CHAPTER 4

STRUCTURAL REFORMS POLICIES

One of the important policies instituted was the structural reform agenda which included the restructuring and recapitalising of institutions, in the financial system, corporate restructuring and addressing deficiencies in corporate governance. These measures were intended to address structural problems that had contributed to the crisis and to provide the foundation for a return to sustainable growth. For IMF assisted countries the World Bank and Asian Development Bank played essential roles in developing structural components of the programs.

Given the central role that the financial sector vulnerabilities had played in bringing about the crisis, financial sector restructuring stood at the top of the reform agenda. While many previous IMF supported programs have included measures to restructure and reform financial systems, the programs in these countries were unparalleled in the scope of the issues that had to be dealt with and under severe time constraints (Lane et al., 1999). These reforms were also necessary for macroeconomic policies to achieve intended stabilisation.

Various measures were introduced to strengthen the resilience of the financial sector to avoid systemic risk and to ensure the continued efficient functioning of the banking sector and to promote market confidence. The major measures were-

(i) Asset management - to address the rise of non-performing loans (NPLs)[3] by setting up of national asset management companies with the primary objective to purchase NPLs from banking institutions and manage these NPLs in order to maximise their recovery value. This will ultimately improve the bank's balance sheet.

(ii) Banking recapitalization - which was necessary to address the erosion of capital in some banking institutions. Recognising the constraints on shareholders to raise capital in the uncertain environment, government intervention was necessary to inject capital.

(iii) Banking sector consolidation and divestment;

(iv) Corporate workouts;

(v) Financial supervision and regulation;

(vi) Corporate governance and competition.

One of the major social vulnerability that pre-existed the onset of the financial crisis was the lack of social safety nets, which was masked by the improvements in standards of living that came with sustained growth. These

[3] NPLs are on a three month basis in Malaysia and three months or more in Korea and Thailand.

countries relied largely on high growth, a stable macroeconomic environment and widespread public provision of health and education services for social protection. Formal safety nets were limited in scope and coverage (Granolati, 2000).

Asset Management and Bank Recapitalisation

In attempting to analyse the effectiveness of bank asset management and recapitalisation programmes in these countries we will look at some of the relevant indices i.e non-performing loans (NPLs), capital adequacy ratios (CARs), banking sector profitability and expansion of real bank credit.

Among the four countries Korea was most effective in reducing its NPLs. In 1999, the ratio of (NPLs) to total loans in the financial sector in South Korea stood at 11.3%. This fell to 8.1% in December 2000 and to 4.9% percent in December 2001. NPLs also reduced from 49.2 percent in December 1998 to 12.4 percent in May 2002 for Indonesia, 13.6 percent to 11.2 percent in Malaysia and 45 per cent to 10.8 percent in Thailand (Table 5). All these four countries showed uneven progress in resolving the problem of high levels of NPLs' in the financial sector (Asian Times, 2002).

Table 5 - NPLs' of Financial System - Ratio of NPLs' to Total Loans (end of period)

	1998	1999	2000	2001	2002[1]
Indonesia	49.2	33.0	18.8	12.1	12.4
Korea	n.a.	11.3	8.1	4.9	n.a.
Malaysia	13.6	11.0	18.8	11.5	11.2
Thailand	45.0	38.9	17.9	10.5	10.8

[1] Up to May 2002
Source: ARIC Indicators, Asian Development Bank

Caution should however be exercised in interpreting the recent improvements in NPL ratios. The reduction in NPL ratios in the affected countries were brought about by the transfer of NPLs from Bank Balance Sheets to the publicly-owned and centralised asset management companies (AMCs). While this has enable banks to resume lending and support recovery, the real test of the restructuring policy hinges on the progress in asset disposal by AMCs. In this aspect Malaysia's Danaharta has been most effective since it had resolved nearly all of its acquired assets by the end of 2001 (Table 6). As of March 2002, Danaharta had acquired (in face value) about RM47.75 billion in NPLs from troubled financial institutions, i.e. about 14% of the country's GDP in 2001. It has resolved all these NPLs at an estimated recovery rate of 55%. With an average discount rate of 54.4% for its acquired NPLs, Danaharta is expected to turn in a small profit by 2005 when it will be dissolved.

Korea also has made significant progress in disposing of assets whereby the Korea Asset Management Corporation (KAMCO) has been able to dispose 59.3% of its acquired assets as of Jun 2002. As of May 2002 KAMCO had acquired a total of $81 billion in NPLS. i.e. about 19% of GDP in 2001 at an average discount rate of about 62%. These assets were disposed at an average recovery rate of 46%.

In Indonesia, however, asset disposal by the Indonesian Bank Restructuring Agency (IRBA), although improving, has proved to be more difficult and slower. This was because of the poor economic conditions, political uncertainties, an ineffective bankruptcy system and political resistance to sell at a huge discount. As of May 2002, IBRA had acquired a total of Rp360 trillion in NPLs, about 21% of GDP in 2001. IBRA has managed only to dispose of only about 12% of these NPLs.

In Thailand, The Thailand Asset Management Company (TAMC) a centralised AMC was set up only in 2001 and was to acquire about half the financial system's NPLs. Asset disposal is still in its early stages, although this is proceeding according to plan. By the end of April 2002 it had resolve a total face value of B132.7 billion i.e. about 19% of the total NPLs it acquired.

Inclusive of assets still held by these centralised AMCs, the NPL ratio remained as high as 50% in Indonesia and more than 20% in Thailand as at the end of 2001.

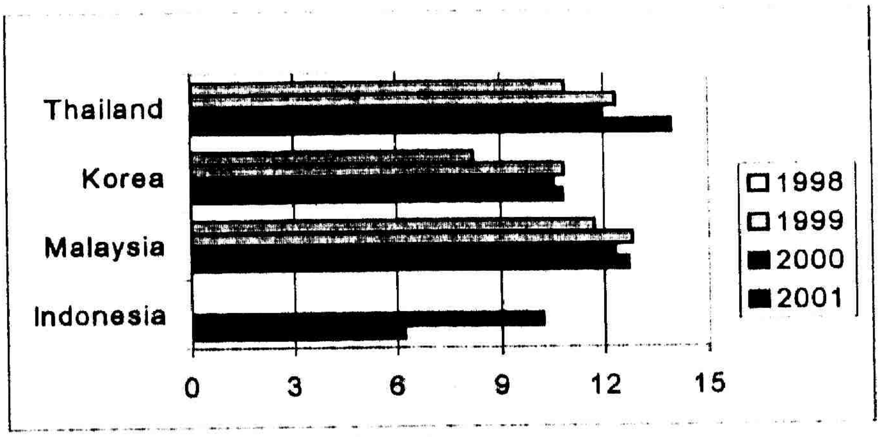
Table 6 - NPL Disposal by AMC as % of NPLs Acquired, (end of period)

	1998	1999	2000	2001	2002[1]
Indonesia	49.2	33.0	18.8	1.7	6.7
Korea		52.2	48.0	57.8	59.3
Malaysia		33.1	75.5	99.9	99.9
Thailand					19.0

[1] Up to June 2002
Source: ARIC Indicators, Asian Development Bank

The banking sectors have seen their capital adequacy ratios (CARs) improving in recent years. For Korea, Malaysia and Thailand the CAR is well above the 8% Basel standard (Figure 2). In Indonesia, CAR data are not available for the entire banking sector. But for the seven banks recapitlaized by IRBA (i.e. BII, Bank Universal, Bank Patriot, Bank Artamedia, Bank Prima Express, Bukopin and Lippo), the average CAR was 6.2% as of end December 2001.

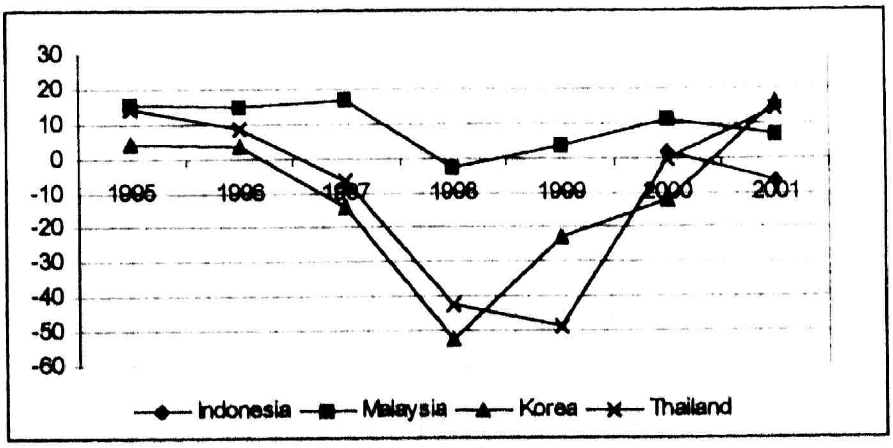
Figure 2 - Capital Adequacy Ratios of Commercial Banks (%)



Source: ARIC Indicators, Asian Development Bank

Unlike CAR, banking sector profitability differed across these countries (Figure 3). In Korea, the average return on equity (ROE) of all the domestic commercial banks rose to 15.9% in 2001, a big turnaround from -11.9% in 2000 and -52.5% in 1998. In Thailand, the average ROE of all commercial banks, domestic and foreign, rose to 14.3% in 2001 from a near zero level in 2000 and -42.4% in 1998. In Malaysia, the average ROE of all listed commercial banks rose from -2.9% in 1998 to 11% in 2000. In 2001 however there was evidence that banking sector profitability worsened in Malaysia, with the average ROE of the listed commercial banks declining to 6.7%in 2001 possibly due to the economic slowdown. Similarly the average ROE of Indonesia's seven recapitalized banks turned negative in 2001 compared to 1.7% in 2000.

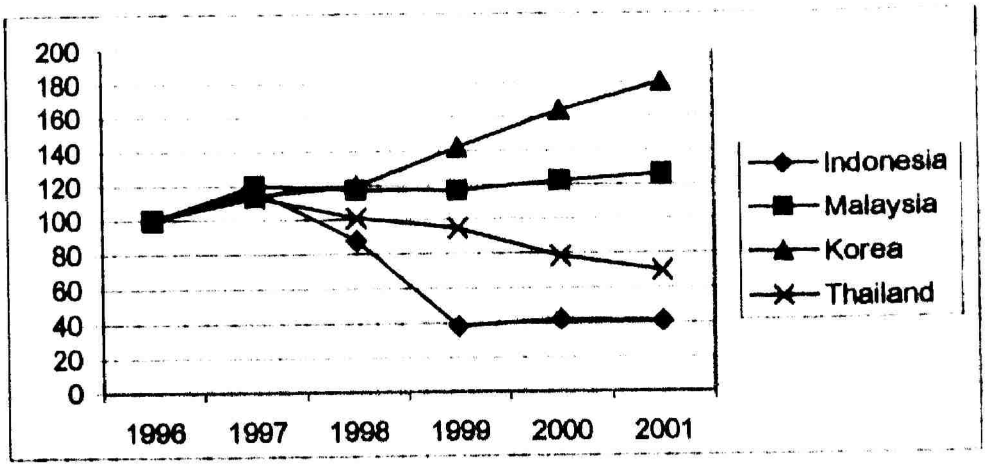
Figure 3 - Banking Sector Profitability (%)



Source: ARIC Indicators, Asian development Bank

In Korea and Malaysia, the stock of real bank credit to the private sector has continued to grow, reflecting success in reforms and strong domestic demand. In Thailand, after three years and half years consecutive contraction, real bank credit appears to have stabilised since early 2002. Indonesia, meanwhile, saw their stocks of real bank credit stabilise in most of 2001, but comparable data for 2002 are not yet available (Figure 4).

Figure 4 - Real Bank Credit (1996=100)



Source: ARIC Indicators, Asian Development Bank

Banking Sector Consolidation and Divestment

This policy was adopted in view of the fact that the financial and banking system had opened up too rapidly in the mid 90's which led to under supervision leading to poor investment quality and efficiencies of financial institutions. As a result the respective governments embarked on a policy to consolidate and divest the banking sector. The objectives were mainly to increase the range of services and to increase efficiency (The Star, 2002) Furthermore bank consolidation was seen as an effective way to promote financial restructuring, enhance the stability of the financial system and improve the competitiveness of domestic banks in the domestic and international markets.

The main difference in this policy approach was that countries under IMF programmes (Indonesia, Thailand and South Korea) were made to reduce the number of banking institutions by effectively closing them down. Malaysia avoided the IMF prescription of closing down the problem banks as it felt the social costs involved in terms of dislocation of resources would be very high. A more reasonable approach adopted by Malaysia was by guided merger, with the central bank playing a proactive role in solving the issues involved and the principle of fairness will be strictly applied to all parties in the merger (The Star, 1999).

Malaysia has advanced furthest in this direction whereby the banking sector merger plan announced in mid-1999 resulted in 54 domestic financial institutions being consolidated into 10 anchor banking groups. The government has indicated that the banking sector will further be consolidated with the 10 groups expected to be merged in three or four large banks that are able to provide the full range of services and others becoming specialised banks serving certain niche areas (The Star, 1999).

In Korea the number of banks fell from 33 to 20 by the end of 2001. In Thailand the Ministry of Finance in March 2002 approved the merger of Bank Metropolitan Bank with Siam City Bank. In Indonesia the bank restructuring program over the past years has left the country with five state banks, 26 regional development banks and 80 private banks.

The current wave of bank consolidation has been seen as a positive development in the restructuring, reforming and modernising of banking sectors in the region. Some also see these as a broad movement away from the family owned-banks towards more "corporatised" banks. Concerns have, however been raised that the consolidation process has been led by the governments rather than driven by market forces. Further, the enlargement of bank sizes should not substitute efforts to improve banks' internal risk management. To avoid excessive concentration of the banking sector, suggestions have been made that bank consolidation should be carried forward through mergers between small and medium sized banks, rather then led by large banks and that entry barriers for foreign banks should be lowered further (Asian Development Bank, 2002).

As mentioned earlier, financial restructuring involved the government injecting a large amount of capital into or nationalising troubled banks in these countries, resulting in the state owning a high proportion of the banking sector. Although governments were committed to privatising these nationalised banks and divesting state ownership in the sector, the process of privatisation has been slow over the past few years due partly to poor market conditions and political sensitivity in selling assets to foreign buyers. Although the recapitalisation and restructuring of a large part of the financial system was expected to be a lengthy process, shortcomings in the institutional and legal framework especially in Thailand and Indonesia helped to prolong it. In both these countries it took along time to establish agencies to oversee and manage the restructuring process and even a longer time to have their procedural and legal aspects of their operations to be clarified (Lane et al., 1999).

Corporate Workouts

In addition to resolving bad debts through centralized AMCs, corporate debt restructuring was carried out on a voluntary basis under the so-called London approach framework[4]. This framework describes a set of principles under which creditors agree to keep credit facilities in place, seek out of court solutions, work together, share all relevant information about the debtor and recognize the seniority of claims (Financial Stability Review, 1999).

In Indonesia the Jakarta Initiative Task Force (JITF) was created to serve as a mediator and facilitator of specific restructuring cases, particularly those involving foreign lenders. Compared to IBRA, debt restructuring under JITF is more successful. As of end-May 2002, JITF had received a total of 130 registered cases with debt value amounting to $30.3 billion and

[4] The London Approach has evolved over a number of years into a widely used set of principles, which govern how banks respond to news of serious financial difficulty in one of their corporate customers, where there is more than one bank involved in the lending. The Bank of England's role is to facilitate discussions between banks, where there is disagreement between them on the right course of action. The Bank of England aims to ensure that decisions are made on the basis of a full sharing and understanding of all relevant information.

completed the mediation of 71 cases with a debt value of$15.4 billion. However there have been concerns over the quality of debt restructuring by JITF, as debt rescheduling was still the predominant method of restructuring, which in 2001 accounted for 53% of total value of the restructured debt.

In Malaysia the Corporate Debt Restructuring Committee (CDRC) was set up after the crisis to provide a platform for borrowers and creditors to work out feasible debt restructuring schemes without having to resort to legal proceedings. Only viable companies with a total borrowing in excess of RM50 million from more then one bank are eligible for workouts under this framework. As of end-July 2002, 81% of all cases had been successfully finalized under CDRC sponsorship, thereby resolving debts totaling RM55 billion. CDRC has not taken the easy way out by swapping debt with equity in the restructuring debts of companies. This because in the long run banks will hold a lot of equity in organizations, sometimes majority stakes where recovery or exit will be difficult for banks. Actual cash, redeemable bonds or instruments received by the banks accounted for 83% of the recovery of debts (The Star, 2002). With remaining 11 cases transferred to Danaharta, CDRC have completed its task of restructuring and was officially closed at the end of August 2002.

In Thailand the government created the Corporate Debt Restructuring Advisory Committee (CDRAC) to encourage and expedite out-of-court debt restructuring. As of end-April 2002 CDRAC had approved 14,850 target debtors with credits outstanding of BT2,625 billion to enter voluntary workout process. Of these cases 68% has been successfully restructured. The failure of CDRAC to facilitate debt restructuring more expeditiously, which some extent made the government resort to the creation of TAMC, is due to a number of reasons. Among others, CDRAC did not have sufficient legal power to deal with debt cases. Moreover, most cases had been filed in the courts were piled up, causing disruption to the debt restructuring process. In addition to restructuring under the process sponsored by CDRAC, debt cases are also being worked out by financial institutions themselves. From 1998 to the end of March 2002, a total of 494,409 cases with credits outstanding of BT2,497 billion had been successfully restructured by financial institutions themselves.

Reforms in Financial Supervision and Regulation

The four countries have made important efforts to strengthen supervision and regulation of their financial systems. In Indonesia, the Government's focus has so far been on restructuring troubled financial institutions. Solely relying on restructuring was not adequate, as such policy objectives were not fully met. This was because the financial and regulation framework was not strong enough to complement institutional restructuring. Realizing this deficiency the government over the last few years placed special focus on improving financial supervision and regulation framework. In January 2002, the central bank issued revised regulations raising the minimum capital adequacy requirement to 8%. According to the regulations, banks that cannot meet the new requirements within the specified periods will be transferred to IRBA for resolution. During 2002, Bank Indonesia intends to complete all the specific actions in its master plan aimed at improving compliance with the Basel Core Principles for Effective Bank Supervision, including moving towards consolidated supervision. To enhance market discipline, it will begin monthly publication of key individual bank financial data. Plans are also afoot for the establishment of an integrated financial sector supervisory agency - the Financial Sector Supervisory Institution.

Several measures were introduced in Malaysia to strengthen banking regulation and supervision, focusing on risk-based and consolidated supervision. The Financial Sector and Capital Master Plans were drawn up and released last year, proposing to achieve full integration of the domestic financial system into globalized market over a 10-year period. Recently Malaysia included discount houses in the liquidity framework coverage, with a view to improving prudential regulation. The framework requires discount houses to project maturity of assets, liabilities and off-balance sheet requirements, and maintain adequate liquidity surplus to meet expected obligations and sustain unexpected withdrawals for at least one month. Other measures taken include strengthening the institutional capacity of Islamic Banking Institutions, broadening the range of financial products and services, intensifying research and development efforts.

In Korea special focus was placed on financial sector supervision. This involved the setting up of the Financial Supervisory Commission in 1998, which later became the Financial Supervisory Service (FSS) with a new management. The FSS had operational autonomy whereby it could license and de-license financial Institutions and also with supervisory responsibilities. Regulations governing the operations of banks were strengthened to bring them broadly in line with Basel Recommendations. In April 2002, FSS issued new guidelines aimed at lowering the ratio of loans classified as substandard, doubtful or presumed loss that are held by nonbank financial institutions (NBFIs) to improve overall asset quality. Under these guidelines, institutions are expected to enter into an agreement with FSS to reduce securities borrowing and lending ratios to 10% or lower within varying target dates. NFBIs that fail to meet the new guidelines are encouraged to undertake significant restructuring steps. In May 2002, FSS instituted new minimum mandatory loan loss provisioning ratios for domestic banks household loans and credit card receivables.

In Thailand over the last few years, loan classification, provisioning and interest accrual and capital adequacy rules have been tightened with a view to bring them up to international standards. To further strengthened financial sector governance, the Government drafted two key legislation, the new Financial Institutions Act and Bank of Thailand Act. The new Financial Institutions Act will standardize the regulatory framework for banks, and finance companies and provide a legal basis for the consolidation supervision of financial conglomerates. It will also tighten regulations in a variety of areas, including interconnected lending, disclosure standards and penalties and prevention against fraud. The new Bank of Thailand Act on the other hand will strengthen the Bank of Thailand's independence and accountability. Under this new act, objectives of the Bank of Thailand will be limited to maintaining price stability and safeguarding the stability of the financial system.

Reforms in Corporate Governance and Competition

Reforms intended to improve governance and competition were a prominent aspect of the initiatives in these countries. It was recognized that the vulnerabilities in the financial and corporate sectors in these countries were attributable, in part, to deficiencies that undermined governance and market discipline. Notably this was due to the lack of well-defined and transparent accounting and regulatory standards, inadequate disclosure requirements and complex formal and informal ties between government, financial institutions and corporations.

Reforms to promote governance and competition in these countries included, dismantling state sponsored monopolies and cartels; privatizing state enterprises that had served as vehicles of crony capitalism; strengthening competition laws; improving corporate disclosure requirements and increasing accountability to shareholders, increasing the transparency of economic and financial data; and restructuring and dismantling corporate networks (such as the chaebols in Korea) that had limited the transparency of intercorporate dealings. To ensure that the state enterprises were not merely sold into the hands of political insiders, competitive bidding procedures for privatization were established. Competitive bidding was introduced for government bidding as well. In addition, tax and regulatory structures that had led to distortions and misallocation of resources, including by bolstering monopolies, were reformed (Lane et al., 1999).

The policy focus differed in each country. In Indonesia the focus was to encourage competition because extensive domestic regulation restricted competition and supported monopolies or cartels in important sectors. A number of these restrictions intersected with governance issues, which added to perceptions of inequity and creating uncertainty for both domestic and foreign investors. In Korea, policies focused in particular on strengthening shareholders rights; eliminating government interference with bankruptcy procedures, mergers and acquisition; and enhancing the transparency of business practice of conglomerates, including through restrictions on cross guarantees. In Thailand the main emphasis was on privatization of public enterprises in the areas of energy, utilities, communications and transport. As for Malaysia the focus was on strengthening the legal and regulatory framework to protect shareholders, enforcement and compliance of operating standards and procedures. Unlike Indonesia and Thailand Malaysia had a well-laid privatization policy to encourage healthy competition. We will now analyze the major reforms in corporate governance in some detail.

Shareholder Protection - reforms in this area focused mainly on strengthening he system of the board of directors and minority shareholders, rights. All the four countries introduced voluntary codes of corporate governance that largely follow international best practice. These code require that at least 20-35% of board members of listed companies be independent and that independent board committees be set up to deal with corporate matters in particular auditing. To strengthen protection of minority shareholders, especially minority shareholders, listed companies are required to grant shareholders such rights as proxy and cumulative voting and filing class action suits; to make shareholder approval of important transactions mandatory; and to require directors to disclose their business interest and remuneration.

Listing rules have been revised to accommodate many of the provisions stipulated in the codes of corporate governance. Stock exchanges cross the region have mostly tightened rules of penalty and sanction for noncompliance. Corporate laws were amended to strengthen legal protection for shareholders. In Korea, the Securities and Exchange Act was revised to clarify the fiduciary responsibility of directors and lower the threshold for exercising rights to file class action suit, make proposals at general shareholders meeting, inspect company's financial accounts and request the dismissal of directors or internal auditors. Thailand amended the Public Limited Company Act in 2001 to provide mechanisms to prevent directors from making use of companies opportunities for their own benefit and to ensure that minority shareholders can exercise their rights in making decisions for the company.

Transparency and Disclosure - this involved changes in accounting and auditing rules to move closer to international standards. In Indonesia, Korea and Thailand major initiatives were taken to harmonize the Financial Accounting Standards with International Accounting Standards (IAS). In Malaysia, accounting standards are the highest in East Asia and are generally consistent with IAS. The only setback in Malaysia was the issue of compliance and enforcement. With this changes it became mandatory that group companies compile and disclose consolidated financial statements according to international practices. Tougher penalties were imposed for non-compliance.

In Indonesia listed companies are required to appoint a corporate secretary responsible for corporate disclosure. Company annual reports must provide audited and annotated financial statements and a company profile. Reports must be available on the Internet and at local registries. In Korea listed companies were required to include in their annual reports details of business goals and strategies, financial conditions, shareholder rights, cross-shareholdings, cross-debt guarantees, directors compensation and events likely to affect share prices and transactions that could change corporate control. As for Malaysia, company's annual reports were made to fully disclose information on the overall financial performance of the company, the extent of compliance with principles of good governance and the state of internal control. In Thailand companies were required to provide shareholders with sufficient and timely information on the companies financial position before shareholder's meetings, information that may effect shareholder rights and investments, and information on company directors holdings and purchases and sales of companies securities.

Bankruptcy Reform - as part of the corporate restructuring efforts, these countries in the immediate aftermath of the crisis set up mechanisms for voluntary and informal corporate workouts. It included efforts to address weakness in formal bankruptcy procedures. The Indonesian government amended its bankruptcy laws in 1998 and established a new commercial court to deal with bankruptcy cases. In 2000, the government passed the Company Bankruptcy and Debt Restructuring and Rehabilitation Act, modeled on US Chapter 11, to facilitate reorganization of illiquid but financially viable companies. It also increased sanctions on uncooperative debtors and empowered the Attorney General o deal directly with cases, improving the incentives for debtor participation. Similarly the Government in Korea amended the bankruptcy laws in 1998, simplifying legal proceedings for corporate rehabilitation and bankruptcy filing, streamlining provisions for nonviable firms to exit markets and improving credit bank representation during resolution. The authorities also attempted to expedite court insolvency proceedings granting district courts authority to process cases. In September 2001, a Corporate Restructuring Promotion Law (CPRL) was passed to address some of the remaining problems in corporate workouts. In Malaysia bankruptcy laws were sound by international standards even before the crisis. Further reforms were introduced to expedite the resolution of NPLs. Danaharta was allowed to sell NPLs it acquired from distressed banks and appoint special administrators to manage and restructure these assets. Authorities also reduced companies' ability to impose restraining orders on creditors under section 176 of the Bankruptcy Act. In 2001, The Kuala Lumpur Stock Exchange introduced practice notes and guidelines, thus increasing the disclosure and reporting obligations of distressed companies on the KLSE. Thailand introduced a Bankruptcy Act Amendment in March 1999 that prevented a company from being forced into bankruptcy due to temporary liquidity problems. This amendment introduced the Frame for Corporate Debt restructuring to the Bankruptcy Act of 1940, along the lines of Chapter 11 of the US Bankruptcy Code.

Social Sector Policies

Social sector policies were drawn to reduce the effects of the crisis on the vulnerable segments of society. With economic contraction, unemployment increased and income-earning opportunities declined. The drop in share prices and the value of property had a negative wealth effect, affecting consumers. Pay cuts and price increases reduced the capacity of wage earners to transfer remittances to the rural areas. The rising costs of education at the tertiary level and health care affected the supply and demand of services available, as well as the quality of the supply of such services. As a result of these social safety nets were implemented with structural adjustment measures, and designed to address either structural or transitional poverty and unemployment, to reduce the impact of adjustment measures on certain groups, or to create or improve both social and physical infrastructure. The formal social safety nets that existed in these countries were considered to be rudimentary[5].

All four countries were affected by an increase in the unemployment rates (Table 7). However the severity of the unemployment impact varied across countries by region and skills level. In general much of the increase in unemployment was concentrated in cities and urban areas as opposed to rural areas. The relatively small increase in unemployment in Malaysia can be explained in part by the flexibility and mobility of the labour force and repatriation of a sizeable number of foreign workers.

The main difference between the impact of the crisis in Indonesia and Thailand was that the agricultural sector in Indonesia was able to absorb most of those who were laid off in urban areas and moved back to rural areas. The same cushioning did not occur in Thailand were, starting in the early 90's, agriculture became more mechanised after the sector adjusted to increased costs of agricultural labour. In Thailand, most of the people

[5] Existing social safety nets in Indonesia, Korea and Thailand are described in Gupta and others. They typically include some form of insurance for old age, disability and death with very limited coverage and benefits; rudimentary health insurance and insurance for work related injuries; and in Indonesia and Korea, limited social assistance programs for poor persons without income and for particularly vulnerable groups. Of these three countries only Korea had a formal unemployment insurance system, which covered, however, only a small portion of the labour force at the onset of the crisis.

who returned to rural areas either remained unemployed or employed in the informal sector outside agriculture (**Granolati, 2001**).

Table 7 - Unemployment Rates (%)

	1996	1997	1998	1999	2000	2001
Indonesia	4.9	4.7	5.5	6.4	6.1	8.1
Malaysia	2.5	2.6	3.2	3.4	3.1	3.7
Korea	2.0	2.6	6.8	6.3	4.1	3.7
Thailand	1.1	0.9	4.4	4.2	3.6	3.4

Source: ARIC Indicators, Asian Development Bank

Even before the crisis there were persistent pockets of poverty. Moreover, many non-poor people lived just above the poverty line so that either a slight increase in poverty line or a slight reduction in household resource availability would produce a considerable increase in the number of poor. The impact of the crisis increased the incidence of poverty[6] mainly in Indonesia and Korea. In Indonesia it increased from 14.7% in 1997 to 20.3% in 1998, in Korea from 9.6% in 1996 to 19.2% in 1998. For Thailand the increase was insignificant (from 12.9% to 13%) and in Malaysia there was a reduction (from 9.6% to 8%). Within each country, reduction of

[6] measured by Poverty Incidence, % of Total Population below official poverty line

poverty has not been uniform across social, economic and ethnic groups and geographic regions.

Although the sharp devaluation of currencies contributed, in part, to improve the economic situation of some groups (Gragnolati, 2001), many of whom were relatively poor before the crisis, the most vulnerable households were apparently urban, dependent on fixed incomes, in sectors closely linked to the financial formal economy. Conversely, rural households, appear better protected, to the extent that the impact was cushioned by their agricultural activities. Given that poverty was concentrated in rural areas before the crisis, the " old poor " did not appear to be shouldering a disproportionate burden of the crisis. In Indonesia, data indicates that average per capita household expenditure in urban areas fell to an estimated 40% over the past year, while the median declined by only six per cent, suggesting that it was primarily the non-poor who reduced their consumption levels. Similarly, in Thailand per capita income declined to an average five percent, but increased prices of agricultural products, mitigated adversity on rural households, despite a worsening income distribution among farmers, directly as a result of the crisis.

The impact of inflation was felt through an increase in food prices most notably Indonesia whereby the food price index increased by 93% immediately after the crisis (Table 8). The policy focus in Indonesia was to allow a substantial increase in subsidies on essential foodstuffs to stabilise prices. Subsidies on food, fuel and electricity prices as well as low-cost housing comprise the bulk of safety net spending. In Malaysia, effective price controls measures prevented hoarding and prices overshoots, which would otherwise have reduced household income and increased poverty.

Table 8 - Food Price Index

	1996	1997	1998	1999	2000
Indonesia	100.0	108.7	209.3	261.7	249.0
Malaysia	110.9	115.5	93.8	98.1	100.0
Korea	103.0	105.7	117.8	123.0	120.0
Thailand	117.7	125.9	137.9	136.7	135.2

Source: ARIC Database, Asian Development Bank

With these concerns the focus of social sector policies in these countries was in four broad areas-

(i) measures to raise income transfers by strengthening and broadening the scope of existing social safety nets;

(ii) measure to limit unemployment through government support for various types of employment and training schemes, as well as self-employment initiatives;

(iii) measures to limit the impact of price increases on the consumption of poor households through new support schemes or the continuation of existing subsidies for basic goods and services, and

(iv) measures to maintain access by the poor to health care and education.

In designing social sector policies, the countries targeted assistance to protect the vulnerable while avoiding labor market disincentives and an unsustainable burden for the budget. Given the severity of the recession, significant increases in budgetary outlays for social programs have been adopted (Table 9).

Table 9 - Central Government Expenditure on Social Safety Nets
(% of total expenditure[1])

	1996	1997	1998	1999	2000
Indonesia	n.a.	n.a.	2.5	2.1	n.a.
Malaysia	3.4	3.8	3.3	3.1	3.2
Korea	8.9	10.1	13.5	14.5	6.5
Thailand	4.1	3.6	4.9	5.1	6.2

[1] For Indonesia total expenditure and social expenditures refer to development expenditures only; data on housing refer to housing and human settlement, regional, rural and urban development, religion, information, press and social communications. For the Republic of Korea, this covers education, health, housing and social welfare. For Malaysia this covers expenditures on education, health, social welfare and housing; social welfare refers to pensions and outlays in welfare services, sports, labour, local government and housing that cannot be disaggregated from the current expenditure account. And for Thailand, this covers expenditures on education, health, social welfare and housing; social welfare includes expenditures on social security and welfare".
Source: ARIC Indicators, Asian Development Bank