The Asian Crisis and Human Development

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1 Introduction

The emerging economies of East Asia had a history not only of sound macroeconomic management, high growth and investment, but also of above average achievements in human development. Promotion of Human Development (HD) involves improving human conditions so as to enlarge choices. Health, nutrition and education are particularly important elements in a human development strategy, especially at the early stages of development.[1] It can be argued that human development achievements were a crucial ingredient in the East Asian spectacular success. All this changed in 1997 when difficulties in export markets and lack of access to international finance initiated the current economic and financial crisis.

This article aims to analyse the nature of adjustment from an HD perspective in the five countries most seriously affected by the crisis: Thailand, Korea, Indonesia, Malaysia and the Philippines. The first part of the article is devoted to reviewing the way in which HD is likely to be affected by the crisis (section 2). Section 3 suggests remedies, including the main elements of a pro-Human Development adjustment package. Section 4 presents conclusions.

2 The Crisis and Human Development

In order to understand the way in which the crisis affects HD, it is important first to analyse the mechanisms by which HD was so effectively advanced in the past in much of East and Southeast Asia. Human Development is the outcome of the rate of economic growth and the way that it is generated and allocated. It is important to differentiate between two types of income: first, *primary* income (or *private income*), i.e. income derived from the economic system, including employment and self-employment, subsistence production and income from assets; secondly, *secondary* income or *social income*, derived from the state via social production of free (or subsidised) goods and services and income transfers (e.g. unemployment

[1] The Human Development approach was initiated by the UNDP in a succession of *Human Development Reports* – see especially the first report (1990) for a discussion of the definition of Human Development.

benefits). (Private transfers – most often within families – can provide another important source of support.) Poverty arises when either primary or secondary incomes are inadequate to meet what are considered minimum needs.[2] The first type of poverty may be called private income poverty (PIP) and the second, social income poverty (SIP). PIP depends on how primary income is distributed among households, SIP on how secondary income is allocated by government to social priorities. Together they determine the relationship between growth and the basic objective of HD.

2.1 Review of past achievements on Human Development, 1970–90

Turning first to PIP, each of the countries, apart from the Philippines, was remarkably successful in reducing both rural and urban poverty over the past 25 years: in Indonesia PIP was estimated at around 57 per cent of the population in 1970 and had fallen to just 15 per cent by 1990; in Korea in 1984 PIP was estimated at only 4 per cent; in Malaysia private income poverty fell from around 50 per cent in 1970 to 15 per cent in 1990; Thailand's rate fell from 39 per cent at the end of the 1960s to 13 per cent in 1992. The Philippines was the one exception, with poverty rates still at 45 per cent in 1991.[3]

Three factors explain this generally good record on poverty reduction: the rapid growth in output and incomes, the generally high employment elasticity of output growth, and the sustained growth in agricultural productivity. With the exception of the Philippines, the countries enjoyed growth in per capita income of 6–8 per cent for most of the period. Moreover, the growth was led by labour-intensive exports generating a fast rise in employment. For example, in the 1980s Indonesia's manufacturing employment is estimated to have grown by 11 per cent p.a., while that of Korea grew by nearly 6 per cent p.a. and that of Malaysia by over 4 per cent p.a. In the Philippines, in contrast, there was slow growth in per capita incomes and manufacturing employment fell during the 1980s. In each country, there was also reasonably high growth in agricultural output, contributing to rising rural incomes, both in agriculture and in linked non-agricultural activities. Thus the generally remarkable improvement in PIP was achieved as a consequence both of the high growth in GDP and the composition of that growth.

It should, therefore, be emphasised that the reduction in PIP was due to the workings of the economy and not to safety-net type schemes aimed at helping the poor. Generally, there were rather few specific interventions in place to aid the poor, which is not surprising in view of the fact that poverty was falling without government intervention directed towards that end.

SIP also fell substantially over the same period. For example, in Malaysia 40 per cent of the population had no access to health services in 1980 and this had fallen to 12 per cent by 1993. In Thailand 34 per cent of the population were without access to safe water in 1980 and by 1994 this had fallen to 19 per cent. In 1965, 78 per cent of girls were not enrolled in secondary school in Malaysia, and by 1993 the proportion had dropped to 39 per cent; in Indonesia 93 per cent of girls did not go to secondary school in 1965, and by 1993 the proportion was 61 per cent.

Good performance on SIP was again due to a combination of high economic growth and its allocation. These countries did not devote a particularly high proportion of their GDP to government expenditure (below 20 per cent, with the exception of Malaysia where the proportion was nearly 30 per cent in the 1980s), although they did have a quite high social allocation ratio (i.e. the proportion of government expenditure going to the social sectors); for example, Thailand spent 16 per cent of government expenditure on the education and health sectors in the 1980s, rising to 28 per cent in the 1990s, while Malaysia had a social allocation ratio above 20 per cent. Indonesia's was lower, but

[2] There is much debate on how to define the 'poverty line' and how to measure the numbers who fall below it, including efforts to incorporate some indication of the depth of poverty. This debate will not be considered here.

[3] Estimates of poverty vary greatly according to how the poverty line is drawn, the price indices used, and whether households or individuals are counted. The estimates above are derived from a variety of surveys brought together by H. Tabatabai (1996) *Statistics on Poverty and Income Distribution*, ILO, Geneva. The precise figures may easily be disputed, but the direction of change is clear.

Table 1: Social expenditure in most affected countries, 1980–95

Country	Govt. expenditure % GDP		Education expenditure % government		Health expenditure % government		Education plus health % GDP	
	1980–90	1990–95	1980–90	1990–95	1980–90	1990–95	1980–90	1990–95
Indonesia	20.2	17.3	8.9	10.5	2.5	2.7	2.3	2.3
Korea, R.	16.6	17	21.5	17.7	1.3	1.1	3.8	3.2
Malaysia	28.9	26.1	16.4	16.6	4.4	5.6	6.0	5.8
Philippines	16.5	19	9.1	10.5	5	3	2.3	2.6
Thailand	16.4	14.9	12.1	19.8	4.2	8.1	2.7	4.2
Av. Asia	19.6	20	10.5	12.3	4.2	4.4	2.9	3.3

Source: World Bank, 1997, *World Development Indicators*, UNDP *1997 Human Development Report*, UNESCO, *1995 World Education Report* and *1996 Statistical Yearbook*

was well distributed, with an emphasis on primary education and health care (see Table 1).

While the proportion of GDP going to the social sectors was not particularly high by international standards, fast economic growth meant that social expenditure increased rapidly. For example, it is estimated that expenditure per head on education increased threefold or more in Indonesia, Malaysia, Korea and Thailand between 1980 and 1995, but by much less in the Philippines.

Despite this good performance, there remained significant levels of SIP in the Philippines, Thailand and Indonesia, with a quite substantial proportion of the people without access to some basic services, as is apparent from some of the figures given above. But SIP was very low in Korea and relatively low in Malaysia.

Those who did remain in poverty over time, the 'old' poor, mainly those who failed to gain access to formal sector jobs or modern social services, remained largely dependent on traditional support systems, i.e. from the family, the informal sector and the community, while NGOs (local and foreign) provided a bit of support. They had not been 'floated' out of poverty by the spectacular rise of income and its relatively equitable distribution experienced by most of the countries under observation. But by the mid-1990s their numbers, as we have observed, were generally not large by least developed countries (LDC) standards; the 'new poor' created by the crisis potentially represent a quantitatively more formidable problem.

2.2 Impact of the crisis

We should distinguish between the consequences of three types of change associated with the crisis: the immediate effects of the sharp reversal from capital inflows to outflows; government policy changes, including those demanded by the IMF; and individual and household responses. The first of these constitutes the source of the problem, while the latter two represent efforts to adjust to it.

With respect to PIP, there is likely to be a severe decline in income as formal sector output and employment are reduced, due to the worsening financial situation, contractionary fiscal and monetary policies, and devaluation, together leading to private bankruptcies and downsizing in both private and public enterprises and reductions in the size of the civil service – usually all under the auspices of the IMF.

The effect of these responses is likely to be a large and sudden increase in unemployment, and consequently an increase in PIP. Some reverse migration has already begun as countries eject foreign workers, creating refugees and additional poverty in their countries of origin (as recipients of such ejected workers, the Philippines and Indonesia are likely to be most adversely affected in the region).

People working in the urban informal sector, who account for as much as half of the urban labour force in some countries, will not be so immediately or severely affected by these policies. But those in the 'modernising' subsector will suffer through their linkages to the formal sector and consequently see a diminution in their markets for producer and consumer goods. In the traditional part of the informal sector, new entrants from the newly unemployed will depress average incomes there.

The agricultural sector is less affected by the crisis, except for the special situation in Indonesia where a coincidence of drought and forest fires is severely curtailing food output and reducing agricultural incomes. There will be some tendency, especially in Thailand and Malaysia, for rural–urban reverse migration, which is liable to depress average incomes in agriculture and increase rural poverty, while providing shared subsistence for the migrants.

There are many ways in which households and individuals adjust to crisis. We have already mentioned the move back into the urban informal sector and into agriculture. Other responses are likely to include some increase in the female labour force participation rate, especially in the informal sector, while the male participation rate decreases as formal sector employment opportunities fall back, although women's employment in some of the export industries will also be adversely affected. Households also adjust to reduced family incomes by substituting low-cost for high-cost sources of nutrition, and by reducing 'luxury' consumption generally. The effects on nutrition are likely to be less marked than effects on income, especially as women gain greater control over household income with increased participation. But it is likely that expenditure on items such as education – school uniforms and books – will tend to be cut back.

All in all, household and community adjustments may moderate the negative impact of the crisis, but cannot eliminate it, especially since the adversity is generalised, and in some cases (e.g. Indonesia) exacerbated by other exogenous shocks.

Forecasts for GDP contraction in 1998 are for 7.8 per cent in Indonesia, 4.1 per cent in Thailand, 2.8 per cent in Malaysia, and 2.3 per cent in Korea.[4] The Philippines is expected to continue to show reduced but positive growth of around 2.0 per cent in 1997, while Malaysia's GDP is expected to be roughly stable. But forecasts change month-by-month. There is a likelihood of large reductions in employment in the modern sector, of perhaps 10-15 per cent in Indonesia and Thailand. All such figures are, of course, speculative. Actual developments depend on how the crisis is handled, including success in sustaining or restoring political stability (especially in Indonesia).

It is estimated that at least 6–12 million Indonesians may lose their jobs in 1998. In Korea, the downsizing of chaebols may result in the loss of one-and-a half million jobs, as 3,000 businesses became bankrupt each month. By May 1998, unemployment had already doubled to 1.5 million and was expected to reach 2 million by the summer.[5] In Malaysia, employment cuts will fall initially on the foreign population from Burma, Bangladesh, Cambodia and Indonesia. The government is expected to expel half the 1.8 million foreign workers. Thailand has already committed itself to restructuring public enterprises, closing many finance companies and some banks, all steps translating into job cuts. Like Malaysia, Thailand hopes to lessen the pain of unemployment for Thais by slashing the number of foreign workers.

The newly unemployed will obviously suffer a drastic loss in income. Those who retain their jobs are also suffering as a result of the sharp price rises associated with devaluation and the removal of price controls and subsidies. For example, in Korea petroleum prices were already up by nearly 40 per cent and kerosene prices by 80 per cent by the end of 1997. In Indonesia, employees have suffered real wage cuts of around 50 per cent. Although the reductions in employment will not directly hit the

[4] Taken from the *Financial Times*, 22 May 1998, apart from Korea which comes from Neil Saker of SocGen Crosby in Singapore, quoted in *Financial Times*, 11 February 1998. ADB forecasts are less alarmist (at +2.4 per cent for the Philippines, +2.5 per cent Malaysia – 1.0 per cent Korea, and -3.0 per cent in both Indonesia and Thailand) (*Financial Times*, 24 April 1998). The Bank of Korea, however, reported an actual decline in GDP of 3.8 per cent for the first quarter of 1998, a fall of investment of 40 per cent and of consumption of 10 per cent (*Financial Times*, 27 May 1998). Moreover, the expectations about Indonesian incomes worsen as the political crisis develops: one estimate is for a fall in income of 15 per cent in 1988 (*Financial Times*, 23–24 May 1998).

[5] *Financial Times*, 18 May 1998.

pre-existing poor in the first instance, there are bound to be knock-on effects arising from the reduced dynamism of the formal sector and the price rises associated with currency depreciation, increased indirect taxation, and, in the case of Indonesia particularly, rising food prices resulting from the agricultural crisis as well as disruptions in transport and distribution due to the political crisis. The old poor, especially in the urban areas, are likely to be especially severely affected since, possibly unlike the new poor, they do not have the buffer of prior savings.

In most of the countries, there are virtually no safety nets for the newly unemployed. The traditional systems that supported the poor in the past – the ability to retreat to subsistence production, close family links and support from the community – have been seriously weakened with the advent of a dynamic, modern, urban economy. Yet new social security systems suited to a modern industrial economy have not yet been put in place. The reliance on a growing economy which proved to be so successful in reducing poverty over the previous 20 years had a severe flaw in making no provision for social security for the newly unemployed, except for Korea where some unemployment insurance is in place. In Korea, unemployment insurance extends to about one quarter of the jobless – those who have paid sufficient contributions in the past – and they will be covered for only a few months on half pay. But most of the newly unemployed workers in Korea, and almost all elsewhere, are likely to suffer considerable hardship unless some provisions are put in place; but at a time of crisis it is not possible to introduce comprehensive support systems.[6]

Turning to SIP, government expenditure is likely to be reduced, though the extent depends on the policy package ultimately agreed upon. In any event, a reduction in the growth rate will have a downward effect on public expenditure. There is likely to be some increase in the proportion of government expenditure going to foreign debt servicing following devaluation, but the effects will be less than in the Latin American case because more of the debt is in the private sector; there is also, however, a danger of a rising proportion of government expenditure going to bail-outs, due to government guarantees, implicit or explicit. For both these reasons there is likely to be downward pressure on the proportion of government expenditure available for the social sectors, i.e. the social allocation ratio.

With the downward pressure on both total government expenditure and the social allocation ratio, SIP is likely to rise in the absence of specific countermeasures. Nevertheless, it seems probable that the short run deterioration in PIP will be more acute than the deterioration in SIP since SIP usually has its own momentum and is rarely reversed quickly.

3 Suggested Remedies

The objective of all the remedies to be discussed here is to attempt to minimise the HD cost of the inevitable need to adjust to the crisis. This will include the avoidance of unnecessary losses in GDP, as well as specific policies to protect human development among those worst affected. In this discussion we will first focus on the real and then the financial adjustments at the macro level, before turning to specific actions at meso and micro levels.

3.1 Real adjustments

The macro situation is key to determining the extent and duration of the crisis. It is essential to avoid excessive deflation and attempt to achieve recovery as quickly as possible. It is widely acknowledged that the IMF, under the influence of its prior Latin American experience, has tended to overstate the deflationary requirements of crisis management, particularly initially, and has focussed excessively on the government accounts. Among the adjustments required, priority should be given

[6] The situation bears resemblance to that of nineteenth century Britain. When the previous systems for protecting the poor had broken down, the emerging industrial society posed new problems of cyclical and chronic unemployment, and there was as yet no provision for the support of the unemployed. The harsh Poor Laws in Britain of 1834 were a response to parishes' inability or unwillingness to provide for the many migrants associated with the industrial revolution and the enclosure movement. The Poor Laws provided minimal support for the destitute, often in horrendous conditions in workhouses. They did not meet the needs of the 'new poor' created by cyclical industrial unemployment. While the beneficiaries from the Poor Law provisions amounted to less than 3 per cent of the population in 1885, Booth and Rowntree estimated urban poverty at about 30 per cent. (See M. Rose, 1986, *The Relief of Poverty 1834–1914*, London: Macmillan.)

to measures which restore the confidence of the private sector, rather than placing an excessive emphasis on government cutbacks.

There clearly exists an overall absorption problem which has to be faced since foreign financing has been drastically reduced and current account deficits remain high. Although the IMF/World Bank/ADB (Asian Develpment Bank) plus bilateral donors have already contributed or will contribute some additional finance to cover short-term needs, such contributions are likely to be inadequate to meet the aggregate needs arising from debt servicing and the current account. As absorption is reduced it is important to protect private consumption by the poor as well as the social expenditure directed towards the poor. Unavoidable cuts should be focussed on luxury consumption as well as 'luxury investment'. In general, given the very high past levels of investment, their deteriorating quality, and the probably temporary nature of the crisis, a large proportion of the burden of any cuts should be focussed on investment rather than on consumption by the majority of the population.

With respect to the public sector, what is needed most of all is a reorientation of government expenditure: this will require a major reduction in defence expenditure[7] and a thorough review of government infrastructure projects with strict prioritisation, the cancelling of some clearly uneconomic prestige projects, the postponing of others, proceeding only with those which have clear priority for economic growth and/or HD maintenance.

Within the private sector a parallel reorientation of private investment and consumption is called for – away from real estate and towards new and productive sectors; and away from luxury consumption by the rich to consumption by the poor. Such reorientation may be achieved by the use of excise taxes on real estate and luxury consumption. In the longer run a review of indirect taxes and subsidies in each country is needed to remove subsidies from all non-essentials (including food consumed largely by the rich), to raise indirect taxes on high income consumer goods, to remove them on products consumed mainly by the poor, and, if fiscally feasible, to introduce subsidies on a few basic food items consumed largely by poor urban consumers.

In the longer term current account deficits should be constrained to moderate levels (with 4 per cent of GDP a maximum, and rates of 2–3 per cent preferable on a sustained basis) to avoid a build-up of debt obligations and the consequent vulnerability to speculative attacks. It is notable that the three Asian systems relatively unaffected by the current crisis – China, Taiwan, and Singapore – have been running surpluses or, as in China's case, only a small deficit expressed as a percentage of GDP. Within limits, foreign borrowing is not inappropriate for emerging countries but makes sense only if it is allocated to productive investment as opposed to consumption binges or real estate speculation.

Foreign Direct Investment (FDI) is preferable to short-term portfolio flows, as it is less volatile, shown by the fact that it has been affected little by the recent crisis.[8] Countries should therefore take measures to encourage FDI, at least relative to short-term portfolio capital flows, by providing disincentives for the latter along the lines of the one-year deposit requirement (without interest payment) adopted by Chile or some variant thereof. However, it would be politically undesirable and economically second-best to encourage bargain-basement purchases of existing facilities by foreign investors.

3.2 Financial sector adjustments

To achieve stabilisation there is a need to generate renewed confidence by foreign investors in these economies, in order to avoid further capital outflows and further declines in the exchange rate. As already pointed out, this requires regaining the confidence of foreign private investors in the

[7] Defence expenditure cuts already are underway: in Malaysia defence expenditure was estimated to have been cut by a fifth in 1998, with further cuts planned, with a reduction of over 40 per cent in real terms in Indonesia, a 35 per cent cut in the defence budget in Thailand, and 30 per cent in S.Korea (*Herald Tribune*, 23 April 1998).

[8] A survey of multinational companies by UNCTAD showed that 88 per cent of firms intend to press ahead with or accelerate their existing investment plans in East and Southeast Asia. While 12 per cent intend to reduce their investments, a quarter of the firms intend to increase them in response to new opportunities created by the crisis (*Financial Times*, 19 March 1998).

effectiveness of the reform package. So far this has not been achieved in Indonesia, and only partially elsewhere. Such restoration of confidence would be greatly assisted by larger standby commitments, including by foreign governments, which may not need to be drawn upon. In the case of Mexico in 1994, such a commitment was provided primarily by the US. In Asia it seems appropriate that Japan should play an equivalent leadership role, possible US and IMF objections notwithstanding.

Second, it is necessary to reconsider the fixed exchange rate policies of the past and replace them with managed floats. The fixed rate vis-à-vis the dollar led to unjustified exchange rate appreciation and made the economies increasingly uncompetitive compared with China and Japan, ultimately generating speculation against the currencies. With more flexible exchange rates it should also be unnecessary to maintain such extremely high interest rates; however, some rise in real interest rates relative to the pre-crisis situation may be warranted in the short-term to curtail some of the less productive investments, which will help the countries deal with the problem of reducing their absorption.

Third, in each country, instead of bail-outs or allowing the market to determine the fate of companies through mass bankruptcies, a review of financial institutions and enterprises is needed, distinguishing between good and bad debts, and allowing for mergers, bankruptcies and rescues, as appropriate. In addition, the entire debt situation of each country, and of the major indebted enterprises within it, should be reviewed, swapping short- for long-term debt at as favourable terms as possible. In this context, foreign private investors should be made to share in the costs of adjustment, along with everyone else.

Fourth, consideration should be given urgently to the adoption of Brady Loan-type packages for each country. In the absence of such packages it would be especially difficult for these countries to export their way out of debt, given the fact that they are already highly export-oriented.[9]

Fifth, financial sector reforms are urgently needed. These include the full disclosure of the size of foreign exchange reserves, bank balance sheets and non-performing loans; total foreign currency reserves should be at least as big as total short-term liabilities; orderly bankruptcy procedures and their implementation are needed; as is the substitution of objective risk analyses and arms-length credit allocations for political favouritism and government guarantees of private loans; general adherence to Bank of International Settlements (BIS) recommendations on the adequacy of bank capital reserves must be enforced; and most importantly, local banks must be forbidden to be net debtors in hard currency.

Sixth, there should be no further liberalisation of capital accounts at this time, and certainly not before the financial sector reforms have been gradually put in place.

3.3 Suggested meso and micro actions

Currently there are few policies in place to protect either the old or the new poor, since, as noted earlier, these countries were able to rely on a growing economy to float their people out of poverty over time. Therefore, there is an urgent need to introduce some new policies to deal with the human impact of the crisis.

The need for support – in terms of numbers to be covered and duration of coverage – will depend critically on what happens to the macro-economy, as has been pointed out above. This is the fundamental reason why deflationary policies should be avoided as much as possible, and the focus be put on improved regulatory and financial systems to reestablish confidence in the system.

A universally accessible support system should have the following features:

- Some provision, of one kind or another, to be available for all who need it, not limited in coverage by a pre-set expenditure limit.
- Whatever form it takes, individual support should be set at feasible levels (e.g. at the nationally defined poverty level). This would almost

[9] The example of Latin America in the 1980s is instructive. It took eight years or so of economic stagnation before the Brady Plan turned the situation around.

certainly mean a cut in living standards for the newly unemployed compared with their previous situation.

There is talk by the International Finance Institutions (IFIs) of the need to introduce some social safety nets. Yet the past record of safety nets which IFIs have supported elsewhere has been extremely poor, in that the schemes have almost invariably reached only a fraction of those in need. Food subsidies have been narrowly targeted, missing the majority of the poor, while Social Funds and/or special credit schemes have typically covered an even smaller proportion.

The following types of programme should be considered to help offset the rise in PIP, depending on the particular situation:

1. Public employment schemes aimed especially at the newly unemployed, in both urban and rural areas. The idea would be that jobs at low wages are available to anyone who comes forward. The schemes should contribute to appropriate infrastructural projects in rural and urban areas, in part possibly replacing some of the larger scale schemes that may have to be cut at the national level. In some cases, the military, especially those with engineering skills, could help organise and develop these projects. Support systems of this type have been helpful in adjusting countries elsewhere in the world, e.g. Chile and Botswana.[10] In the early 1980s Chile introduced open-ended public works schemes that were effective in reaching as many as wanted employment at the very low wages offered. At one point 13 per cent of the labour force was employed in these schemes.[11]

2. Supply of food relief channelled through the market in order to bring food prices down where there has been significant agricultural failure – notably Indonesia. Such provision should preferably use domestic buffer stocks, supplemented only if necessary by international shipments of food aid.

3. Provision of food for especially vulnerable elements of the population, such as babies, children and pregnant and lactating women. Such schemes should be located in low-income areas (urban and rural).

4. Credit allocation for small and low income investors, i.e. those without substantial assets for collateral. This would be facilitated by requiring commercial banks to set aside a certain proportion of their loans at competitive rates for this purpose. In most cases, they would achieve this by lending to intermediaries such as the Grameen Bank or the Self-Employed Women's Association, specialising in this type of loan.

5. In general, measures to facilitate people's own adjustments are desirable, e.g. subsidies to community organisations providing meals for those in poverty[12] or setting up nurseries to look after the small children of mothers who have been forced to seek work.

6. The crisis underlines the need for a more self-reliant strategy, with a greater focus especially on balanced growth in the rural areas. This implies encouraging rural non-agricultural activities, including both industry and services, which are usually linked to the agricultural sector as inputs, processing or for rural consumption.[13] To the extent that urban industry and services continue to be relatively favoured by government policy, such discrimination should be removed, and infrastructural expenditure more equitably distributed throughout the country, a process which may be facilitated by a greater degree of decentralisation.

[10] See G.A. Cornia, R. Jolly and F. Stewart (eds.) (1987) *Adjustment with a Human Face*, Oxford: O.U.P.

[11] See D. Raczynski and P. Romaguera (1992) 'Chile: poverty, adjustment and social policies in the 1980s', paper prepared for the conference Confronting the Challenges of Poverty and Inequality in Latin America, The Brookings Institution and Inter-American Dialogue, 16–17 July, Washington DC, Santiago: CIEPLAN.

[12] As, for example, the *Comedores Populares* in Peru.

[13] For an analysis of the difference the policy framework can make in this regard see G. Ranis and F. Stewart (1993) 'Rural non-agricultural activities in development: theory and application', *Journal of Development Economics*, Vol. 40, No. 1, pp. 75–102.

7. Local governments and NGOs have an important role in assisting the newly unemployed moving into the informal sector or back to the rural areas and in promoting rural linkages, e.g. by providing public works, small credit schemes and information. They may also be able to tap additional local resources.

8. Information about all measures adopted to reduce PIP should be well publicised, both so that people can take advantage of them and that they do not have false expectations about the likely extent of state support.

9. For the longer term, these newly industrialising countries need to develop systems of insurance for the unemployed as the traditional support systems weaken, particularly once the majority of the labour force has moved into modern sector employment. As noted above, a start has been made in South Korea. Such systems would involve small compulsory contributions from employers and employees which would provide some income at a low level, say half their wage income over a transitional period. Equally, a longer term aim should be the provision of small means-tested pensions for those who cannot work (the old and handicapped specifically), as has been effectively introduced in some poor areas (e.g. Tamil Nadu). These measures cannot be introduced immediately, given the financial situation, but should be explored after economic recovery. They would ameliorate the human effects of possible future crises.

As far as social poverty is concerned, as noted above, there is likely to be a considerable squeeze on expenditure on social priorities, given the pressure on total government expenditure and the demands of interest payments and industry bailouts. Under these circumstances it is vital that priority services (primary health, potable water, and primary and secondary education) be protected, and that charges for these services are not introduced, especially at a time when PIP is rising. To achieve this, it will be necessary to (i) resist undue reductions in total government expenditure, (ii) maintain the social allocation ratio, and (iii) improve the allocation within the social sectors towards items which benefit the poor. For example, it is important to maintain primary education, possibly at the expense of government expenditure on universities. Indonesia provided a successful example of selective cuts in government expenditure which protected priorities in the early 1980s.[14]

As pointed out above, the countries in the region differ quite significantly in the proportion of GDP available for government expenditure (the expenditure ratio), in their social allocation ratios and in the proportion of social expenditure going to priorities for HD maintenance or growth. The appropriate policy mix will differ accordingly. Where the expenditure and social allocation ratios are already high, as for example in Malaysia, there is considerable scope for improving performance on SIP by reallocation within the social sectors towards HD-oriented priorities, while it would be difficult to raise expenditure and social allocation ratios substantially. In contrast, where the proportion of GDP going to government expenditure and the social allocation ratio are low, efforts should be made to raise both these ratios. An example is Indonesia where the INPRES system has ensured reasonably good priority allocation within the social sectors but where there exists a large potential for raising the expenditure and social allocation ratios.

An important issue is how the efforts just described to contain the rises in PIP and SIP in the context of the crisis would be financed. As implied above, examination of the budgets of any of the countries affected would lead to the conclusion that there remains much 'fat' which could be eliminated, and other projects which could be postponed. These include military expenditure and some large-scale prestige projects, mainly infrastructural. Systematic in-depth reviews would be needed to identify precise candidates for budget reallocation. Potential resources to finance some of the schemes suggested above can undoubtedly be found from such reallocation. It is important to remember that even in a tightly constrained government budget major savings can usually be made not only in military expenditure but also in administration and in the avoidance of low-priority expenditure of other types.

[14] See F. Stewart (1995) *Adjustment and Poverty: Options and Choices*, London: Routledge, Chapter 8.

Revenue-raising efforts by local governments should also be facilitated (e.g. by reducing restrictions on their tax-raising powers), particularly since they are likely to play a significant role in assisting the newly unemployed. It should be noted that the whole of public expenditure on the education and health sectors amounts to only between 2.5 and 5 per cent of GDP in these countries, while investment rates are generally over 30 per cent. Unlike other countries, investment rates are so high that there is a considerable potential for redirecting resources, public and private, to those social sector activities which directly affect low income groups.

Reform of the legal system is another important longer term reform needed to secure greater social justice, contributing to improving both SIP and PIP. Much misery and deprivation originates from human exploitation, either by private groups or by the state. The key factor in bringing about respect for civil rights is the existence of a fair and equitable judicial system. But resource scarcity, combined with manipulation and collusion by the powerful, has often biased the law in favour of the privileged. Access to the legal system is an important social good, often neglected in the analysis of poverty. It is not only a significant aspect of well-being in itself, but can also be essential to the enforcement of economic rights (e.g. the use of common or traditionally held resources). Legal access for women is particularly important and usually disproportionately weak. The absence of law, order, and judicial services, especially in poor neighbourhoods, severely limits the exercise of individual civil and property rights. In the longer term, a review of the legal situation, especially with respect to legal access by the poor, could improve both SIP and PIP with little budgetary expenditure required. The first prerequisite is that there exist a comprehensive and equitable system in the nation as a whole; the second, that the physical proximity of courts be sufficient to ensure reasonable access; the third, that poor people be able to procure proper representation in the courts and not be prevented from doing so by the absence of willing legal representatives or excessive costs. There is little systematic evidence available on these issues. A first priority is to collect such information so that the adequacy of legal access can be assessed on a country-by-country basis.

3.4 The role of international institutions

The prime responsibility for adjustment to the crisis while protecting HD must clearly rest with the countries themselves. International agencies, however, can influence the outcome, hopefully for the good. Thus far, the principal international actor has been the IMF, with the World Bank one step behind.

1. The notion of IMF infallibility has, however, become a casualty of recent events. Not only did the Fund fail to warn the countries adequately of impending problems, but its initial response was too much rooted in its prior Latin American experience, regarding the central problem as one of government profligacy in both its fiscal and monetary dimensions. Moreover, both Fund and Bank continue to urge further liberalisation on the capital account, which we believe to be inappropriate at this time. The fact that the IMF quickly had to go to second and third round amendments of its country packages in the region can be viewed as commendable, showing unusual flexibility, but it also meant that it failed to contribute to the early restoration of international confidence.[15] After all, it is generally agreed that it is not the public capital flows made available by the IMF and others which matter – these are small in relation to the total size of short-term debts–but the return of private flows as a consequence of restored confidence. The conclusion from this is that the institution seems ill-equipped to respond to crises that are primarily micro- and private-sector oriented, given its traditional focus on monitoring and affecting macro- and public-sector performance. We recommend that the IMF return to its original charter obligations, macroeconomic stability, while leaving to others – mainly the countries themselves – the responsibility for structural reform.

[15] One observer is said to have commented: 'We give countries a choice: the wrong advice from the Fund straight away or the right advice from the Bank too late' (quoted in the ***Financial Times***). Actually, the countries are NOT given that choice, but have to take Fund advice, nor is it clear that World Bank advice has been notably better.

2. The World Bank's prime contribution should be to provide support for structural reforms, possibly including financial sector reform, while desisting from pushing for across-the-board additional liberalisation at this stage. However, the BIS and some experienced central bankers from outside the region – e.g. Chile, Colombia or some OECD countries – are probably in a better position than the World Bank to provide advice on the hands-on details of the working out of existing debt and financial sector reforms.

3. Handling the current crisis clearly requires a much greater input of local knowledge than exhibited by the still highly centralised Breton Woods institutions. Nuanced advice and assistance cannot be provided by short-term visiting teams. Agencies rooted in the region should take a leading role, in collaboration with local experts, in helping governments develop a specific agenda of reform along the general lines outlined in this paper and in monitoring changes. This would mean a much greater role for Japan, the Asian Development Bank (ADB), and UNDP. We suggest revival of the proposal for the creation of an Asian Fund, previously rejected by the IMF and the US. Such a fund would be in a better position to develop policy packages that are sensitive to local conditions, as well as to secure additional financial commitments from countries in the region, including not only Japan but also Australia, Singapore and Taiwan. It is unreasonable for the US to prod Japan consistently to play a larger international role, but equally consistently to reject specific initiatives that Japan puts forward. Finance from the proposed Asian Fund could contribute to debt restructuring and structural adjustment packages developed in collaboration with the IMF, the World Bank and bilateral donors.

4. The UNDP, including relevant United Nations specialised agencies, particularly UNICEF and WHO, should create a specifically HD-oriented partnership with the ADB, based on their more differentiated local knowledge and acceptability. This partnership should:

(i) Focus on monitoring the HD consequences of the crisis and reactions to it, country by country
(ii) Finance highly qualified local experts and, with their cooperation, identify appropriate policy packages that are likely to contain poverty levels and help maintain HD
(iii) Identify and finance the specific pro-HD project and programme activities outlined in general terms above
(iv) Increase public awareness, locally and internationally, of the importance of the HD consequences of the crisis and of the fact that progress on HD can be maintained in spite of the crisis, if sharp increases in PIP, and especially in SIP, are avoided by the sort of measures discussed earlier.

4 Conclusions

The economic crisis is already having very harsh human consequences, and these are likely to increase over the next few months. A great deal will depend on how the crisis is handled, and on the political consequences that follow. It is already apparent that, while the crisis seems to have had common origins, country reaction has differed greatly. On the one hand, Indonesia's financial and economic crisis and the severe policies required by the IMF to deal with it have precipitated a political crisis; Malaysia has recently decided to reimpose foreign exchange controls and lower interest rates; South Korea and Thailand are attempting to make rapid adjustments under IMF auspices.

In each case, the magnitude of the human costs will be closely related to the speed and magnitude of adverse developments in the macro-economy. Consequently, the article has focussed quite heavily on the macro-side even though its purpose is to elucidate policies to prevent human costs. The affected economies potentially have the resources to protect the newly unemployed and others suffering from the crisis. But politically difficult decisions will be needed to secure these resources, including new sources of taxation and a drastic reorientation of government expenditure.

It is of critical importance that human development is protected during the recession, not only to avoid human suffering but also to facilitate resumed economic growth, since serious undermining of education, health and nutrition will have adverse economic consequences. In general, however, HD performance tends to be affected more slowly than incomes, in response to fluctuations in economic activity. The Asian economies are in a strong position to preserve and continue their past progress in HD. Moreover, because of their existing high levels of achievements on HD, they are also in a particularly good position to adapt to economic change and resume economic growth.