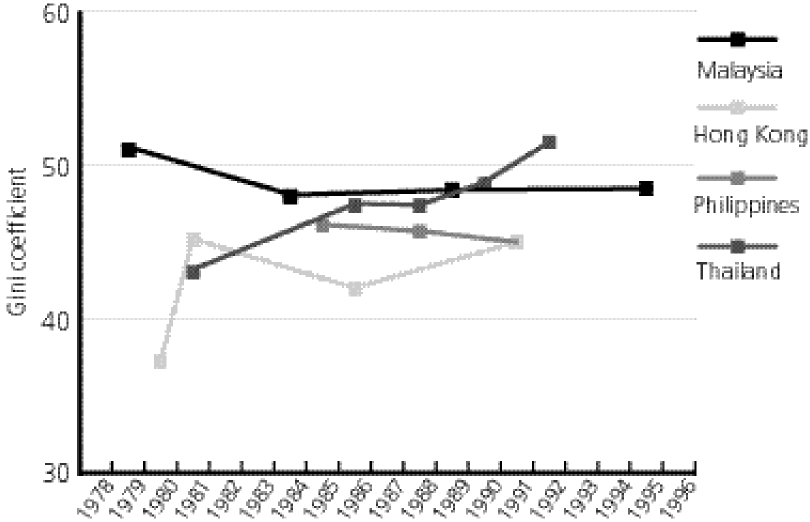
a. Ginis are based on household distributions of income per capita, except for Indonesia, where Ginis are based on household distribution of expenditures per capita.

b. The 1997 and 1998 data for Korea are calculated observing urban household income for wages and salary earners only. Korea has experienced an increase in inequality from 1997 to 1998: according to quarterly data on urban household monthly income the top 20% to bottom 20% inequality ratio was 4.8 in the first quarter of 1997, and evolved in the following quarters to 4.4, 4.5, and 4.3, reaching 5.5 in each one of the first three quarters of 1998.

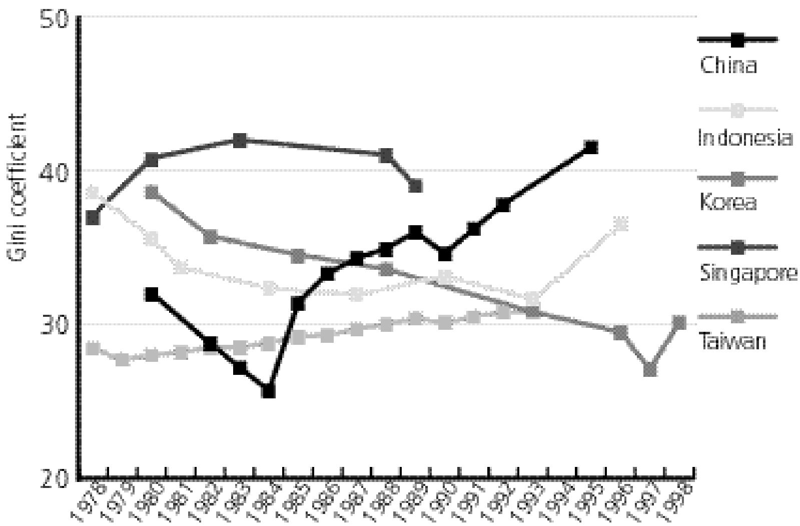
Sources: Deininger and Squire (1996); for Korea: World Bank data (1999); Korea National Statistical Office (1998).

FIGURE 1. GINI COEFFICIENTS IN HIGH AND LOW INEQUALITY EAST ASIAN COUNTRIES, 1978–1998

High Inequality Countries



Low Inequality Countries



Source: Table 1.

and assets became high. Pre-crisis booms in stock and property markets in the 1990s generated large and visible gains for the very top of the income distribution, and the subsequent collapse revealed that some of these gains were the result of insider dealing, cronyism, and corruption. The steep losses imposed on urban workers and their households, and the efforts of corporate owners and managers to secure bailouts, became sources of resentment to large parts of the population.

With rising income and wealth inequality, another shortcoming of the limited safety net became obvious: that growth did not dramatically reduce poverty in all of the countries of East Asia. Even though the most prosperous countries of the region continue to have regional pockets of poverty analogous to those in Appalachia in the United States, East Asia's gains in reducing poverty have been dramatic. Using the international standard of $1 per day per capita at 1985 prices, poverty in Korea, Taiwan, Hong Kong, Singapore, Malaysia, and Thailand had been virtually eliminated by 1995.[4] But in the same year, 11.4 percent of Indonesians (or 21.9 million people) and 25.5 percent of Filipinos (17.6 million) still lived in poverty; and in Korea and Thailand, according to those countries' own official poverty lines, 15 percent of their populations lived in poverty.[5] But for the middle-income countries (excluding Indonesia), whatever poverty remains will less easily be eliminated by growth alone.

THE POLITICS OF THE MISSING SOCIAL CONTRACT

Thus for at least three decades, from about 1960, rapid and broadly shared growth in effect precluded the notion of a social contract that would include a safety net. In 1960, many households were poor or not far above the poverty line. But the reduction in agricultural production, increased labor mobility, and rapidly rising incomes all generated strong expectations of future improvements in welfare, expectations that were generally realized. Perhaps more important, lack of political pressure for a social contract also reflected the political strength of the business community in these countries, a community on which the governments relied to deliver growth. Export-oriented growth strategies made business particularly sensitive to both taxes and labor costs, and thus spawned private sectors that while friendly to social investment in education (which enhanced labor productivity), were typically hostile to a broader social agenda. The truncated nature of the political spectrum, limitations on interest groups, and outright repression meant that any nascent political demand for state-run social safety nets was attenuated. During periodic political or economic crises, such as the ethnic riots in Malaysia in 1970 or the oil shocks of the 1970s, governments did respond to social pressures by instituting new programs. But they did so in the same way as Bismarck had over a century before: preemptively and on terms set by the government and conservative political forces. The result was the establishment of formal mechanisms that limited direct state expenditure, relied on schemes funded by business and labor and, with the exception of Malaysia's ethnic affirmative action policies, shunned redistributive objectives.

Although a number of commentaries have emphasized the "shared" nature of East Asia's growth and the existence of an implicit social compact (Campos and Root 1996), such agreements were not achieved through democratic political processes (Haggard 1990). Rather, they were the outcome of authoritarian paternalism. Prior to the democratic transitions of the 1980s and 1990s, all of the developing countries in the region were authoritarian or at best semi-democratic. Social democratic political parties were weak and restricted. Labor movements were weak, repressed, or both, and interest groups and nongovernmental organizations or civil society groups had only the narrowest space in which to operate.

The effect of authoritarian politics on industrial relations was also important. By allowing labor markets to clear relatively freely, East Asian economies avoided the labor-market dualism visible in Latin America and Africa, with positive implications not only for efficiency but also for equity. They achieved this result, however, by direct and indirect government controls over the labor movement (Birdsall and Sabot 1995). Governments could not push wages below market-clearing levels, but they could guarantee that labor had little say either in the wage-setting process or in the rules governing the shop-floor. In some cases, government paternalism did introduce some rigidities. For example, in Korea, the system of industrial relations established under Park Chung Hee made it difficult for firms to fire. But high growth meant that the constraints associated with such policies were rarely binding.

It is true that prior to the crisis, the politics that had supported a limited or absent social contract were also changing—but not necessarily in a manner conducive to new initiatives. The democratic transitions in Korea, Thailand, Taiwan, and the Philippines were still led by a conservative cast. In Korea, the first transitional election was won by an ally of the outgoing dictator. In Taiwan, a single dominant political party retains office to this day. In Thailand, gradual democratization in the 1980s occurred under military auspices and was interrupted by a coup and brief military interregnum. The "revolution" in the Philippines was led by elements of the armed forces, and was supported by (among others) the church and Manila's middle class.

But the political changes did provide incentives for politicians to address social issues in some form, and they also encouraged mobilization of new social groups. Even the dominant party and authoritarian systems of Indonesia and Malaysia were not immune from some pressures. In Indonesia, social protest and violence did not end with Suharto's resignation and even escalated. In Malaysia, Mohamad Mahathir's incumbency has been challenged by a *reformasi* movement that includes elements of the urban intelligentsia and middle classes, as well as Islamic parties and groups. So in a sense, broad political changes prior to the crisis were increasing the potential for a new level of political participation among a wide array of social groups, including the new urban strivers. Yet, as we shall see, although the crisis clearly adversely affected these very groups, it also revealed their political impotence.

3 INTERNATIONAL LENDERS ENCOUNTER BUSINESS-FRIENDLY POLITICS

The economic effects of the crisis in three of the hardest hit countries—Indonesia, Thailand, and Korea—were visible and widespread across a broad spectrum of the population. The actual response of governments was limited and was largely focused on temporary interventions, and many "emergency" programs were neither easily nor quickly implemented. With the partial exception of Korea, the foundation for more institutionalized social insurance was not established. Despite enthusiasm and financial support from international funders, the lack of a political constituency—representing the vulnerable strivers to say nothing of the poor—could not be overcome. Administrative and bureaucratic obstacles and the legacy of conservative, business-friendly political arrangements, which perpetuate the tradition of limited government involvement in social transfers, were simply too strong.

WHO GOT HIT?

The capital flight and devaluations with which the crisis began, combined with the initial policy response of tight monetary and fiscal policy, brought layoffs, declining demand for new entrants into the labor market, and real wage declines. They also resulted in a squeeze on the informal sector. Table 2 shows the effects of the crisis on unemployment, real wages, and consumption. These, along with heavy reliance on high interest rates to defend failing currencies, hit workers as well as small business owners very hard.[6] Countries also undertook controversial fiscal adjustments. Asian

TABLE 2. GROWTH AND UNEMPLOYMENT IN EAST ASIA

	Real GDP % change	Unemployment Rate	Average Wage % change	Per Capita Consumption % change
Hong Kong				
1996	4.6	2.8		
1997	5.3	2.2	1.7[g]	
1998	-5	5	-0.1[g]	
Indonesia				
1996	8	4.9		
1997	4.6	5.4		-34[d]
1998	-15	15	-34[h]	-33 (urban)[c] -13 (rural)[c]
Korea				
1996	7.1	2		
1997	5.5	2.7	2.4[a]	4.2[e]
1998	-7	7	-8.1 (1st Q)[a] -8.6 (2nd Q)[a] -14.2 (3rd Q)[a]	-10.7[e]
Malaysia				
1996	8.6			
1997	7.8	2.2[d]		
1998	-6.4	3.8[d]		
Philippines				
1996	5.7			
1997	5.1	7.8[d]		
1998	-0.6	9.4[d]		
Singapore				
1996	6.9	3		
1997	7.8	2.4		
1998	0	4.4	1.0[f]	
Thailand				
1996	5.5	2		
1997	-0.4	4		
1998	-8	6	-6[b]	

Source: IMF 1998.
Notes: 1998 GDP and unemployment figures are forecasts.
a. Private, non-agricultural only. Moon, Lee, and Yoo (1999), p. 14.
b. February 1997 to February 1998 (8.3% in urban areas; 4.7% in rural areas). Manuelyan-Atinc (1999), chapter 6.
c. Thomas, Frankenberg, Beegle and Teruel (1999).
d. Knowles, Pernia, and Racelis (1999).
e. National Statistics Office, Korea (1999).
f. Second quarter 1998 to second quarter 1999. Statistics Singapore (1999).
g. Hong Kong Census and Statistics Department (1999).
h. Formal sector wages. Manuelyan-Atinc (1999), chapter 6.

countries in general did not have severe fiscal problems, and some were even in surplus. But the IMF initially pushed for fiscal cuts as necessary to the overall current account adjustment, to provide "space" for financing for the private sector, and to anticipate the high costs of financial sector restructuring programs. The resulting fiscal stance compounded the initial severe demand contraction, in addition to the accompanying employment and income declines.

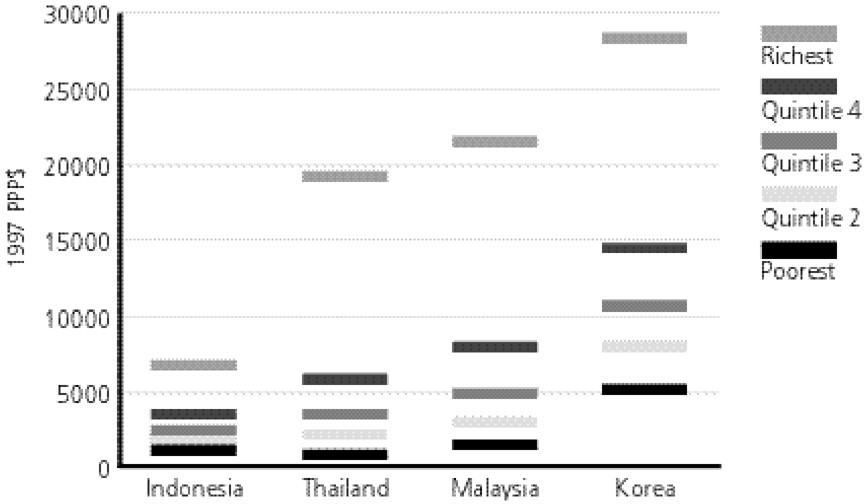
Not surprisingly, the rural poor and urban households dependent on work in the low-productivity informal sector were particularly vulnerable to the resulting economy-wide recessions. But a second group, more broadly defined and including many households with formal sector workers, was also hit. The least well off of this second group is not easily distinguished at any one moment from the currently poor. Indeed, there is growing evidence that in many countries many households move in and out of poverty from year to year. Thus, in East Asia, many households above the poverty line in the late 1990s faced a reasonable probability of falling into poverty even in the absence of a major economic shock. Pritchett, Suryahadi, and Sumarto, using survey-based information on the variability of expenditures per capita from year to year and assuming that 20 percent of households are poor, estimate that an additional 30 percent of households in Indonesia face a better than even risk of falling into poverty in a three-year period (Pritchett et al. 2000). The authors report that households in Indonesia in urban areas and with heads having primary education experience greater variability in expenditures than do households in rural areas with heads having less than primary education. Thus, although such households are less likely to be poor in any one year than less-educated, rural households, they are also more "vulnerable" to poverty over several years.

We have labeled this admittedly ill-defined group of vulnerable households the urban strivers; they are likely to include many households whose heads have low-wage but steady jobs or thriving small businesses, but relatively limited education and accumulated physical assets.

Across countries, the group is best defined in absolute income and education terms, rather than in terms of their relative income or education status within each country. In Figure 2, we provide a comparison of absolute income by quintiles of the population for the four countries under examination. In absolute terms, the average income per capita of the richest 20 percent (or quintile) of households in Indonesia, at about $7000, is slightly below the average of the middle quintile in Korea. (This average for Indonesia's richest 20 percent includes, but obscures, the very high income and wealth of the perhaps 1 percent of households that constitute the now-notorious insider class.) In Indonesia, 80 percent of households and in Thailand more than 60 percent of households have income per capita below $5000. It is at and somewhat below this income level of $5000 that households are likely to be in the new urban striver class.[7] In Indonesia, this group is in the top 40 percent of the distribution, in Thailand, closer to the middle, and in Korea, closer to the bottom, though still mostly above Korea's poverty line.[8] Similarly, with respect to education (Figure 3), those with no more than six years of schooling are among the 40 percent with the most education in Indonesia, while in Thailand they are in the middle of the distribution, and in Korea near the bottom.

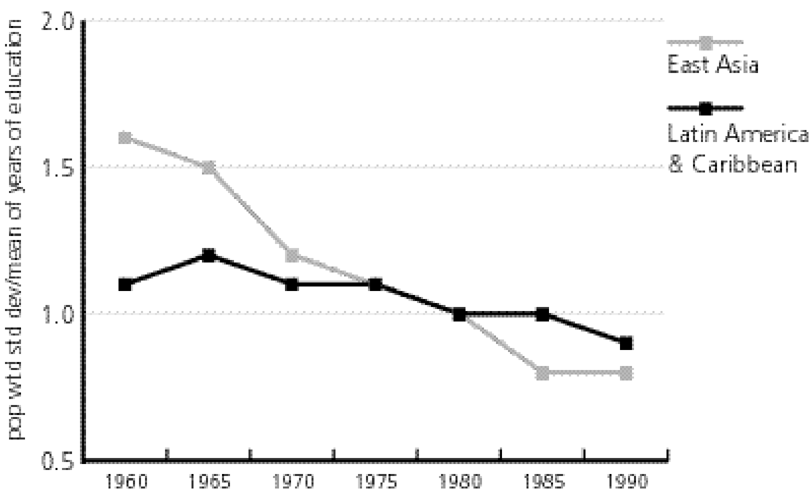
In Indonesia,[9] with 11 percent of the population in poverty, the social risk of the crisis seemed greatest. Government estimates in June of 1998 put the number of people living in poverty at 40 percent of the entire population and the international media ran stories suggesting the possibility of widespread malnutrition and even starvation. But it turned out that initial fears of dramatic increases in poverty were unwarranted. Though most of Indonesia's poor live in rural areas, the effects of the crisis were concentrated in the urban economy. Construction and industry were the sectors hardest hit. Household per capita expenditures fell an alarming 34 percent in urban areas compared to 17 percent in rural areas.[10] Urban daily wages fell by 20 percent compared to 6 percent for rural wages. The number of self-employed expanded rapidly, as did employment in agriculture; the informal and rural sectors played the role of shock absorbers.

FIGURE 2. AVERAGE ABSOLUTE HOUSEHOLD INCOME PER CAPITA (1997 PPP$) BY QUINTILE



Source: Authors' calculations from World Bank (1999); and Deininger and Squire (1996).

FIGURE 3. INEQUALITY OF HUMAN CAPITAL: A REGIONAL COMPARISON



Source: Birdsall and Londoño (1998).

Household expenditure data show only modest declines in median expenditures (5.0 for urban households and 1.6 for rural ones); this suggests that expenditures of the better off fell most sharply. And in fact, real per capita expenditures of the top 20 percent of households (in terms of per capita expenditures) fell much more dramatically (by 23 percent) than for the bottom 40 percent (about 10 percent), although the fall in expenditures at the very bottom of the income distribution contributed to the increase in the poverty rate. Similarly the less-well educated fared better than the educated.

Education and health data point to the same conclusion: Relatively better-off households in urban areas were the ones hardest hit. Enrollment in junior secondary school in 1998 compared to 1997 fell more in urban than in rural areas. Use of both public and private health care fell most among middle-income households. In agriculture, those parts of Java with closer links to the formal economy—and therefore higher incomes to begin with—were the hardest hit. Other islands, including large parts of Sumatra, Sulawesi, and Maluku were either minimally affected or actually gained because of the effect of the depreciation on export crop earnings.

These findings suggest some of the reasons that the effects of the crisis on poverty and other key social indicators, like school dropout rates, were somewhat mitigated even before we take into account the government's response: Many of those most seriously affected by the crisis were among the relativelywell-off to begin with.

In Thailand as in Indonesia, the urban formal sector was hit hard. Unemployment doubled from 1997 to May 1998, with the greatest losses concentrated in urban construction (32 percent). Small- and medium-sized firms experienced the bulk of the unemployment, while employment in the service sector grew somewhat, indicating the role of the informal sector in absorbing the unemployed.

In both these countries, wage declines between 1997 and 1998 were greater in urban areas (8.3 percent) than in rural areas (4.7 percent). Men working in urban construction and women in urban manufacturing saw larger than average losses (24 percent in construction). In contrast, agricultural households fared somewhat better than the average household if we compare 1996 and 1998, and the one-quarter of farming households that were net producers of food actually profited from initial price increases for their crops. Overall increases in poverty were relatively contained, and inequality worsened only marginally.

The economic welfare of the average Thai household actually improved between the first half of 1996 and the first half of 1998. Indeed, consistent with this, school dropout rates continued to decline nationwide for all age groups, with the exception of the lower secondary level in and around Bangkok.[11] At the same time, it appears that the welfare of the median household in Thailand (at an income level below the average and closer to our $5000 marker) declined, implying new insecurity for households in the middle of the income distribution.

In Korea, the richest, most urbanized, and most industrialized of the most seriously affected economies, similar groups to those in Indonesia and Thailand were at risk. Though closer to the bottom of the income distribution, they were also urban and in absolute terms at the marker income of about $5000. Overall unemployment in Korea rose sharply with the crisis, from 2 percent in October 1997 to almost 9 percent in February 1998, near its peak. The loss of employment was concentrated in manufacturing and particularly construction (21.3 percent); as in the other Asian countries, agricultural and fishing sectors picked up some of the slack. Contrary to the argument that the Korean labor market showed major rigidities, rising unemployment was accompanied by sharply falling real wages, by more than 12 percent from mid-1997 until the end of 1998.

Urban employment losses were concentrated among the less-well-paid temporary and day laborers in small- and medium-sized firms, while workers in large firms saw only slight declines. Those with less than secondary education bore the brunt of employment losses (Moon et al. 1999: Table 3.9). The number of employed professional, managerial, technical, and administrative workers actually rose. Thus in Korea, the fall in income was most serious for the bottom 20 percent of households (23.7 percent, versus a 2.5 percent fall for the top 20 percent of households). For the poorest of the poor—those with incomes lower than 80 percent of the poverty line—the numbers in poverty rose even more rapidly.

In sum, in all three countries the effects of the financial crisis were by no means limited to the traditional poor in rural areas and in the urban informal sector. The newly vulnerable group included workers in the formal urban sector, particularly in construction and to a lesser extent manufacturing, and workers and owners of small and medium enterprises. It also included many who had completed primary education—though with less than secondary education—and had risen above the poverty line. The crisis, in short, affected precisely those emergent, transitional, and weakly organized "striving classes" to whom high growth had historically granted social mobility. The social consequences of the crisis were partly mitigated because this group was able to draw on personal savings, rely on intra-family transfers, shift to informal employment, work longer hours, migrate, and reallocate expenditures to protect investments, including in human capital. In this sense, the outcome vindicated the region's reliance on informal mechanisms and the limited role of government. But it also revealed the limited political clout of this group, and their consequent economic exposure, if not to dire poverty at least to sudden and severe income and welfare losses.

RECALCITRANT GOVERNMENTS AND AMBITIOUS OUTSIDERS RESPOND

The immediate social response to the crisis—including strikes, demonstrations, and in a few cases riots—generated official interest in minimizing social tensions. Governments also felt some external pressure, as a stream of international visitors—the World Bank, the Asian Development Bank, and a host of UN agencies—produced reports on the social consequences of the crisis; even the IMF issued reports on the potential social costs of the crisis. Governments needed substantial external financial support to stem panic and manage their budgets. Thus interests coincided. The governments and the multilateral institutions agreed that overall financial support should be linked to government efforts to develop and provide a better social safety net.

The result was a proliferation of program initiatives, summarized in Table 3 (from a World Bank report) for the most seriously affected countries. For some of these initiatives, such as maintaining levels of health and education expenditure in the short run, or launching emergency public works employment programs, the governments' own inclinations to meet immediate and visible needs were supported by outside intervention. Support for education and jobs was also consistent with past success emphasizing the productivity benefits of social spending. But in varying degrees across countries and programs, ideas that called for specific anti-poverty efforts and a broadening of the policy response beyond temporary measures ran into institutional and political difficulties.

The problems facing the East Asian governments were in the first instance administrative. In all cases, and particularly in Indonesia, the large size of the informal and self-employed sectors posed daunting administrative problems for reaching the poor and even more for constructing a broader system of social insurance. Lines of bureaucratic responsibility were not clear and the agencies with responsibilities for social issues lacked reliable information on the income status of households. Not only did bureaucracies lack the capacity to respond in a timely fashion, they were also poorly positioned to act as political advocates for those affected. As a result, delays in responding to the social dimensions of the crisis were a common feature in all countries.

A deeper problem was that a number of Asian policy makers, as well as political oppositions and nongovernmental organizations (NGOs), were wary of the new social agenda because of the potential for leakage not only to the non-poor (always a legitimate tech-

TABLE 3: SOCIAL SAFETY NET PROGRAMS IN EAST ASIA DURING THE CRISIS

	Food Security	Cash Transfers	Social Funds	Health & Education	Workfare Programs	Unemployment Assistance/Insurance/ Severance Pay	Active Labor Market Policies
Korea		Temporary non-contributory means-tested livelihood protection program (new). Social Pension for the elderly (new).			Public workfare scheme (new).	Unemployment insurance program expanded.	Active labor market programs (vocational training, wage subsidies, job placement) expanded.
Malaysia							Training for unemployed expanded.
Thailand		Social pensions for the elderly and cash transfers to needy families expanded.	Community-based programs (new).	Low income health care for the poor and voluntary health insurance for the near-poor programs expanded. Scholarships and educational loan program expanded. Allowance of fees to be paid in installments; fee waivers; and provisions for free uniforms to students. School lunch program expanded.	Public workfare scheme (new).	Severance payments increased. New Employee Welfare Fund set up to partially finance unpaid severance claims for workers from bankrupt firms.	Training for skills development for unemployed expanded. Self-employment loans.
Philippines							Computerized job assistance network launched, and some expansion of training.
Indonesia	New program of targeted cheap rice distribution.		Community-based programs.	Back-to-School program launched (provides scholarships for the poorest students and grants for schools in the poorest communities). Subsidies to maintain prices of essential drugs.		Existing *padat karya* programs expanded and subsequently redesigned.	

Source: Manuelyan-Atinc (1999), chapter 6.

nical concern with social welfare subsidies) but also to local politicians prone to corruption. These concerns were present in Thailand and were particularly acute in Indonesia, where controversy about corruption in anti-poverty programs engulfed initial World Bank efforts.

A third problem was that many of the programs encouraged by the international community were focused on the needs of the structurally poor. This reasonably implied substantial emphasis on targetingof programs to avoid the technical leakage noted above and to minimize fiscal costs of social safety net programs. (The focus on targeting by the international community also reflected political difficulties in the donor countries, especially in the United States, with permanent "poverty" or "welfare" programs for the structurally poor. Because such programs are not appealing to the middle class and are therefore politically vulnerable and less securely funded, they tend to be narrowly targeted with strict eligibility criteria to minimize their costs.) The targeting approach with its implied emphasis on transfers, however, was not particularly relevant to the experience of countries whose social programs had been universal and investment based, and that emphasized broad-based education and the creation of employment opportunities. Moreover, in the Asian context, targeting, which can create social stigma for beneficiaries, ran the risk of undermining the social solidarity undergirding the informal safety net, and could have actually discouraged use of programs by the new poor and near poor who were seriously affected by the crisis. And of course, a highly targeted approach would miss many of those above the poverty line who were hit hard by the crisis.

Equally important, efforts to institutionalize more explicit forms of social insurance faced fundamental political barriers. Governments in Korea, Thailand, and Malaysia expressed concern about taking on the spending and transfer programs of the Western welfare state. As Tables 4 and 5 show, social insurance commitments are relatively modest in the countries in question. Malaysia's Employees' Provident Fund (EPF) is the most comprehensive, but

TABLE 4: INTERNATIONAL RESPONSES AND LOCAL CONSTRAINTS IN INDONESIA, THAILAND, AND KOREA

Country	International Community Responses	Local Political and Institutional Constraints
All three	Revision of initially stringent fiscal targets (IMF). Balance of Payments (BOP) support conditional on maintaining public spending on health and education (World Bank, ADB). Emphasis on targeting the poor (all donors).	Labor unions weak and not representative of most workers. Weak or absent "social democratic" political parties representing urban working class and poor. Weak local government and poor information in central government social bureaucracies.
Indonesia	Encouraged to switch from general rice subsidy to targeted cheap rice distribution. Heavy emphasis on redesign of programs to minimize corruption. Delay of social loan disbursement due to broader political risk (World Bank).	Fear of corruption. Political resistance to redirecting spending to poor provinces. Weak transitional governments (1998–99).
Thailand	Emphasis on community-based initiatives and strengthening of civil society.	Central government resists European-style welfare state. Strong state enterprise unions resist wage flexibility and employment policies.
Korea	Encouraged to expand coverage and enlarge eligibility for existing (tiny) unemployment insurance programs.	Labor unions in organized sectors resist layoffs.

Note: See Table 3 for government social programs during the crisis.

covers just under half of all employees and involves no direct government commitments. This skepticism resulted from legitimate doubts about the European model as well as from a traditionalist rhetoric that emphasized reliance on family and community and past success in harnessing work, discipline, and responsibility at the individual level. The idea of new social welfare programs that included entitlements to government transfers faced strong resistance from the conservative forces referred to above, which argued that they were costly to business and undermined the roots of past economic success (Goodman, White, and Kwon 1998).

TABLE 5. MAIN INDICATORS OF ECONOMIC ACTIVITY AND HOUSEHOLD IMPACT

	Per Capita GDP Growth			Per Capita Private Consumption Growth			Inflation (CPI)		
	1990-96	1998	1999	1990-96	1998	1999	1990-96	1998	1999
Korea	6.3	-6.6	11.5[a]	6.5	-10.2	10.3[a]	6.0	7.5	0.7[b]
Thailand	7.0	-10.8	na	6.4	-15.1	na	5.0	8.1	0.3[c]
Indonesia	5.7	-14.4	na	6.8	-4.7	na	8.8	57.6	0.27[d]
Malaysia	7.0	-9.3	3.6[e]	5.4	-12.6	na	4.2	5.3	2.8[h]
Philippines	0.4	-2.6	3.0[f]	1.0	1.3	na	9.8	9.7	6.6[n]

	Poverty Incidence[m]		Unemployment			
	1990-96	1998	1990-96	1998	1999	Peak Crisis Unemployment
Korea	9.6	19.2	2.0	6.8	6.6[g]	8.7[j]
Thailand	11.4	13.0	1.8	4.5	4.6[h]	4.6[k]
Indonesia	11.3	16.7	4.9	5.5	na	na
Malaysia	8.2	na	2.5	3.2	3.5[i]	4.5[l]
Philippines	37.5	na	8.6	10.1	9.7[n]	11.8[o]

Source: World Bank (forthcoming: Table 1) except as noted. World Bank source includes the following note on poverty incidence: "The poverty incidence numbers are derived using national poverty lines and are based on income for Thailand, Malaysia and the Philippines, and on consumption expenditure for Korea, Indonesia and China. Poverty incidence numbers for Malaysia and the Philippines are for 1997, and the incidence for Korea is for urban areas only."

Notes:

a. National Statistics Office, Korea, 1999. Third quarter 1998 to third quarter 1999, total income growth corrected for population growth of 0.79 by authors.
b. National Statistics Office, Korea, 1999 (January to November 1999).
c. Ministry of Finance, Thailand, 1999 (January to November 1999).
d. Statistics Indonesia, 1999 (January to November 1999).
e. Department of Statistics, Malaysia, 1999 (January to November 1999).
f. National Statistics Coordination Board, Philippines, 1999 (First three quarters 1999).
g. National Statistics Office, Korea, 1999 (January to November 1999).
h. Ministry of Finance, Thailand, 1999 (January to November 1999).
i. Department of Statistics, Malaysia, 1999 (First three quarters 1999).
j. February 1999.
k. Ministry of Finance, Thailand, 1999 (May 1999).
l. Department of Statistics, Malaysia, 1999 (March 1999).
m. See source note above on measures of poverty.
n. National Statistics Office, Philippines, 2000.
o. National Statistics Office, Philippines, 1999 (April 1999).

Governments faced some economically motivated demonstrations and strikes in the wake of the crisis. But with the partial exception of Korea, none of the political systems had strong parties representing the interests of those most seriously affected by the crisis in an ongoing and institutionalized way. Many of those hit are difficult to organize anyway—such as in the small-business sector—in the absence of highly pluralistic and well-developed democratic processes. European-style social democratic parties are altogether absent in the region and links between parties and civil society are

generally weak. Where opposition parties did seek to exploit social issues, it was often through appeal to other identities—religious, such as Islam in Indonesia and Malaysia, or regional, such as the Northeast in Thailand or the Cholla provinces in Korea.
Finally, the organized groups that are historically most associated with the advance of the social agenda, namely labor, were either controlled by the government (as in Malaysia), weak (in Indonesia), or concentrated in sectors where they did not necessarily speak for the interests of those most seriously affected by the crisis (for example, state-owned enterprises in Thailand). Korea, again, is a partial exception, as we shall see. Thus, in the absence of any organized, politically relevant pressure to expand the social contract, official skepticism prevailed.

The following sections look at the particular circumstances, the political setting, and the ways that programs and policies played out in individual countries.

INDONESIA

The crisis was most severe in Indonesia. Prior to the fall of Suharto, the government's social policy response was confined to ensuring adequate supplies of basic foodstuffs. A subsidy flowed to all consumers regardless of income level (and had the perverse effect of encouraging rice exports just at the moment the government was fearing a shortage).

Once B. J. Habibie assumed the presidency and the political situation was at least temporarily stabilized (and the IMF had agreed to loosen fiscal targets), the government began responding to the donor community's insistence on a more coherent response. A targeted program of rice distribution to poor families was instituted, and had expanded to nearly ten million families by early 1999. Though the program no doubt reached many poor in rural areas, the benefits to the poor and newly poor in urban areas were limited. Only 5 percent of recipients were urban (World Bank 1999a). Long-standing pressures from politically well-placed rural districts, and the weak organization of labor and—as always—the urban poor, limited the expansion of the program to households in the cities.

Even the efforts to maintain education and health spending and to generate public employment, all with strong support from external agencies, faced problems in implementation. Government expenditures for the first nine months of FY98/99 on social safety net programs were only 37 percent of the annual budgeted amount (World Bank 1999a, p. 6). The donors pressed for reallocation of education spending to the poorest groups, and a "stay in school" program—providing block grants to the poorest schools and fellowships (direct transfers) to the poorest students—was popular and successful, perhaps because it was consistent with maintaining the historic broad-based approach to education. But the financing for this program apparently ended up reducing financing for secondary schools, and thus encouraged the high crisis-period dropouts at that level.

Implementation of programs was inhibited by fears of corruption. In a political setting characterized by a weak transitional government, impending elections, and the proliferation of political challengers from both inside and outside the government, the risk that funds would be diverted to political and electoral uses or outright corruption was high. Indeed, the World Bank was stung in mid-1998 by the "revelation" that some Bank-supported programs were subject to political leakage. A loan document outlining a comprehensive social safety net program approved in mid-1999 refers to "implementation delays, fund leakage, budget allocation issues, and inadequate or inappropriate design" (World Bank 1999a, p. ii), euphemisms for corruption and the political use of funds.

The risk of misuse of funds was compounded by the effort to rapidly increase social spending and the emergence of strong populist pressures in the system. A $600 million World Bank Social Safety Net Loan devised a complex governance structure that attempted to increase accountability, in part by engaging NGOs directly in monitoring disbursements in the hope of "less misuse of funds...better targeting and design, and less delay" (World Bank 1999a, p. iii). Even with these controls the World Bank chose to temporarily suspend some loan disbursements prior to the elections of June 1999 to avoid charges by the opposition that they were indirectly supporting the government.

Some crisis programs—the emergency "cheap rice" program and the stay-in-school program—did work relatively effectively given administrative constraints. But employment generation programs pushed by the international funders, such as labor-intensive public works programs, demand-driven community funds, and credit schemes to small and medium enterprises, ran into trouble because the beneficiaries had no political base. Provincial leaders from better-off areas resisted efforts to redirect spending to poorer areas, and employment creation programs failed to get off the ground. Moreover, despite well-intentioned efforts by the World Bank and other funders and donors to institutionalize efforts, little had been done with respect to a longer-term agenda by the end of 1999.

THAILAND

In Thailand as well, the crisis failed to generate long-term changes in the design of the social contract. The response to the crisis was slow and cautious, as the government was reluctant to undertake new social insurance commitments. When the crisis hit, Thailand had a social security system that provided benefits to workers in the private sector and self-employed professionals. But the program covered only 6 million workers and was limited to sickness, childbirth, death and disability benefits; it did not provide unemployment benefits (Kittiprapas and Intaravitak 1998). The strongest safety net for urban workers has been severance pay. Under pressure from labor, the government extended the length of severance payments from six to ten months, and launched a special program to provide free health care to laid-off workers and their families as well as job placement services. But these were special crisis-linked benefits not to be institutionalized and were, of course, limited to workers in the formal sector.

The government of Likphai Chuan (elected in late 1997 after the crisis hit) was openly resistant to expanding the social security program, including a prior government commitment to the development of the pension system, arguing that it would have high fiscal cost and that it raised issues of moral hazard and entitlement (O'Connell 1999). In the words of one government official, "the reason behind giving them such a tiny amount of money is to create an incentive for them to look for jobs; otherwise they may want to live on social security for the rest of their lives and take advantage of others."[12]

This reluctance can be traced in part to fiscal constraints, but also to features of Thai politics. Despite the significance of greater Bangkok in the Thai economy, the country remains largely rural. In general, the urban-based parties have not accommodated rural interests, although they did, for example, devise a rural debt forgiveness scheme and micro-lending programs that fell outside the ambit of multilateral financing. At the same time, organized labor interests reflect relatively privileged segments of the working class, such as workers in the state-owned enterprise sector. As a result, the government has resisted calls from both the donors and domestic political opponents for a formal safety net. Rather, the Chuan administration has favored temporary measures, increased attention to education and training—which has lagged in Thailand—and various forms of local self-help.

As part of its crisis-induced external financing package, the government signed social loans with the Asian Development Bank in 1998 and, after considerable negotiation, with the World Bank in 1999. Given the weakness of existing machinery for managing the social safety net, and the reluctance of government to move into new social insurance programs, the loans generally supported or expanded existing programs, particularly in education and health (World Bank Thailand Office 1999a, 1999b). The health program expanded funding for the poor and the education component increased a student loan program to keep children in school. The loan also supported existing government programs designed to provide jobs to the poor.

The most innovative dimension of the World Bank loan was its emphasis on decentralization and local community development through the creation of a Social Investment Fund (SIF), which included objectives broadly in line with the new constitution's emphasis on devolution of power to lower levels of government.[13] The SIF would provide grant support for small-scale sub-projects proposed by local governments, NGOs, or community groups, or lending support to larger, revenue-generating projects in selected municipalities.

But the opportunity provided by the social funds for patronage, particularly given the coalition nature of the cabinet, made both the government and the multilateral banks cautious in approving projects. As noted in the Bangkok Post on March 4, 1999, less than 10 percent of all project money had been allocated by March 1999. Despite the constitutional changes, the development of effective local government remained a long-term project that faced resistance from within the central government bureaucracy.

MALAYSIA

Malaysia, unlike Indonesia and Thailand, did not negotiate large financial packages with the World Bank and donors during the crisis and, as shown in Table 3, was much less active in initiating safety net programs. Comments of Prime Minister Mahathir summarize well the resistance to certain forms of social insurance that was visible elsewhere in the region, including in Thailand and Korea. Referring to social safety nets in the form of unemployment benefits, Mahathir argued:

> When those who are jobless are given dole, they will choose not to work. . . . Surely the cost of production and cost of living will increase. When the cost of living increases, the government will also have to increase the dole. This means the taxes will have to be hiked further.[14]

Malaysia does have an Employees' Provident Fund, which insures against disability and old age. But in line with the Asian welfare model, the fund is financed entirely by mandated contributions from employers and workers, and direct transfers are minimal. Only one poor household in ten receives a government transfer, which accounts for only about one percent of the poor's gross income (World Bank 1999b, p. 4).

KOREA

In contrast to Indonesia and Thailand, Korea had two obvious signs of an incipient social contract before the crisis: active labor unions and a government-managed system of unemployment insurance that, though modest, was more institutionalized than elsewhere. In Korea, more so than in Indonesia and Thailand, the crisis seemed to catalyze new initiatives, in part because of organized labor pressures and an administrative head start. But even in Korea, there were still only limited steps toward a modern and sustainable social contract.

The Korean government faced a particular dilemma in regard to workers in state-owned enterprises. On the one hand, the unemployment problem in Korea was the most serious of the three countries, with fewer opportunities for the rural and informal sectors to absorb displaced workers from the small and medium enterprise sector. On the other hand, the high concentration in the market had resulted in fairly strong and militant unions, which though representing only 12 to 13 percent of wage and salary workers, were dominant in large firms and public enterprises. This meant that while small firms faced little resistance to layoffs and could adjust to redundant workers illegally, large firms had to resort to early retirement, voluntary leave, and wage restraints.[15] Such measures were not likely to be adequate to encourage the corporate restructuring envisioned by the government. Moreover, these labor market rigidities could act as a deterrent to foreign investment in sectors such as banking.

To secure labor agreement to greater layoffs, President Kim Dae Jung, elected in late 1997, resorted to a mechanism that had not been used in Korea with any success before: the tripartite commission. In return for agreement to permit layoffs, or in the case of takeovers, the government established, among other things, a 5 trillion won unemployment fund, agreed to the right for public servants to form a labor consultative body and for teachers to unionize, and reversed a longstanding prohibition on labor involvement in political activities. The tripartite agreement eventually broke down; labor walked out in early 1999 following repeated government interventions to encourage downsizing and to break strikes during 1998. But an important precedent had been set—of labor bargaining for a better safety net to offset greater risks of layoffs.

Meanwhile, in adjustment loans negotiated with the World Bank and the Asian Development Bank, the Korean government entered into a series of commitments to expand eligibility and coverage of its unemployment insurance (initially covering only workers in firms of 30 or more employees) to small firms. The government also agreed to increase budget outlays for social assistance and unemployment programs (which in 1998 had been budgeted at a mere 1.3 percent of GDP)—but only if the numbers of those below the poverty line increased. Under further pressure, including from the World Bank, the government raised the budget allocation for these programs to closer to 2 percent in 1999. Reflecting concern with incentive effects and the risks of "welfare disease," benefits under these programs are low: 70 percent of the minimum wage, which is itself just 25 percent of average earnings (Moon et al. 1999, p. 43).

Actual implementation, moreover, fell short. As of June 1998, among the 1.5 million unemployed, only 7 percent had received unemployment benefits. The extension of benefits to day laborers, formally set in October 1998, had not been implemented a year later due to lack of administrative capacity (Park 1999). Public assistance, confined to those without family members able to assist, is less than 9 percent of average earnings, probably not enough to cover basic expenses.

In sum, the four countries on which we have focused showed a wide variety of crisis circumstances, from dealing with immediate food shortages to managing organized labor. But in all four, the response to the social dimension of the crisis was limited. The social risks were not ignored: Governments responded to the threat of social unrest, and were pushed along by the multilateral banks and the IMF, on whose resources for general purposes they were greatly reliant. But with the possible exception of Korea, the crisis did not generate a broader debate on the wider social contract.

4 LESSONS FOR A NEW SOCIAL CONTRACT

A new social contract should address the problem of poverty that in the miracle years was so effectively managed through high growth. At the same time, it must also deal with the new insecurities faced by the emerging working and middle classes of more open economies in a global marketplace.

THE SAFETY NET: SOCIAL INSURANCE AND SOCIAL ASSISTANCE

In every country, the social safety net programs that make up the program part of a social contract need support from the working and middle classes, who can affect political outcomes. The programs must have two characteristics. They must address risks that are real for this group, including individual risks such as permanent disability and old age, which prevent work, and the systemic (or covariant) risks of an economy-wide recession, which lead to widespread layoffs and potential loss of homes, small businesses, and other assets. At the same time, the programs must avoid burdening these groups with taxes for programs that end up reducing incentives to work, thus supporting the so-called “lazy and undeserving.” In the West, success in establishing a safety net came first with collective agreement on social insurance programs—universal and incentive-compatible programs such as contribution-based unemployment insurance and protection from inability to work due to infirmity or old age.

These programs can be compared with the other half of a complete safety net that is in effect in most Western economies—so-called social assistance programs that are aimed at the non-working poor, such as nutritional supplementation for poor children, and cash entitlements and health programs for single mothers and their children. The current vision of the social safety net—and the one embraced by and encouraged for all developing countries by the World Bank—includes these programs for the persistently or structurally poor. In fact, this vision was only a later development in the West and was generally a byproduct of the broad universal anti-poverty programs. In the United States, for example, Lyndon Johnson's War on Poverty came three decades after Franklin Roosevelt's New Deal.

The economic and moral logic of protection for the poor is unassailable. But in the aftermath of the crisis in East Asia, there are two problems with the "poverty" or social assistance half of the conventional Western safety net. The first is political. Even in mature democracies, the poor are unlikely to command political voice consistent with their numbers. In addition to the reality that "money talks" in politics, the poor have less time and less command over information and influence. Adding to the political unpopularity of poverty programs are, first, the problems of moral hazard, that programs designed for the poor will induce the very behavior that leads to poverty; and secondly, the leakage problem, that programs meant for the truly poor will end up benefiting the non-poor (always a legitimate technical concern with social welfare subsidies) or worse, will end up as a source of patronage and corruption of local politics. The idea of "targeting" social expenditures very carefully to the truly poor, by defining strict eligibility criteria or minimal benefits only attractive to those in great need, is in part a reaction to the political difficulty of financing permanent poverty or "welfare" programs for the structurally poor. Targeting minimizes the financial burden on middle-class taxpayers and is meant to minimize moral hazard. But it implies a limited number of beneficiaries who by definition will not be politically powerful. And, it requires taking precautions against leakage, which is technically difficult and raises administrative costs. It also means that a certain stigma may be associated with poverty programs, making some potential beneficiaries reluctant to claim benefits, contributing further to the political unpopularity of such programs.

The second problem, made more visible by the crisis, is that targeted programs designed to assist the persistently poor fail to protect the larger swath of populations, including the strivers, who are not currently poor but are vulnerable to poverty. The numbers cited above for Indonesia indicate that an informal safety net that provides family help in the event of a particularistic or individual shock (illness, sudden job loss) will be full of holes in the event of an economy-wide downturn. Yet maintaining this vulnerable group's assets—and indirectly their stake in the market economy—may be critical to renewed economic growth and the strengthening of democracy.

THE POST-CRISIS LOGIC OF SOCIAL INSURANCE

The crisis has thus highlighted the logic of establishing more formal systems of social insurance in the middle-income countries of East Asia. Such programs would protect the vulnerable—both those who are currently "poor" in income terms and the often larger group that risks becoming poor without the safety net that insurance against predefined shocks would provide. A permanent system of unemployment insurance is likely to be particularly salient to the striving class. The most comprehensive system consists of universal (rather than targeted) unemployment benefits, financed by some form of earmarked contributions made by employers and employees[16] and paid out over a certain period based on contributions, age, and so on; or benefits in the form of a lump-sum payment (a severance payment) that is ideally portable from one employer to another. In those places where a large segment of the labor force is in the informal sector, the equivalent “insurance” can be provided through labor-intensive public works programs that are financed by general revenue. During the crisis, such public works programs were initiated in all of the Asian countries, although on an ad hoc basis. Such programs could be a permanent feature of the social contract, legislated to kick in and shut down more or less automatically in response to the business cycle.

There are at least three economic advantages to establishing a more formal system. First, unemployment insurance plays a macroeconomic role as a counter-cyclical Keynesian stabilizer, stimulating an economy that is structurally sound but at risk of a deflationary episode. In Latin America, one could imagine risks to fiscal and macroeconomic stability of automatically triggered insurance programs that are too generous. But in East Asia there is little risk of this given the history of fiscal rectitude. At the microeconomic level, unemployment insurance helps protect the assets (such as small businesses and incomplete investments in children’s schooling) that are hard to recover once lost, allowing urban strivers to take on the risks of investment and innovation that are important for resumption of broad-based growth. Social insurance also has the potential to complement rather than substitute for (and thus discourage) the informal safety net, to the extent that beneficiaries tend to be providers for others before and after the contingency triggering their benefits; and with insurance the beneficiaries can maintain some support for others even at the time of a shock.

Second, unemployment and other social insurance (particularly old-age insurance) can be a means of deepening capital markets and encouraging much needed financial reforms. Social insurance schemes based on individual contributions create an increased supply of long-term financing (one positive outcome of the pension system in Chile) and provide alternative sources of financing to commercial banks; in contrast, aggressive and incautious bank-led finance, often to related parties, can, and in this case did, lead to crisis. The reform of social insurance can also democratize the capital markets by encouraging participation by small investors, in turn giving them a political stake in a market-oriented economy.

Third, unemployment insurance can encourage job mobility—an advantage to economies undergoing needed structural change—and reduce resistance to temporary layoffs; this is often a more efficient step for firms than reducing wages or firing workers.

The economic conditions for launching these kinds of initiatives are in some ways more propitious in Asia than in other developing regions. Household savings is already high in the region, and formal insurance schemes would simply channel some portion of these savings through new institutional mechanisms. Most middle-income Asian countries have good records with respect to the conduct of fiscal policy, so both internal and external markets are likely to tolerate the fiscal effects of rule-based spending with clear sunset provisions.[17] There are also political advantages to a greater focus on social insurance. We have emphasized the greater potential appeal of more-encompassing or universal programs, especially after the experience of the crisis, and the greater appeal of contribution-based systems grounded in the work ethic, particularly in economies that are successful with broad-based job-intensive growth. In addition, once insurance systems are established, their administrative costs are low compared to targeted social assistance programs, and they are much less vulnerable to misuse for political patronage and to corruption in general.

On the other hand, the politics even of these insurance programs are by no means clear-cut. In East Asia, progress in social insurance, to say nothing of a more explicit and complete social contract, must take into account new democratic politics, in which political pressures for the status quo are surprisingly strong, as well as top-down politics, which continue to have a pervasive effect. The political channels through which the strivers, especially urban informal sector workers and small entrepreneurs, can express their views remain limited, in part because democratic politics are relatively new.

What then are the political bargains that would support progress, initially with social insurance and eventually with a broader Asian social contract, while avoiding a number of important political risks that might arise?

First, as is obvious, there will be differences among the post-crisis countries. For both political and administrative reasons, contribution-based insurance is likely to emerge earlier in the more developed countries—Korea, Singapore, and possibly Malaysia—where a substantial portion of the workforce is in the formal sector, as the example of Korea already suggests. Thailand, the Philippines, and Indonesia are likely to follow only later. In this second group of countries, emphasis should be placed on improving the design and administration of public works and institutionalizing them to ensure they are automatically triggered in response to crises.

In the first group of countries, conservative biases and the absence of either strong encompassing unions or social democratic parties suggest that such schemes should avoid emphasizing redistributive objectives, and instead focus on an ethic of individual responsibility. For insurance schemes, this would imply an emphasis on prior contributions and, in the case of other forms of insurance such as pensions and health, the maintenance of individual accounts. This approach is more likely to be supported by a powerful and conservative business sector. The financing design can appeal to an ethic of individual responsibility, while also reducing social risk, through mandatory but flexible programs that give individuals defined rights to borrow against their insurance accounts—not only during spells of unemployment but also for housing, children's education, or small business investments (Stiglitz 1999).

In public works programs, emphasis on the ethic of individual responsibility implies wage-setting below the prevailing market in order to avoid the work disincentives that have plagued European unemployment insurance programs. More generally, unemployment programs financed by general revenues can be made more politically palatable, as well as efficient, if the macroeconomic conditions under which they kick in are transparent and automatic.

Gaining political support for such programs will still require overcoming financing concerns. Smaller businesses are most likely to complain about the cost of employer contributions, and the support of larger export-oriented firms facing stiff cost pressures is by no means guaranteed. Moreover, it is far from clear that the "strivers" themselves would necessarily support such programs. The debate over social policy in Korea showed that organized labor in larger firms may prefer measures that ensure job security over forms of insurance that make layoffs and downsizing more acceptable. Where the informal sector is large, as in Indonesia, potential beneficiaries are poorly organized and would certainly resist making contributions.

The Korean experience suggests that the optimal political sequence for initiating insurance schemes should begin with workers in larger firms. This approach is vulnerable to the criticism that it addresses the needs of the best-organized first. But if successful, the program will generate its own demand for expansion to other categories of workers, including smaller firms and the self-employed. Western experience also suggests that the largest firms may have sufficient interest in worker loyalty to accept such programs (and may see them as a less costly alternative to private plans).[18]

Gaining political support for such programs also depends critically on their governance structures. Governance structures must guarantee effective oversight of funds and prevent theft and diversion. This can be done by ensuring the political independence of fund managers or their regulators, while simultaneously insisting on high degrees of transparency and opportunities for citizen oversight through participation on boards or panels. A few countries have developed mechanisms that remove government from direct management responsibility of social insurance schemes (Chile, for example, in the case of pensions). This seems appealing where there is a history of cronyism and corruption. But even with management in private hands, the government needs to play a strong and independent regulatory role to avoid capture by powerful financial interests.[19] The problem of government involvement in public works programs is more immediate. In Indonesia, the padat karya, a nationwide, emergency labor-intensive works program, was welcomed by incumbents and bureaucrats, but was hotly contested by opposition groups who saw it as little more than traditional patronage.

LABOR RELATIONS

The formulation of social insurance programs is heavily dependent on a second component of a broader social contract: a new approach to labor relations. As we have argued, the traditional social bargain in East Asia rested on an authoritarian approach to labor relations in which unions were simply repressed or, more typically, were brought under various forms of government control (Deyo 1989). Democratization made such arrangements anachronistic, and in all of the newly democratic countries, old unions sought to remake themselves and new competing federations and unions entered the political fray.

A wide array of factors will influence the nature of the new union structure and its relationship with government. These include: industrial structure and the size of the informal economy, and political factors such as the nature of the authoritarian status quo, the party system, and the partisan identity of incumbents, and current economic conditions.[20] Despite these variations, there are some simple principles that can guide a new political deal for labor in the region, and thus contribute indirectly to advancing the cause of the new social contract. The first task is to get government out of the union business and to recognize the right to form unions, engage in collective bargaining, and strike. In return, the government should insist on its right to guarantee that unions themselves are organized and run in a democratic and transparent fashion and to mediate disputes that cannot be settled between management and labor directly.

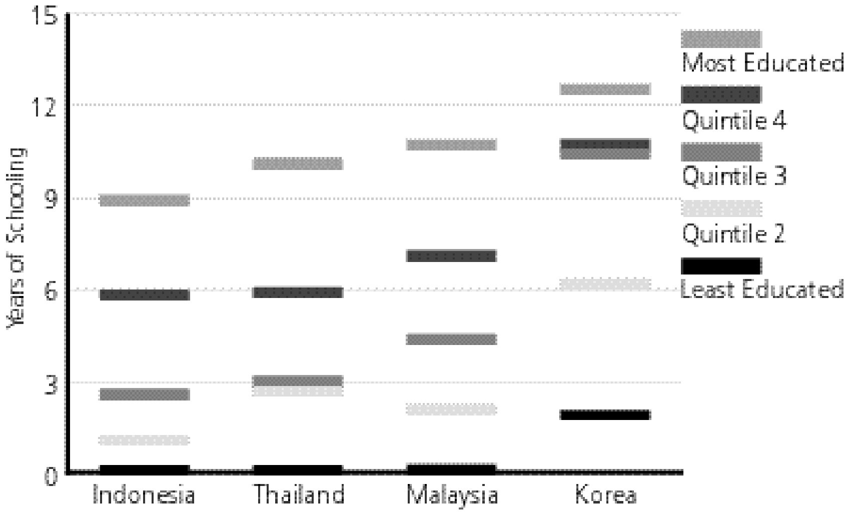
Once this broad framework is in place, it is difficult to predict what political role labor will play. A variety of patterns are possible.

For example, in Korea the existence of a government-controlled federation, the relatively concentrated industrial structure, and the high share of manufacturing in total output resulted in two competing federations following the transition to democratic rule in the late 1980s. Competition between the two federations, a conservative incumbent government, and an economic boom generated a brief populist phase when strike activity rose and union wage demands far outstripped productivity growth. In Indonesia, by contrast, the agricultural and informal sectors are large, and the sheer size of the country and the fragmented party structure generated a plethora of new federations and unions in 1998–1999. Strike activity also increased dramatically, but the crisis meant that unions wielded limited influence over wage setting.[21]

Despite this diversity, we can identify a number of likely outcomes. Where union organization is relatively concentrated, governments may go beyond their minimal role and draw labor into broader tripartite discussions. In Korea, Kim Dae Jung's government was able to trade new political rights and innovations in unemployment insurance for greater managerial flexibility with respect to layoffs. Government policy can also encourage union involvement in the organization and provision of training, and in the design of industry-wide skill certification programs, which encourage labor mobility by recognizing workers' acquisition of new skills. Indeed, such certification programs can be part of a larger bargain in which workers acquire enhanced mobility across employers, and employers acquire greater flexibility in hiring and firing. Singapore's experience shows that governments can, in principle, run efficient schemes geared to private sector needs, in part by creating strong channels for private sector input. But the requisite public sector efficiency is an exception, and in most settings it is more practical to strengthen the strategy used in the past of providing incentives for private sector training and involve labor more actively in program design and certification.

The prospects for policy change will depend in part on the political position of labor, which played a pivotal role in the develop-

FIGURE 4. AVERAGE YEARS OF SCHOOLING PER ADULT (>25Y) BY QUINTILE (1990)



Source: Calculated using Barro and Lee estimates of completed adult schooling by level (Barro and Lee 1996); Duryea formula transforming level data to number of completed years of schooling (Duryea and Székely 1998); Pettinato interpolation to obtain schooling years by education quintile (Pettinato 1999).

ment of the Western European welfare state. In the end, however, expectations about labor's political role should be modest. In some countries and sectors, for example in large firms in Korea and state-owned enterprises in Thailand, labor unions are relatively strong. For a number of reasons, however, labor's overall influence in East Asia has been small, in part because of the newness of democratic rule, in part because of structural factors such as the size of the small-firm and informal sectors and the emphasis on export-oriented manufacturing. A new system of industrial relations is as likely to result in as contribute to a new social pact.

Because labor is relatively weak, the nature of political parties and other civil society groups is critically important. Political parties are able to aggregate and reconcile the interests of poorly represented and diverse and sometimes conflicting groups—from the new middle class to workers in small firms and the urban informal sector—and can thus stand as a counterweight to powerful conservative and pro-business forces. Yet these parties also need to be pushed by a denser organization of independent civil society groups. Such groups provide information and signals to politicians and represent both geographical and functional constituencies that have been ignored in the past. In some cases, they can also play a direct role in monitoring and implementing new social initiatives.[22]

OTHER ASPECTS OF A NEW SOCIAL CONTRACT

The unusually rapid improvement in the amount and distribution of education (Figure 4) in most countries of East Asia was not the result of specific efforts to target the poor. On the contrary, education policy emphasized universal access to education; only Thailand stands out for its relatively poor performance in raising secondary school enrollment rates in line with per capita income growth. East Asia's good record in education was based on universal access, and was ensured via heavy public spending on primary and secondary education. In contrast to the pattern in Africa and Latin America, public spending on university education remained relatively low (Birdsall, Ross, and Sabot 1997).

An obvious ingredient of a post-crisis social contract is a guarantee that public spending on primary and secondary education will not be cut in the event of future economic downturns. There is evidence that education (and health) were initially cut in the early attempts to reduce public spending and meet IMF fiscal targets. If fully implemented, such spending cuts would fall especially hard on such inputs as books and supplies (which could be reduced quickly compared to personnel costs), creating substantial inefficiencies and hitting hardest the households most reliant on good schools.

In addition, the reductions in enrollment rates at the junior secondary level in Indonesia, including in urban areas, were a worrying reminder that parents have to be active participants in schooling investments and that children's enrollment is still vulnerable to temporary income losses. Given this, the stay-in-school subsidy program initiated in Indonesia was a particularly noteworthy crisis-induced innovation, and one that is well worth assessing and institutionalizing for application in any future downturns.

In education, however, the biggest challenges will come at the tertiary level. Political pressures for increased public spending on university education will inevitably mount as the emergent middle class seeks upward mobility for its children. The demands of a number of technology-intensive sectors will require that the middle-income countries of Asia, while maintaining incentives for private research and development, also ratchet up public investment in basic and applied research. The larger firms are likely to support public-private partnerships with universities.

The key principle for a post-crisis social contract on higher education should thus be a channeling of public spending on universities primarily to research and other public goods, while avoiding the across-the-board support that can contribute to overbuilt and inefficient public university systems. Misguided spending on tertiary education can be highly costly, particularly in poorer countries, draining human and administrative as well as financial resources from other levels of education and ultimately making public spending on education highly regressive. Adequate access for students to university training can then be based on the deepening of capital markets that is critical anyway to healthier financial systems, and on government-led management of student loan and scholarship programs for the sons and daughters of the poorer members of the "striving class."

A final element of the social contract, and one that is likely to garner widespread social support under democratic conditions, is the greater decentralization of social programs. The arguments in favor of decentralization of service provision—as well as the risks—have been examined in detail elsewhere and need not be fully presented here (Haggard et al. 1999). Greater decentralization is a critical part of the new social contract because education and health services that are publicly financed will only continue to be efficient and effective where providers—whether public or private with public financing—are accountable to immediate consumers. Across a range of other social services, from water to identification of the poor, local governments are likely to have better information than higher levels of government, and be more responsive to local tastes.

The central dilemma of decentralization of services is that it requires political decentralization if it is to be fully effective. A number of Asian countries remain highly centralized and unitary in their political structure, and there is great resistance at the center among both politicians and bureaucrats to ceding power to lower levels of government. Yet to fully realize the social benefits of decentralization requires not only the ceding of greater functions to lower levels of government, but the institution of electoral accountability, local revenue-raising capacity, and the involvement of local community groups and NGOs in the decision-making and implementation process. These changes are clearly not just administrative; rather, they involve a replication at the local level of the process of democratization at the national level, including the formation of responsible and accountable governments and of local party organizations that can recruit leaders and politicians, as well as the institutionalization of accountable and transparent government. These are clearly long-term tasks, but they are likely to be advanced by the development of local civil society groups, for which the barriers to entry into the political game are clearly lower at the local level.

THE RISKS OF DEMOCRACY

We have made the point that democratic politics are relatively new, reducing the channels by which the poorly organized and vulnerable strivers can express their views as an economic group. In fact, immature or incomplete democracies create some risks in the area of social policy.

The first risk is that democratic politics will place demands on government that politicians would attempt to meet at the cost of fiscal and macroeconomic stability, what might be called the Latin American disease. We have already noted, however, that this is unlikely to happen in East Asia. In no East Asian case has political reform been accompanied by an unsustainable expansion of government. The reasons for this are multiple, but include the conservative nature of the democratic transitions and the absence of the yawning social deficits and inequalities that generate populist politics. Rather, the risk is almost exactly the opposite: that changes in tax and expenditure patterns may be increasingly regressive in their structure, as the example of university funding suggests. A sound social contract would have at its core either near-neutrality in the incidence of government, or biases in favor of the structurally poor, rather than of the middle classes or rich. By and large, the countries in the region achieved this enviable feat in the early years of their growth (World Bank 1993).

In the aftermath of the financial crisis, however, the situation is less pretty. The opening of capital markets in the 1990s led to collusion between the corporate and banking sectors in which the rich used the banks to accumulate debt-financed wealth. A substantial portion of the resulting liabilities in the form of non-performing loans has now been assumed directly or indirectly by the governments. This socialized debt will ultimately be paid off by the taxpayers, as the increasing share of debt servicing in government expenditures already demonstrates. In short, the risk to a new social contract comes not from populist demands, but from the threat that the cleanup of the financial crisis involves fiscal commitments that will squeeze out social expenditures, and thus erode most the categories of public spending that were most progressive. This threat is particularly real in Indonesia, where the burden of the crisis is heaviest.[23]

A second and related risk is that democratization will allow newly freed interest groups, and particularly labor and the "popular sector," to launch an assault on market-oriented policies. This is the muchtouted fear of "backlash" that has become common currency in both academic (Rodrik 1997) and popular (Friedman 1999) discussions. Examples of such backlash might come in the form of new business-labor alliances for greater protection, resistance to privatization, or the crafting of various labor entitlements that would reduce labor market flexibility and have the effect of increasing dualism and inequality. The Brazilian Constitution of 1988 is perhaps the most egregious example of the latter, including no fewer than eight pages devoted to the length of the work week, vacation pay, severance pay obligations, and other policies, the costs of which ultimately fall not only on capital but on unorganized workers.

But again, as our brief review has shown, the risks seem very much the opposite. Outside of some isolated areas, labor seems relatively weak in the region and if there is a threat of future populism or backlash it is not likely to come from politicians' response to a strong, well-organized labor movement but from political frustration on the part of the weak that manifests itself in strikes, demonstrations, and even social violence. The strategy of incorporation that is an underlying theme of our emphasis on social insurance, industrial relations, and education is designed precisely to forestall such an eventuality from arising.

A third and more troublesome risk stems from various forms of corruption to which the programs we have outlined might be subjected. These take a bewildering variety of forms, from the expropriation of individual retirement accounts by unscrupulous financial agents (as in Albania), to the political use of fiscal resources to benefit either cronies, or to advance electoral aims. It is important to recognize that such risks are real; but it is equally important to highlight that they were also apparent under authoritarian rule and arguably even more flagrant. Lacking non-instrumental sources of legitimacy, authoritarian rulers typically resorted to payoffs to secure political loyalty. Moreover, the closed and non-transparent nature of government provided ample and, in some cases, virtually unlimited opportunities for such malfeasance.

The antidote to this risk thus lies at least to some extent in democracy itself. It is true, democratic politics do generate pressures for corruption, particularly with the importance of campaign financing in seeking office. And all governments are vulnerable to the misappropriation of public funds, no more or less in the area of social policy than in other areas, such as spending on infrastructure and defense. But democracy has the advantage of providing oppositions with incentives to ferret out such abuses in the process of political competition. Moreover, democratic governance allows for various forms of participation by outside parties, which, while running the risk of capture and undue influence, also provide opportunities for oversight and monitoring.

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

Again, our suspicion is that these fears are misguided: The prospects for social protection of the poor indeed seem more, rather than less secure under democratic rule. First, as we have suggested, where the poor have benefited from programs of social protection, it is often because the middle class endorses program designs that provide help to all who face some risk of falling into poverty under well-defined circumstances. The poor may in fact gain more from a small portion of a large program than from a large portion of a targeted but underfunded program (Nelson 1999). Second, we cannot rule out the fact that political entrepreneurs do have incentives to appeal to the poor wherever they can be counted on to vote. The strong showing of Sukarnoputri Megawati in the Indonesian elections was based in no small measure on her implicit appeals to the urban disadvantaged.[24] Finally, there is the relevance of social solidarity and moral impulses. Historically it seems to be the case that once citizens act collectively through government to provide social protection in some form, the moral imperative of including the poor is likely to receive at least some attention. In politics, it is too narrow to rely only on the play of interests without some understanding of reciprocal obligations that have deeper cultural roots.

We began by observing that the social contract is necessarily the outcome of a sometimes contentious democratic process. Indeed, the social response to the crisis showed the stamp of a new democratic politics at a number of points: in the efforts of Kim Dae Jung to bring labor into the policy dialogue in Korea; in the role of urban and middle-class civil society groups in the emergency social programs in Thailand; and in the *reformasi* movements in Malaysia and Indonesia. We conclude by noting that over the next decade the deepening of democratic processes and the evolution of a social contract can ideally reinforce each other in East Asia, in turn also providing social and political support for the economic restructuring that is central to the region's long-term growth. The social contract, including specific safety net programs and the underlying rights that shape and insure it—rights to membership in political groups, to collective bargaining in the workplace, and to the vote—are in the end the outcome of political bargains that are bound to be locally forged. Asia has a long tradition of adapting and remolding ideas from outside. During the crisis, international pressure and the financial incentives from the World Bank and other lenders provided the context for initiating various poverty and social insurance programs. In the long run, we must look to democratic politics to see which ideas take root and in what forms they blossom. With this in mind, the impact of these social programs and others will be longest lasting if they contribute to the development of politics that are more democratic and to the shaping of a more explicit Asian social contract.

NOTES

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

2. Moreover, although East Asia in the 1980s and 1990s was, as a whole, much more equal than Sub-Saharan Africa and Latin America, it was no more equal than the Middle East and North Africa and was less equal than South Asia or the advanced industrial states (Ahuja et al. 1997: Table 3.1).

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

4. Ahuja et al. 1997: Table 2.1 (p. 6) shows the percent of population in poverty in Malaysia and Thailand below 1 percent in 1995.

5. Gupta et al. 1998: Table 1. The poverty line per person ($/month) was $227 in Korea (apparently 1990s dollars) (with citation to Sung 1997). There continues to be some controversy about the setting of the poverty line in Indonesia; a comparative assessment of Indonesia's and the Philippines' poverty lines used in the 1980s suggests that the incidence of poverty in Indonesia was understated compared to the Philippines at that time (Asra et al. 1997).

6. High interest rates in normal circumstances restrict access to credit more for small than for large borrowers. In Korea, for example, the number of bankruptcies doubled between November and December 1997, and remained above the pre-crisis level until August of 1998. Unemployment data confirm that workers in small firms were the ones most likely to be laid off.

7. The income figures cited here are in purchasing power parity (PPP) terms, which are higher for these countries than conventional estimates of GNP per capita. Estimated per capita GNP for Indonesia in 1995 was $3880 in PPP terms and $980 in conventional terms; for the United States in that year, both the PPP and conventional estimates were $26,980 (World Bank 1997). The PPP estimates take into account differences across countries in local prices of non-tradables; prices for them tend to be lower than the lower average income in a country.

8. Some household data indicate that among the richest 25 percent of households in Indonesia, almost one-half the household budget went for food in 1996; this high percentage is an indication of the relatively low absolute income even of the relatively well-off. The proportion of income spent on food by the average household in Indonesia is 70 percent, compared to 10 percent in the United States (Poppele et al. 1999).

9. The principal sources for this section are: for Korea, Park 1999; Moon et al. 1999; Fields 1999; for Indonesia, Beegle et al. 1999; Poppele et al. 1999; Thomas et al. 1999; for Thailand, The Brooker Group 1999; World Bank Thailand Office 1999a and 1999b; Pongsapich and Brimble 1999; Kittiprapas and Intaravitak 1998. For an excellent review covering all countries, see Manuelyan-Atinc 1999.

10. SMERU 1999; Thomas et al. (1999) corrects for differences in inflation, leading to a higher estimate of the decline in rural areas.

11. World Bank Thailand Office 1999b.

12. “Academics Tell Government to Set Up Safety Net,” The Nation, June 7, 1998.

13. The World Bank has supported the social fund approach extensively in Latin America and Africa; in those regions the targeted beneficiaries are those at the lowest levels of poverty.

14. A. Ashraf, “PM Says No to Dole as Wider Safety Net,” New Straits Times, June 10, 1999, p. 2.

15. As of July 1998, wages had dropped by 12.4 percent in real terms (Park 1999).

16. Even when these contributions are, for all practical purposes, payroll taxes, they are typically understood to provide “insurance” rather than unearned transfers. Even when employers contribute, it is not clear who bears the real costs of the payroll tax. Employers can pass on the costs to consumers in the form of higher prices as long as the demand for their product is not too price-elastic. In open economies this will be difficult in the tradable sectors. Employees will indirectly bear the costs of employer contributions the more flexible wages are.

17. To the extent that the markets remain wary of resulting fiscal deficits, the IMF can play a role in distinguishing between countries depending on their fiscal history, thereby supporting appropriate counter-cyclical efforts in settings where fiscal discipline has been the norm.

18. It is Singapore, with a dominance of American, Japanese, and European multinationals, that has the most comprehensive—and costly—form of social insurance in its Central Provident Fund.

19. In Chile, efforts to reduce the high administrative costs of the privately managed funds by reducing the number of eligible managers (among other steps) were resisted, but were eventually overcome.

20. See for example Deyo 1989; Frenkel 1993; Frenkel and Harrod 1995.

21. Diwan 1999, shows that, in general, financial crises are associated with declines in the labor share, which are not made up fully in the aftermath of the crisis.

22. In the short run, the absence of center and center-left parties, which in the West played this role, is a constraint; the question is whether a political force representing the diverse interests of these groups will emerge as a healthy counterpoint to the historically powerful conservative and pro-business forces.

23. Recent estimates of the cost of the financial crisis are as high as 30 percent of annual GDP, far higher than in Mexico and Venezuela, where records show the cost to be about 15 percent of GDP (Pangestu, personal communication 1999).

24. Graham and Kane (1998) shows that politically “opportunistic” social expenditures may benefit the poor (and help build the case for economic reform), but at the risk of inefficiency and misuse.

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