



an eye on east asia and pacific

2 Labor markets in East Asia during crisis: developments and policy implications?

by Chul Ju Kim*

The global economic and financial crisis did not result in dramatic labor market adjustments in East Asia in terms of employment loss and open unemployment unlike the 1997–98 Asian financial crisis ten years ago. This note attempts to compare the labor market outcomes of the two crises for countries that were hit the hardest during 1997–98 and explore the possible reasons behind the significant differences in adjustment patterns. Subsequently it provides a couple of policy implications.

Comparison of labor market adjustments during the crises

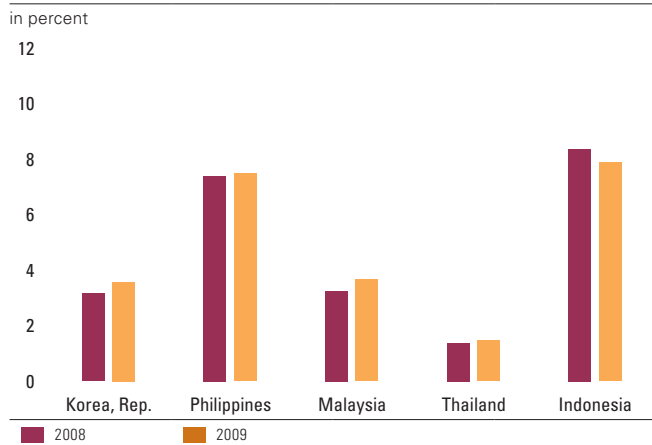
Stylized facts from the past crisis show that labor market adjustments during the crisis occur in the combination of; (i) household labor supply; (ii) quantitative adjustment on employment level and hours worked and/or price adjustment of wages; and (iii) a shift among labor market segments such as industry/agriculture and/or formal/informal sectors. The relative weight of each adjustment to the crisis depends on a number of factors including the structure of the economy, the magnitude and type of shocks, the degree of formality in the labor market and policy responses. This note explores outcomes of the two financial crises in East Asian countries in 1997 and 2008 in view of these labor market adjustments.

The economies¹ in East Asia were hit the hardest from the global financial crisis (GFC) in the late half of 2008. While the crisis itself was originated in the highly industrialized countries, they suffered from plummeting economic activities through channels of lower external demand, seizure of external financing, fewer tourist arrivals and reduced remittances, which could have inevitable consequences on labor markets as well. However, the labor markets of the countries in the region have not shown discernable impacts during the crisis. Of course, there has been some degree of job churning in certain sectors and segmental shifts in employment, and some countries had disproportionate impacts depending on their relative extent of integration into international trading system. But overall aggregate labor market indicators remained remarkably stable. This relative resilience in labor markets during the GFC was a stark contrast with painful adjustments in the aftermath of the 1998 Asian financial crisis (AFC) that the countries had to endure.

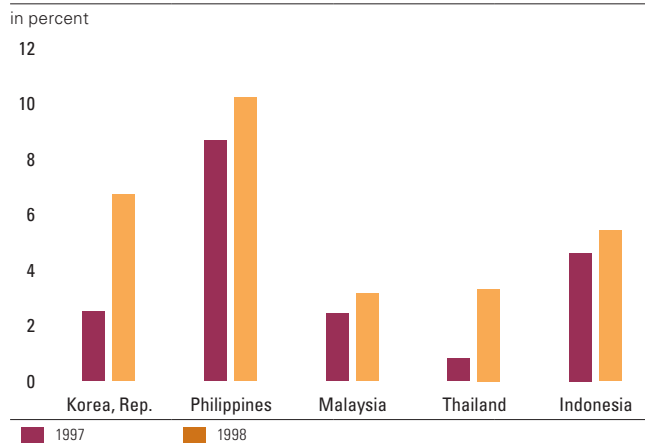
First of all, unemployment has remained remarkably resilient over the GFC period. Only Korea and Malaysia experienced a slight increase in open unemployment with only about 0.4 percentage points rise in 2009, and the Philippines and Thailand had no discernable unemployment rate change at all (Figure 1). Moreover, surprisingly Indonesia showed a relatively big decline in unemployment despite the GFC with unemployment rate continuing to decrease from 9.1 percent in 2007 to 8.4 percent in 2008 to 7.9 percent in 2009. In contrast, however, the AFC ten years ago led to unprecedented skyrocketing unemployment across almost all the countries (Figure 2). The most substantial was a rise in Korea's unemployment rate with a 4.25 percentage points increase followed by those of Thailand and the Philippines with increases of 2.5 and 1.6 percentage points, respectively, adding about a million workers in each country to the unemployment pool. Indonesia and Malaysia also showed an increase in the unemployment rate—though actual increase was less than 1 percentage points.

¹ In this note, we cover five countries that were hit hardest during both crises, namely Thailand, the Philippines, Malaysia, Indonesia and Rep. Korea.

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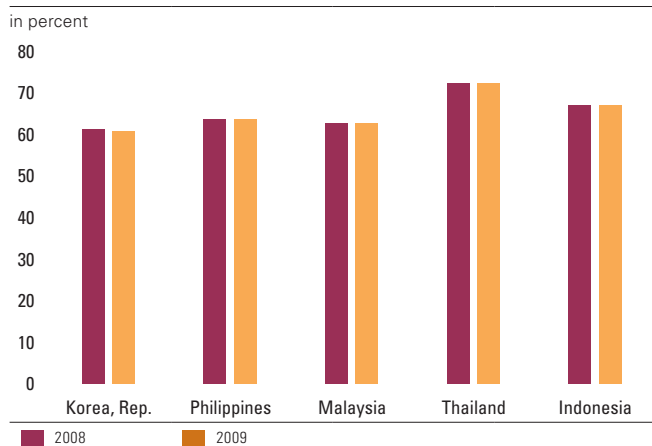
Figure 1. Unemployment rate during GFC

Sources: CEIC Data and staff calculation.

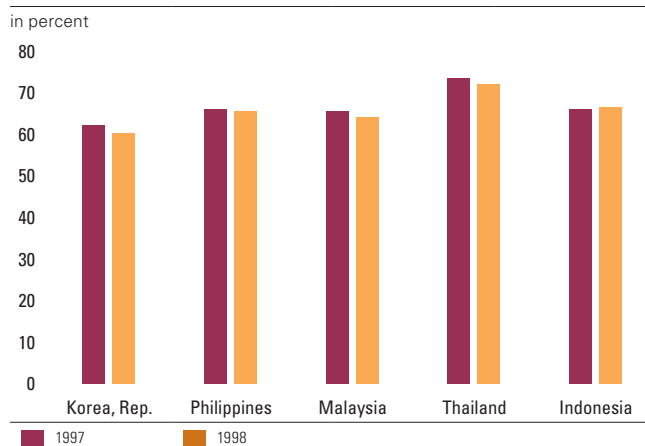
Figure 2. Unemployment rate during AFC

Sources: CEIC Data and staff calculation.

What caused this stark difference in unemployment? To answer this question, we need to look at the changing pattern of labor supply and demand. The change of labor supply depends on the relative extent of substitution and income effects. Ambiguous as the overall effect is, household labor supply during the crisis tends to fall meaning prevailing discouraged workers. Throughout the GFC labor supply did not change much in the countries as evidenced by stable labor force participation (Figure 3). The only country with a comparably big change in the region was Korea where labor force participation declined quite significantly. Whereas during the AFC, all countries except Indonesia experienced sizable declines in labor force participation suggesting many workers became discouraged and stopped looking for work (Figure 4). However, Indonesia during the both crises saw an increasing participation rate as more workers, especially women, joined the labor force possibly to compensate declining earnings—the *added worker effect*.

Figure 3. LFP rate during GFC

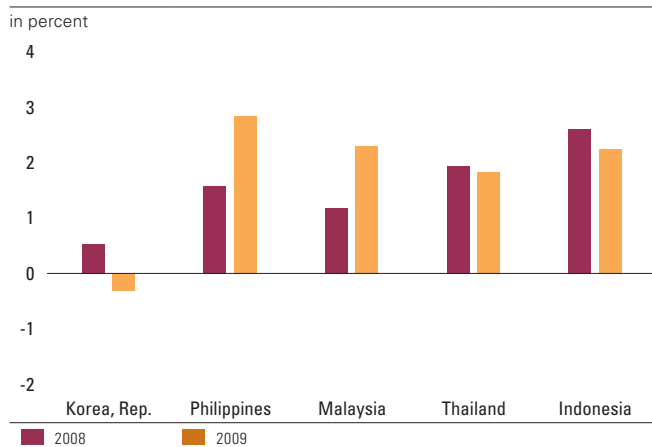
Sources: CEIC Data and staff calculation.

Figure 4. LFP rate during AFC

Sources: CEIC Data and staff calculation.

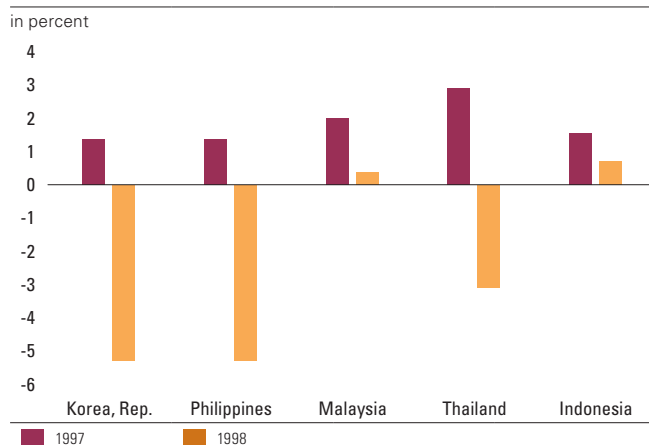
While there is a slight difference in adjustments in labor supply, the differences in changes in unemployment during both crises appear to be caused by changes in labor demand. The slowdown in economic activities translates into disproportionately reduced labor demand. Labor demand at the macro level during the GFC had no visible impacts, albeit changes in sectoral level composition (Figure 5). With the exception of Korea, all economies experienced employment gains during the GFC although the employment growth slowed – only moderate compared to previous years to the GFC. In sharp contrast, total employment during the AFC was much severely affected (Figure 6); Korea and to a lesser extent, the Philippines and Thailand experienced a huge amount of employment loss amounting to from 3 to 5.6 percent of total employment. While Indonesia and Malaysia showed slight employment gains despite severe reduction in economic activities, this was mainly a result of gains in informal employment in the agricultural sector, especially women.

Figure 5. Changes in employment growth during GFC



Sources: CEIC Data and staff calculation.

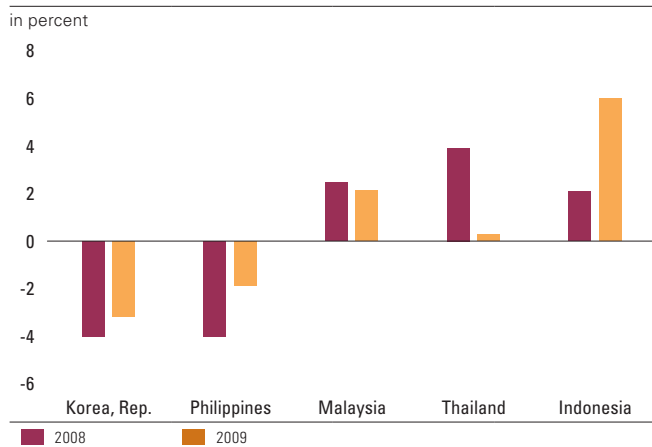
Figure 6. Changes in employment growth during AFC



Sources: CEIC Data and staff calculation.

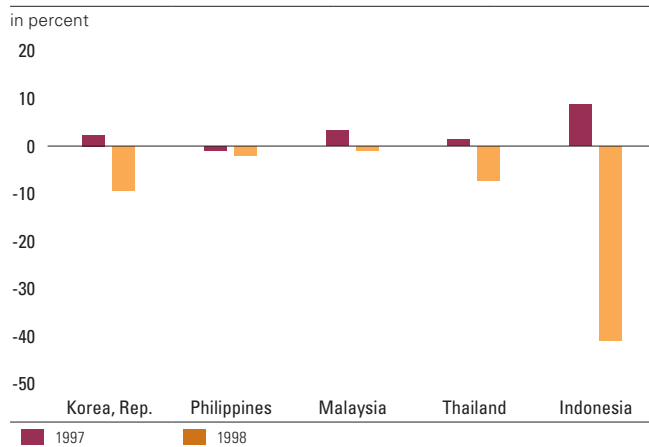
Finally, wages and earnings responded differently to the crises. Real wages during the GFC have actually increased during the GFC in line with increasing labor demand again with exception of Korea and the Philippines (Figure 7). Korea suffered from a drop in real wages due to employment loss and the Philippines appeared to have had negative impact on real wages by rising food and fuel prices coincided with the GFC. This increase in real wages needs to be interpreted with caution as it could be caused by a selection bias. Low-skilled workers vulnerable to the crisis tend to drop out of the labor market or move to non-wage segments, and as a result average wages could increase during an economic shock. However, the real wage trend appears to be starkly contrasted with the period of the AFC when significant wage adjustments occurred in all countries that were facilitated by sharp currency depreciations and higher inflation (Figure 8). Real wages fell dramatically by 41.0 percent, 9.3 percent and 7.4 percent in Indonesia, Korea and Thailand, respectively. The impact was much more intensified because the decline reversed the course of relatively high real wage growth over the past years before the crisis except Philippines.

Figure 7. Changes in real wages during GFC



Sources: CEIC Data and Betcherman and Islam (2001).

Figure 8. Changes in real wages during AFC

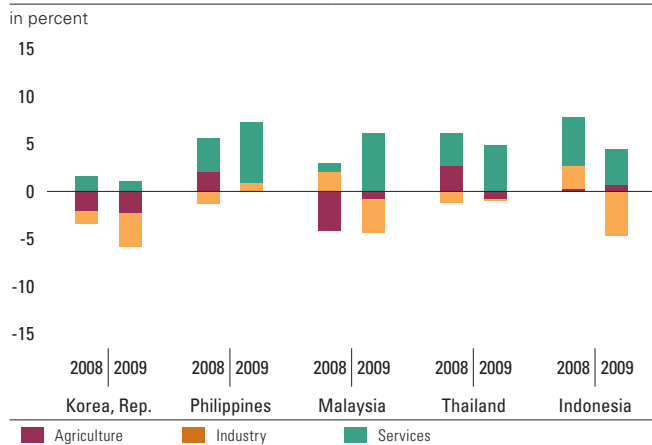


Sources: CEIC Data and Betcherman and Islam (2001).

Notwithstanding the difference in overall adjustments to the crises, there is a considerable similarity in job churning across the labor markets that masks aggregate patterns. However, as illustrated by Figure 9 and Figure 10 the magnitude with which churning across sectors happened is significantly smaller in the GFC. Above all, almost all economies underwent some degree of employment restructuring across sectors during the GFC. Particularly Thailand, Malaysia and Korea experienced a significant employment decline in the manufacturing sector as a result of their high integration with the international trading system. These losses are especially skewed toward women's works. For the former two countries this decline was offset by an increase in the number of workers in services. However, jobs in the service are usually considered low productivity jobs and could therefore only partially ease the burden of losing a job in the manufacturing sector. The shift of employment from manufacturing to the services sector was less drastic in Korea, probably because of its better social safety nets such as

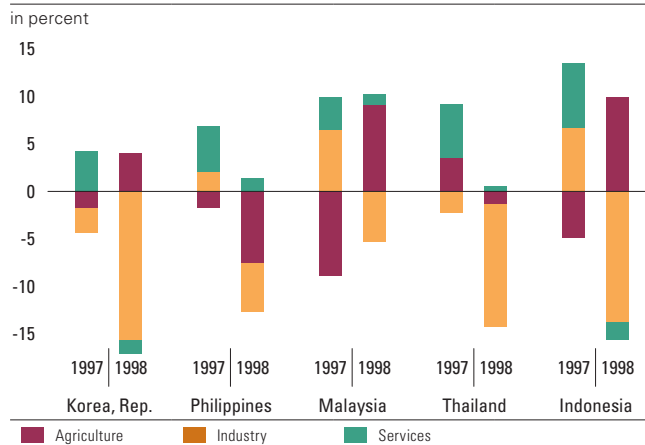
unemployment benefits. The agricultural sector in the Philippines lost some employment which was partially attributed to the erratic behavior of commodity prices throughout 2008 and early 2009.

Figure 9. Changes in employment across sectors in GFC



Sources: CEIC data and staff calculation.

Figure 10. Changes in employment across sectors in AFC

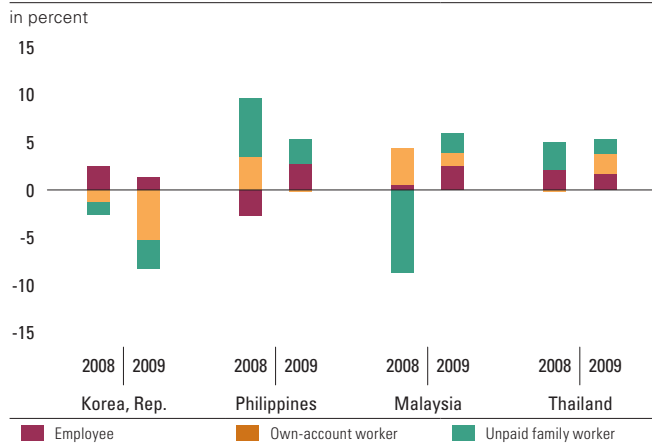


Sources: CEIC data and staff calculation.

The AFC was also accompanied by a substantial change in the sectoral composition of employment in all crisis-affected economies. The hardest hit were the construction and manufacturing sectors, in which employment markedly fell across the countries in accordance with severe decreases in construction and manufacturing activities.² Employment in agriculture considerably expanded playing a role of absorbing displaced workers from construction and manufacturing sectors in Indonesia, Malaysia and even Korea. On the contrary, agricultural employment shrank substantially in Philippines on the back of a record decline in agriculture activity of 6.4 percent in 1998 due to the effects of the severe El Nino drought. Services employment responded disproportionately to the contraction of services activity suggesting a large number of displaced workers moved to informal sectors, albeit in Philippines where services activity and employment increased.

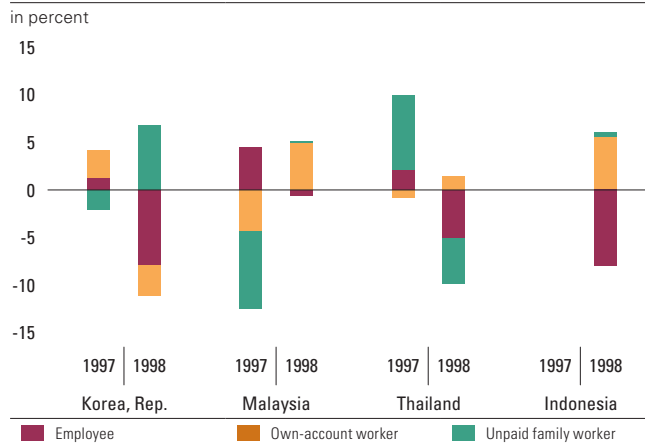
There are considerable changes in the composition of employment status as well during the both crises. Workers displaced from formal wage sectors tend to move to non-wage or family works that could have lingering welfare consequences. For the GFC we cannot observe a further informalization of the workforce (Figure 11). In Thailand, the Philippines and Malaysia unpaid family as well as paid employment increased. Interestingly, Korea experienced an increase in wage workers whereas the

Figure 11. Changes in employment status during GFC



Sources: CEIC data and staff calculation.

Figure 12. Changes in employment status during AFC



Sources: CEIC data and staff calculation.

² Changes in employment of the construction sector in 1998 were; -36.7% in Thailand, -21.3% in Korea, -16.2% in Indonesia, -9.5% in the Philippines and -5.9% in Malaysia.

number of employment for work typically associated with the informal sector actually declined. This may again be attributed to better social systems. In general the numbers suggest that employment rather increased during the GFC—probably because of the nature of the shock and the associated increase in food prices we will discuss further in the next section.

During the AFC as well, all economies experienced a sharp decrease in the number of wage workers suggesting displaced workers moved to informal sectors or discouraged to look for jobs. It accounted for roughly 50 percent in the total employment changes with Korea having more than 70 percent (Figure 12). This decrease in wage workers was offset, though partially, by increases of own account workers particularly by men and unpaid family workers particularly by women, depending on the structure of economies. For instance, Korea showed a decrease of own account workers reflecting a severity of domestic demand loss, while in Thailand the number of unpaid family workers sharply decreased.

Reasons behind different labor market adjustment during the crises

What are reasons behind these remarkable differences in the paths of labor market adjustments during the both crises? Many factors are involved. From the outset, the magnitude of shocks that hit the countries in late 2008 was much smaller than those of 1997–1998. The contraction in economic activity in 2009 among the economies averaged 0.3 percent with only Malaysia and Thailand showing negative growth. On the contrary, the average GDP growth rate in 1998 amounted to -7.3 percent, which tells a severity of labor market adjustments the countries went through.

Table 1. GDP changes during the AFC and GFC (%p)

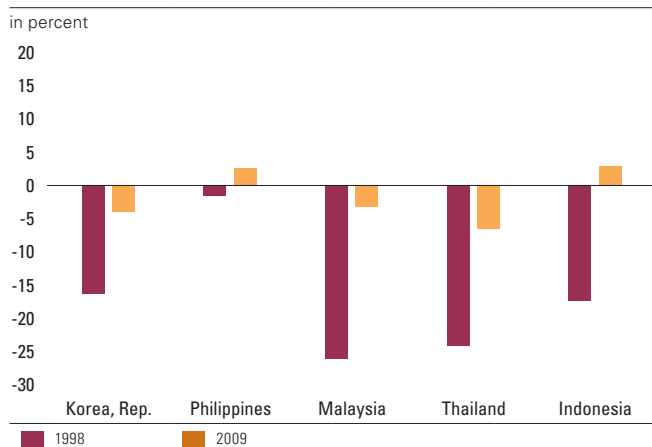
	IND	KOR	MAR	THA	PHP	Average
1997–1998	-13.1	-5.7	-7.4	-10.5	-0.6	-7.5
2008–2009	4.6	0.2	-1.7	-2.3	0.9	0.3

Source: CEIC data.

Furthermore, the different responses in economic activities to crises with different origins played an important role in making difference to the paths of labor market adjustments as well. The 1998 AFC stemmed mainly from internal structural weaknesses inherent in crisis-hit economies such as overinvestment, over-valued currencies and lax regulatory regimes

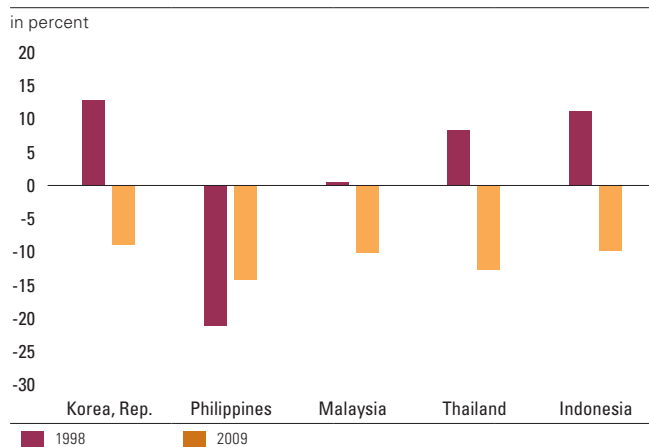
in financial markets. Once crisis started to spread, these internal factors led to a near collapse of domestic demand, while exports continued to expand partly thanks to a sharp depreciation of currencies under favorable trade environments except in Philippines. However, in 2008, the crisis was external and thus was export demand that drove the economic recession while the contraction in domestic demand was relatively mild. This appears to contribute to no discernable declines of employment during the GFC when falling export demands made job losses mainly confined to tradable sectors. In addition, as the GFC did not stem from structural weaknesses in financial and corporate sectors in the region, nor this crisis forced countries to embark major structural adjustments which helped to avoid additional labor market frictions and unemployment typically associated with structural reforms such as a closedown of non vibrant banks and corporate sector restructuring.

Figure 13. Changes in domestic demand



Sources: CEIC Data and staff calculation.

Figure 14. Changes in export demand

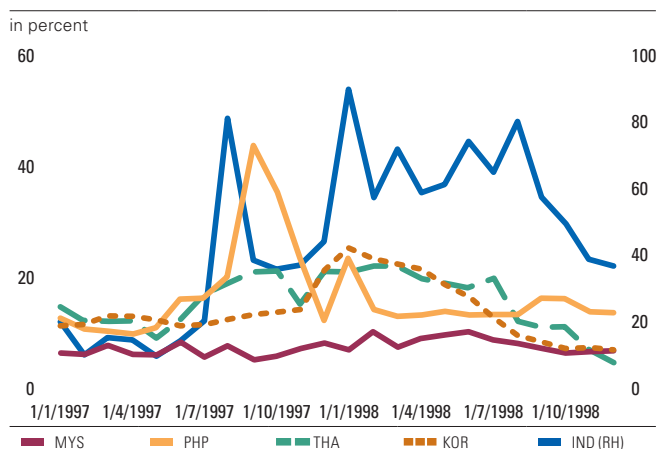


Sources: CEIC Data and staff calculation.

It is worth noting that the GFC followed on the heels of the food and fuel price crisis and households were impacted directly via increased cost of living and a decline in real income. Qualitative results from focus group discussions suggest that individuals felt the hardship caused by increased prices and adjusted their labor market decisions. Families had to supplement income by finding additional work or increase their hours worked which partly explains the added worker effect during the GFC. In Thailand more women entered the labor market in 2008 in order to earn additional income and support their families. In some countries, such as Cambodia, the average number of jobs per worker as well as the total number of hours worked increased. This means that the impact of the food and fuel crisis overlapped to some extent with those of the GFC in late 2008 and early 2009.

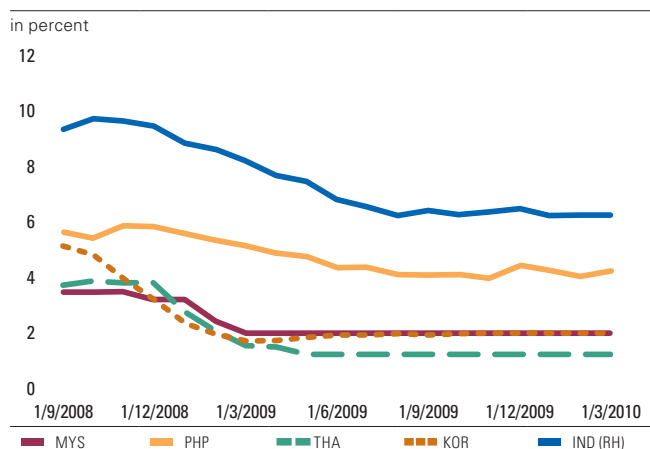
Due to the different causes of crises, there has been a sharp contrast between the policy reactions to the crises, which turned out to be critical in labor market adjustments. During the AFC, initial response of the governments, mostly forced by IMF programs, was a heavy tightening of monetary policy to prevent currency depreciation from leading into a spiral of inflation and continuing depreciation. Fiscal policy at the first stage was also tightened in the case of Thailand and neutral in Indonesia and Korea. The result was the aggravation of recession which led to a flurry of massive bankruptcies and lay-offs. However, this time most countries in the region responded proactively and boldly to the crisis by easing both monetary and fiscal policy stance thanks largely to better fundamental positions with bigger foreign exchange reserves, ample fiscal and monetary space. This helped to keep aggregate labor market indicators – open unemployment, employment loss and real wages declines from growing rapidly across the economies.

Figure 15. Changes in inter-bank interest rate



Source: Datastream.

Figure 16. Changes in inter-bank interest rate



Source: Datastream.

While still limited and controversial in their effects, more institutionalized labor market programs seem to contribute to lessen burdens of pressures on labor market adjustments from the crisis. When the 1998 financial crisis hit, none of the affected-countries had policies in place to help workers cope with -except to a small extent Korea such as the unemployment insurance. Accordingly, the governments had to painfully work, from the scratch, to develop policy instruments to tackle labor market risks and actual outcomes that the AFC revealed. The governments' intervention largely took the forms of job creation measures including public works program, vocational training, employment services, wage and employment subsidies and income support measures. This time the governments across the region have stepped up their response to the crisis to mute the negative social impacts as parts of stimulus packages. However, the difference is that the governments could launch and scale up such several social protection measures without much difficulty on the back of already introduced programs in the wake of fuel and food price crisis in 2008 as well as the AFC ten years ago. Examples are Philippines's conditional cash transfer program and Indonesia's targeted unconditional transfer programs. Korea also implemented more specific and target-oriented active labor market programs that were essentially expansions of existing programs under the Employment Insurance system. In addition countries such as Thailand and Malaysia introduced general social safety systems such as unemployment benefits social security and health insurance in the wake of the AFC.

Conclusion and Policy implications

Descriptive comparison of different labor market adjustment paths during the GFC and AFC point to a couple of policy implications to deal with economic crisis and resulting labor market repercussions.

First of all, economic stability matters for employment, and maintaining economic stability particularly during the crisis requires strong institutional fundamentals as well as flexible macro-economic policies. Unlike during the AFC ten years ago when the countries suffered from the skyrocketing unemployment, huge employment loss and plummeting real wages, the labor markets in the region remained remarkably resilient thanks to relative economic stability even in the midst of the worst global recession since the Great Depression. What made economies so stable during the GFC was the sound institutional healthiness gained from ten years of painful structural reforms in financial and corporate sectors after the AFC and unprecedented scale of flexible macroeconomic policies with ample monetary and fiscal space to prevent the crisis from spreading to domestic activities and thus labor markets.

Secondly, the GFC once again underscored the need to have more institutionalized labor market programs and social safety nets in place to be able to effectively cope with daunting social consequences of the unexpected crisis. In the absence of social safety nets, displaced workers due to reduced labor demands are forced to enter informal segments or be out of labor force, which has lingering impacts on welfare distribution. Devising and implementing such programs and safety nets take time, and the GFC has proven that countries with labor market programs and social safety nets already in place found it much easier to tackle fallouts of the crisis by expanding existing programs than countries that had to rely upon emergency programs. At the same time, developing countries could take an opportunity that the GFC poses to introduce or revisit innovative labor market programs that provide a comprehensive package of training, income support, internship and re-employment services to deal with the multiple challenges workers are facing rather than isolated programs.

Finally, developing countries need to further enhance their capacities of monitoring labor market and social outcomes and evaluating their assistance programs. During the crisis, given limited and narrow pockets of resources in developing countries, it is important that labor market and social responses should be focused on and tailored to needs of vulnerable groups—the low-skilled, young and older workers and women. In order to target effectively support programs to the vulnerable in need, it is also critical to correctly capture impacts of the crisis with high frequency labor market data and social indicators which developing countries are generally lacking. All the more, a widespread existence of informal segments in labor markets makes this task more daunting, unlike the countries with more formalized labor markets where unemployment tends to rise substantially during the crisis whereas it is relatively easy to fathom the impacts of the crisis and thereby design targeted programs. Labor market information system along with micro-surveys including integrated household surveys need to be further developed in this regard.

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