The Effects of the Thai Economic Crisis and of Thai Labor Market Policies on Labor Market Outcomes: Executive Summary*

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Thailand was the first of the Asian developing economies to experience the financial crisis of the 1990s. For most Thais the most important manifestations of the financial crisis have been through the labor market because their most important earning assets—particularly for the poorer members of society—are their labor. The unemployment rate for the third quarter was fairly stable or declining during 1995-7, but then more than tripled in 1998 and further increased in 1999 to include 1.75 million people.

The objective of this report is to contribute to better understanding of the effects of the economic crisis on Thai labor markets and what role public policies have played or might have played in mitigating the adverse effects of this economic downturn on labor earnings and employment. The results in this report in some ways complement that in the previous literature, but also in some important ways go beyond or differ from the previous literature. They go beyond the previous literature, for example, by discussing in some detail the nature of relevant labor market policies and presenting new multivariate estimates of what geographical location, firm and worker characteristics are associated with such policy related measures as receiving wages below the minimum wages, being covered by severance pay, being covered by social security and being union members. This study also differs from most of the previous literature by demonstrating that real wage rates as estimated from the Labor Force Surveys (LFSs) did NOT decline in the immediate post-crisis period relative to the immediate pre-crisis period, despite many previous claims that suggest that they did fall. This casts a considerably different light from most of the previous literature on the extent to which the negative shock on the labor market caused quantity adjustments in employment and hours worked versus adjustments in wage rates, which may have important implications not only for understanding the recent past but also for anticipating future developments. This study further differs from the previous literature in showing that, while overall the labor market impact probably was regressive in terms of income distribution, there were a number of important exceptions.

OVERALL LABOR MARKET EFFECTS

Analysis of the post-crisis period in comparison with the pre-crisis period and the time paths of labor market outcomes relative to the underlying secular trends, all using the LFS, indicate:

(i) A number of possible labor market quantity, price and earnings outcomes need to be considered. Examination of just employment on the quantity side, for example, may miss important quantitative adjustments in hours worked and in shifts between wage and nonwage employment. The pre-/post-crisis comparison suggests that there were important downward quantity adjustments in employment, but also in hours worked and in shifts from wage to nonwage employment.

(ii) The same pre-/post-crisis comparison suggests that there was *not* a downward adjustment in the real wage rate on the average, though there was some downward adjustment across rounds within the post-crisis period. In fact, post-crisis average real wage rates *exceeded* pre-crisis average real wage rates apparently due to a combination of reduced hours worked for workers paid monthly and weekly and selective movements from wage to nonwage employment and to unemployment by previously lower wage workers.

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(iii) The time patterns of adjustments differed importantly among the major labor market outcomes. Initially, for the third quarter of 1997, employment was on the longer-run secular trend and the number of unemployed workers was below the secular trend, so that the quantity adjustment basically was in hours worked (including some increased underemployment). This, together with apparent wage rigidities, contributed to increased measured real wage rates. Subsequently, adjustments became larger in employment and in wages.

(iv) Thai workers fared better (in terms of their real earnings being protected) than workers in most other countries affected by the Asian financial crisis. Wage labor earnings declined by about -7.6 percent in 1998, which was less than the decline of -10.0 percent in GDP. In contrast, wage labor earnings declined nearly three times as much as GDP in Korea and Indonesia. That the share of wage labor earnings in GDP increased in Thailand during the crisis period suggests that capital and land owners fared worse in a proportional sense than workers during the economic crisis.

(v) Previous studies on the labor market outcomes in Thailand and other East Asian economies are misleading with regard to “price” (wage) effects because of aggregation problems and because they confound changes in hours worked in their purported measures of changes in real wage rates.

(vi) Thai labor markets are not as flexible as those in some low-income countries, such as Indonesia, where virtually none of the adjustment to the economic crisis occurred on the unemployment side. The apparent limited wage flexibility in Thai labor markets is somewhat of a surprise given the absence of indications that governmental policies or unions introduce much rigidity.

(vii) The impact of the crisis on labor markets was not over at the end of the data analysis in this report. While unemployment stopped increasing in the third quarter of 1999, the unemployment rate still was significantly higher than it was before the onset of the crisis and most of the major labor market outcomes remained relatively far on the recession side of the secular trends in that quarter.

DIFFERENTIAL EFFECTS ON LABOR MARKET OUTCOMES FOR GROUPS DEFINED BY GEOGRAPHY, TYPE OF EMPLOYERS, AND INDIVIDUAL WORKER CHARACTERISTICS

Most previous studies on the impact of the Thai crisis have concluded that in most dimensions labor market outcomes worsened in the sense that they tended to impact more negatively on lower-income labor force participants—though with some exceptions, particularly regarding how women fared relative to men. This report provides a more nuanced characterization of these distributional effects by considering more labor market outcomes and by directly including among those outcomes the changes in real hourly wage rates. It finds, as in the previous literature, that the shifts on net probably were regressive. But there also were a number of important relative shifts in the opposite direction, such as relative total employment gains by agriculture relative to manufacturing, services relative to banking and migrants relative to nonmigrants; relative wage rate gains by agriculture relative to services, construction relative to services, primary schooling relative to secondary schooling, production workers and craftsmen relative to professional and technical workers, and private employees relative to government employees; and relative real average monthly wage earnings shifts to services from banking and to primary schooling from secondary schooling. Thus the data suggest a number of progressive aspects of the relative labor market outcomes that resulted. They also suggest that the one progressive shift emphasized previously, from males to females, may not have been very large and in certain important respects may have favored males. Therefore this examination leads to a somewhat different understanding of the extent to which there were regressive shifts in labor market outcomes than that presented in the previous literature. As a result, the net effect of the different changes was to generally worsen the overall distribution of wage earnings in the population. However, the magnitude of the change was small; the Gini coefficient of wage labor earnings increased only by 1.5 percent during the crisis.

THAI POLICIES RELATED TO LABOR MARKETS

Thai governmental roles in the labor market are reviewed with respect to general labor protection, minimum wages, severance pay, the employee welfare fund, the social security fund, labor market information, various ad hoc short-term public measures to mitigate the crisis effects on workers, and regulations concerning unionization. These policies are placed into a broader historical perspective in order to be able to better understand changes subsequent to the initiation of the crisis in 1997. The report then considers how governmental policies related to labor markets changed during the crisis—with particular attention to minimum wages, severance pay, social security coverage, unionization, employment creation policies and public sector employment—and addresses the adequacy or inadequacy of the government’s responses to the crisis. We include multivariate exploration of what geographic, firm and individual characteristics are associated with access to a number of these programs.

(i) *Minimum wages:* The proportion of Thai workers earning less than the minimum wage did not change substantially during the economic crisis but remained large (about 30%). Since payment of the minimum wage is a legal requirement at least for formal sector employers under Thai labor law, there is obviously widespread disregard for this law. The non-compliance with the minimum wage law is greatest in the construction and agricultural sectors, in the North and Northeast regions, and in rural areas. Female workers, younger workers and workers with less schooling are at the greatest risk of being paid wages that are below the minimum wage. One implication of the limited effectiveness of minimum wages pertains to public employment generation programs. An important requirement of well-targeted (to the poor) rural employment creation programs is that they offer compensation that is less than prevailing wages in the rural areas. This automatically limits participation in these programs to the genuinely poor. However, job creation programs that were implemented in Thailand during the crisis paid workers at least a minimum wage. This means that these programs must have attracted a large number of the nonpoor, as a very large proportion of Thai workers earn less than the minimum wage. A significant proportion of the poor may not have been able to obtain employment in these public works programs.

(ii) *Severance pay:* Thailand relies on severance pay requirements as opposed to an unemployment insurance scheme. The relevance of severance pay as a form of insurance against unemployment is limited in Thailand owing to the small proportion of workers covered by severance pay benefits. Obviously, only wage employees, who constitute less than 40 percent of all Thai workers, can avail of severance pay benefits. But even among these wage employees, the proportion actually covered by severance pay benefits is small—fewer than a third of all wage employees in the country and only 13 percent of private sector wage employees reported having severance pay coverage in the third quarter of 1999. Some of the most vulnerable workers from the perspective of being laid off during the crisis were more likely to have severance coverage (e.g., those in manufacturing). But those identified to be in many of the most vulnerable groups to be laid off had average or less than average probabilities of severance coverage (e.g., those in the North, service and clerical workers; and those working in construction and commerce). And schooling, which is not related to the probability of being laid off, is strongly associated with the probability of severance coverage. Therefore, the extent to which severance coverage provided more protection to those who were at greater risk of being laid off is limited, and in many cases it provided more protection to those who were at lesser risk of being laid off. In fact, severance pay coverage is strongly biased in favor of high-wage workers. It is thus clear that extending the severance pay requirement from six months to 10 months did not affect the vast majority of Thai workers.

(iii) *Social security:* The social security system had been in place since 1990 but in late 1998, a significant change was initiated, establishing pension and child allowance schemes for private sector employees. Due to the crisis and hardships on employers and workers, the implementation plan will phase in the full contribution rates over several years, so as to minimize the contractionary impact of the new system. Questions remain about the long-term financial viability of the scheme, given the mandated benefits and contribution rates. A child allowance scheme uses general government revenues to finance benefits for children of only enrolled families, a relatively better-off group. The 1999 LFS data indicate that only 15 percent of Thai workers reported being covered under the Social Security Act (SSA), with wide variations across different types of workers. Not surprisingly, reported coverage is higher among private-sector employees than among state-enterprise workers and government employees, as public employees are already covered by the Civil Servants' Pension Scheme and the Civil Servants' Medical Benefit Scheme. Generally within the private sector, social security coverage currently favors better-off workers. The Thai government plans to expand the social security program next year to cover employees of companies with 10 or fewer employees. The expansion would add an additional 3.6 million workers to the program, boosting coverage to 9.3 million workers. These moves will go some way toward bringing low-wage employees into the folds of the social security program. However, it is clear that simply enacting laws will not achieve much, as current rates of compliance are poor.

(iv) *Unionization provisions and coverage:* Labor unions can protect some worker interests in an economic crisis. However, labor union penetration is very low in Thailand, and collective bargaining has not played an important role in Thai labor markets, especially after unions in state enterprises were disbanded after the 1991 military coup. In addition, state enterprise workers are forbidden to form unions, although the Thai parliament in mid-February 2000 passed the State Enterprise Labor Relations Act, which reinstates the right of workers in state enterprises to form unions and allows them to bargain collectively. The LFS data indicate that, as of August 1998, 4.6 percent of all private-sector wage employees in the country had a labor union in their workplace. Even fewer—2.9 percent—reported being members of a union. These are among the lowest rates of unionization anywhere in the world. Even these low numbers may overstate the importance of Thai labor unions in influencing the "social dialogue" among labor, industry, and government because the number of collective bargaining agreements—a better indicator of labor unions' influence—is much smaller than the number of labor unions in Thailand. The low rates of unionization are the result of significant obstacles to union organizing that are codified in Thai labor law and Ministerial regulations. For instance, there is no protection of a worker wishing to organize a union until he/she has successfully organized that union and is formally elected an executive board member of the union. In addition, unionization faces a significant "free rider" problem in Thailand, since current Thai law states that a negotiated work agreement applies to all workers in the factory, regardless of whether they are members of the union that negotiated the agreement or not. Thai workers are thus able to benefit from union-negotiated contracts without being members of a union and contributing dues to it. The fact that unions are more commonly found in large establishments implies that there is a greater tendency for the better-off workers in Thailand to have access to and be members of labor unions.

(v) *Employment creation programs:* The government's 1999 economic stimulus package placed priority on creating employment and increasing incomes for those severely affected by the crisis in both rural and urban areas through a set of employment creation programs, including the so-called Miyazawa package, which was by far the largest of the job creation interventions. The objective was to spend the money quickly to stimulate the economy through job creation and productive investments, while at the same time cushioning the poor from the crisis and creating a foundation for future competitiveness. The Miyazawa package has provided employment to 88,967 educated employees and to 3.5 million workers equivalent to 319,182 person years. With such a large number of beneficiaries, one would expect the impact of the job creation programs to show up in reduced unemployment numbers for the country in mid to late 1999 (as the Miyazawa package began to be implemented only in April 1999). An examination of the August round of the LFS 1999 confirms this: unemployment in Thailand fell from 1.14 million persons in August 1998 to merely 0.99 million in August 1999—a decline of nearly 14 percent year-on-year. This was the first such decline in unemployment year-on-year since the onset of the crisis. Of course, it is unlikely that the Miyazawa package accounted for all of the decline in unemployment in August 1999. The improving economy and the other employment generation programs also likely contributed to the decline in unemployment. Real GDP had increased by 7.4 percent year-on-year in the third quarter of 1999 (after a 2.6% increase in the second quarter). Detailed data on the characteristics of individuals who obtained employment under these programs are not readily available. This information would be important in calculating the distributional effects of these interventions to see if these interventions provide employment and income assistance to the poor or to better-off workers. Given that these projects paid at least the minimum wage and about 30 percent of Thai workers receive less than the minimum wage, it seems unlikely that they effectively targeted the poor. These programs also were developed and implemented rather slowly, more than a year and a half after the start of the crisis, and appear to have had relatively low labor intensity.

(vi) *Public sector employment:* Though the private sector dominates in Thai labor markets, public sector employment also is important, particularly among wage employees. The pre-/post-crisis comparison indicates that total employment increased substantially for public sector workers—11.3 percent for government workers and 27.5 percent for state-enterprise workers—in sharp contrast to the decline of -9.6 percent for private wage employees. Thus the substantial expansion in relative terms of public sector employment offset a little of the large drop in private wage employment (but only a little because private sector employment is so much greater than the public sector). For government employees, average real wage rates declined by -6.3 percent, despite the increased average schooling in this sector. This decline in the real wage rates of government employees probably reflects the fact that new part-time, contract hires were paid much lower wages than existing permanent employees. In contrast, real hourly wage rates for state-enterprise employees increased by 18 percent, much more than the increase of 1 percent for private wage employees. This large increase partly reflects a composition shift toward more-schooled and more experienced (or at least older) workers. But still it is striking in light of the increase of over a quarter in the number of state-enterprise employees and the general tendency documented in this report for marginal workers moving in or out of particular sectors to be lower-than-average wage recipients. It is all the more striking because state-enterprise employees tend to be much more highly paid than employees in the government sector or the private wage sector.

CONSIDERATIONS FOR FUTURE POLICIES

Current policies seem to provide very limited social protection for most of those affected adversely by changes in labor markets, some dimensions of what protection is provided have become available only with a considerable lag, and generally those who are covered best by such protection are those who are better off, not the poorer members of society. At the same time traditional social safety nets, such as the agricultural sector and unpaid family work, appear to have but limited capacity for providing such protection in response to the crisis that started in 1997. As the Thai agricultural sector and labor markets develop further, the agricultural sector and unpaid family labor status are increasingly going to be unable to absorb other workers laid off in an economic downturn. This also means that there will be an increasingly greater need for developing formal safety nets for workers laid off at such times. Further, as far as can be discerned from the pre-/post-crisis periods comparisons, real wage rates do not seem to have adjusted downward in response to the crisis—despite evidence that suggests that neither governmental regulations nor unions introduce the kind of rigidities into downward wage adjustments that are common in many other countries.

One implication of these factors is that it would be desirable to consider changing policies so as to offer meaningful social protection to vulnerable workers. One route to do so might be to attempt to ensure compliance by employers with existing laws, as suggested, for example, in a recent World Bank review of the impact of the crisis on Thai labor markets. But it is not clear that with present laws the benefits of making current legislation much more effective will outweigh the costs. The costs include the potential of making labor much more expensive. For example, about 30 percent of current wage earners earn less than the minimum wage and only about an eighth of those employed (a third of wage earners) are in fact covered by severance pay provisions. Making effective for all workers (or for all wage workers) minimum wage and severance pay coverage would seem to increase substantially the cost to employers of hiring workers and exacerbate the current possible problems of limited downward wage flexibility—probably with significant costs in terms of economic growth and adjustment capacities to respond to changing markets and technologies. From this perspective, if there are to be efforts to strengthen the effectiveness of minimum wages and severance pay provisions, care should be taken to assure that they are not at such high levels so as to be very costly.

An alternative to deal with the effects of downward shocks is to introduce unemployment insurance. This is a contentious possibility, with unions, employers, government agencies, and non-governmental organizations taking different sides on the need for such insurance. While there is some merit to the argument that the concept of unemployment insurance may not be required due to traditional Thai values of self-help and reliance on the family and community, it is also the case that traditional support systems have been slowly breaking down in Thailand, as they have in other countries, as a consequence of rapid industrialization, urbanization, marketization of labor and modernization. As rural-urban migration continues, employment in the agricultural sector declines, wage labor markets expand, and Thai society continues to experience structural change, the need for augmenting the current system of informal social safety nets with more formal safety nets like unemployment insurance will increase. At the same time, there are a number of economic and administrative issues that determine whether or not unemployment insurance is feasible in Thailand at this time. Unemployment insurance schemes are not always feasible (or equitable) for labor markets characterized by relatively small formal sectors, though part of the argument above is that the formal labor market is likely to expand. In addition, there are questions about whether the existing infrastructure is capable of administering unemployment insurance effectively. At the very least, however, a comprehensive study on the economic and administrative feasibility (as well as equity implications) of having an unemployment insurance scheme in Thailand is warranted.

Unemployment insurance schemes also do not deal with the possibility that earnings of many who are employed are inadequate to cover what society deems to be a minimum standard of living. Unemployment insurance schemes moreover are often financed out of revenues that are tied to employment, and thus raise the cost of hiring workers (though there is no reason why this has to be the case). For such reasons it will be worth considering having a comprehensive study on the economic and administrative feasibility and the equity implications of having other form of income-support schemes, including employment projects at low wages for those capable of working and welfare transfers for those not capable of working. The better such systems work, of course, the less reason there is to intervene directly in labor markets in ways that are likely to make most labor more expensive for employers—and, thus, effectively to tax employment creation. There are many questions about various dimensions of such possibilities, which is all the more reason why systematic consideration would be useful to clarify what are the magnitudes of potential costs and benefits.

Another important implication of the factors described above is that better information about labor markets would be desirable. Information has basic public good characteristics in the technical sense, which means that there is a strong efficiency case for the public sector subsidizing the production and dissemination of information. Limitations in current information about labor markets probably has been an important factor in the slowness of some policy responses and in the limited extent to which real wage rates apparently have fallen to facilitate adjustments in the labor market to the crisis. Indeed, an important indication of the need to improve information is that the current LFSs do not permit knowledge of whether in fact real wage rates fell for the same individuals. In this case, changing the LFS sample design to have a rotating panel design as in many countries would improve substantially the capacity for understanding what happened to individuals over time without inferences being confounded by compositional changes among various groups. But the information question is much broader than to provide a better foundation for historical analysis of the sort in this report. The payoffs in terms of private and public sector adjustments to changing conditions may be quite high from providing better and more timely information about a multiplicity of aspects of labor markets. Though there has been some recent consideration of how labor market information could be improved, the returns from substantial efforts to improving such information further are likely to be high.

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