In a recent contribution to this journal, Manning (2000: 106) offers an analytical framework that, he argues, enables him to demonstrate why ‘unemployment and the incidence of poverty did not rise more than they did during the (Indonesian) crisis’. The crux of his discussion rests on the notion of labour market flexibility. In enunciating his propositions, the author makes some references to a study conducted by the ILO (International Labour Organization) and financed by the UNDP (United Nations Development Programme) (ILO/UNDP 1998) that run the risk of misrepresenting one of its key conclusions.

This comment makes two points. First, the author needs to be careful in the way he depicts the work of the ILO. Second, the analytical construct of labour market flexibility helps to explain why unemployment did not go up sharply during the crisis, but is perhaps too stylised in one respect. It does not enable one to appreciate fully an important feature of the Indonesian crisis, namely, the volatility of consumption poverty (that is, poverty defined in terms of current expenditure) in the short run.

The 1998 ILO/UNDP Study and Forecasts of Unemployment during the Crisis

Manning (2000: 106) states that: ‘Various estimates predicted that perhaps 10–14 million people (out of a workforce of 90 million) would find themselves without jobs in 1998 …’ and cites a single source (ILO/UNDP 1998). This point is repeated on p. 121: ‘As noted, earlier studies had predicted quite dramatic increases in unemployment based on elasticity calculations with respect to GDP growth by sector …’, and again cites ILO/UNDP (1998) as the single source. These citations run the risk of misrepresenting the forecasts of the ILO/UNDP study on unemployment during the crisis. The study categorically states that: ‘Open unemployment will rise to 6.7 million, or from 5 per cent of the labour force before the crisis in mid-1997 to 7 per cent in mid-1998. Open unemployment will remain a problem mainly experienced by educated job seekers in towns and cities’ (p. 2). This analysis was then supported by table 3 and figure 1 of the report (pp. 26–7) and contrasted with considerably higher forecasts of crisis-induced unemployment by the Ministry of Manpower and
Bappenas. Admittedly, the ILO/UNDP projection of open unemployment for 1998 (7%) turned out to be higher than the reported 1998 Sakernas unemployment rate of 5.4%, but it was well below the dramatic magnitudes of alternative forecasts available at the time.

**Labour Market Flexibility, Poverty and the Indonesian Crisis**

The author uses two theoretical extremes – a Keynesian model of rigid real wages and a neoclassical model of fully flexible real wages – and suggests that the Indonesian case, like the rest of East Asia, offers a reasonable approximation of the neoclassical model. He concludes (p. 130):

In a Keynesian-type world with rigid real wages – akin to ... conditions in some Latin American countries – the brunt of adjustment occurs in employment, unemployment rates rise steeply and there is a marked increase in poverty. The second model, a stylised ‘East Asian case’, is more consistent with a neoclassical framework, where real wages adapt quickly to sharp changes in labour demand and there is a much smaller rise in unemployment and ... poverty.

Certainly, if one posits a particular model of the labour market in which prices (that is, real wages) adjust readily, then it follows that quantities (that is, unemployment) will play a much more marginal role in the adjustment process. Hence, the author is correct in emphasising why unemployment did not go up sharply during the crisis.

The implications of the author’s framework for analysing changes in poverty are more problematic. In the Keynesian labour market, the primary vehicle for the rise in poverty following a demand shock is the rise in unemployment (Manning 2000: 107, figure 1). In the neoclassical labour market operating in a dualistic, developing economy, the primary vehicle for the rise in poverty as a consequence of a demand shock is a decline in real wages reflecting a reallocation of labour to low-productivity activities (p. 109, figure 2). Whether the unemployment-driven increase in poverty (the Keynesian case) will be higher than the real wage-driven increase in poverty (the neoclassical case) is ultimately an empirical issue and cannot really be determined a priori. Furthermore, it is worth noting that the empirical relevance of Keynesian labour markets is probably questionable, even in Latin America. As the author recognises (p. 108), studies have shown that apparently protective laws and regulations that are supposed to create real wage rigidity ‘often turn out to be paper tigers’ during sharp economic downturns.

It appears that a better way of coming to grips with understanding the evolution of poverty during the Indonesian crisis is to eschew preconceived notions of the virtues of labour market flexibility and carefully revisit the current state of knowledge on what could have happened to the poor. The emerging consensus seems to be that there was an inflation-driven collapse in purchasing power – leading to a steep fall in real wages and a sharp rise in consumption poverty. If one combines the ‘inflation shock’ of 1998 with the fact that a significant proportion of Indonesians are clustered around the poverty line, then relatively small shifts in the latter may lead to large changes in the incidence of consumption poverty (Dhanani and Islam 2000). However, the sharp rise in poverty (and the steep fall in real wages) during 1998 turned out to be transient as inflation abated (and became deflation for a while) and as the government launched a comprehensive, donor-supported social safety net program.
Finally, it is noteworthy that the World Bank, once associated with the view that the rise in nation-wide poverty during the crisis was moderate, has now offered a careful re-statement of its position. In its latest poverty assessment report on Indonesia, the World Bank makes several points. First, it acknowledges that the ‘... best current estimates are that the ... poverty rate increased substantially – at least doubling from its pre-crisis low (in August 1997) to the peak in late 1998/early 1999’ (World Bank 2000: ii). Second, it recognises – as this note does – that poverty trends during the crisis were quite volatile, rising sharply and then tapering off to pre-crisis levels by mid 1999. Third, it highlights findings that ‘... around half of all Indonesians now face a greater than 50–50 chance of becoming poor’ (World Bank 2000: ii).

Notes
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References