

## **The Employment Problem in Korea**

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What Korea has is not an "unemployment problem" but rather an "employment problem." The employment problem includes continued high unemployment, but it goes well beyond it, also encompassing falling labor earnings, rising poverty and inequality, disproportionate impacts on disadvantaged groups, informalization of employment, increased job insecurity, and consequent social strains. This paper documents Korea's employment problem, characterizes the problem as deficient aggregate demand rather than frictional or structural unemployment, examines in some detail three of the most important elements of the social safety net (the Employment Insurance System, the Livelihood Protection Program, and public works), and considers four major ways of strengthening conditions in product markets and labor markets: stimulating macroeconomic growth, fighting unemployment and low earnings, improving the industrial relations climate, and establishing appropriate labor market flexibility.

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### **1. INTRODUCTION**

In November of 1997, the Republic of Korea faced a sudden and unprecedented financial crisis. In the ensuing year, the country experienced a devastating economic decline. Real per capita GDP fell from \$10,307 in 1997 to \$6,823 in 1998 (Park, 1999, p.2), and unemployment rose from 2.1% in October 1997 to 8.6% in February 1999 (Cho, 1999, p.12). Real wages shrank by 9.3% in 1998 in terms of won; after allowing for the depreciation of the

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won relative to the dollar, the one-year decline in dollars was a stunning 34.2% (KOILAF, 1999). The Koreans refer to these events as the "IMF Crisis" and blame the IMF for their "incorrect policy package" and "one size fits all conditionality." Of course, we can only guess whether the economy would have fared better or worse had Korea decided to go ahead on its own without the IMF's funds and the conditions they placed on the economy. What is undisputed is that the crisis put great strains on the labor market and the social structure, which is the topic of this paper.

Happily for Korea, conditions are improving markedly (National Statistical Office). The macroeconomic growth rate was 10.7% in 1999 and is now 9.2% (third quarter 2000). According to the latest data (October 2000), the unemployment rate has fallen to 3.4%. Real wages grew by 11.1% in 1999 and by another 6.6% between January and September, 2000. Women, who had been discouraged by high unemployment and dropped out of the labor force, have been returning to the labor force and finding jobs at the same rates as before.

Still, in a number of dimensions, the labor market has not yet returned to its previous level. According to the latest figures available at the time of this writing, unemployment is still half again as great as before the crisis (3.4% versus 2.1%), inequality of urban household income is 15% higher now than before, and urban poverty is more than double its pre-crisis level.

My main point in this paper is that what Korea has is not an "unemployment problem" but rather an "employment problem." The employment problem includes continued high unemployment, defined according to standard international definitions as people who were not working but actively looking for work. But by this definition, anyone who worked even one hour for pay the preceding week or fifteen hours not for pay in a family business or a family farm is counted as employed, regardless of the amount earned. Korea's employment problem therefore goes well beyond high unemployment alone, and also encompasses falling labor earnings, rising poverty and inequality, disproportionate impacts on disadvantaged groups, informalization of employment, increased job insecurity, and consequent social strains. Misdiagnosis of the problem may lead to misguided policy responses, in both the short and the longer runs.

In what follows Section 2 describes the most important parts of the story in

the crisis years. Sections 3 and 4 consider short-run policy responses and ways of coping with the employment problem in the longer run. The main conclusions are summarized in Section 4.

## 2. DIMENSIONS OF THE PROBLEM

### 2.1. Reversal of Past Progress

In the last several decades, Korea has been one of the world's great economic successes, not only in terms of growth of Gross National Product but also in terms of improved employment conditions. Real per capita GNP grew at an average annual rate of 7.5% between 1965 and 1995 (World Bank, 1998). While this was taking place, virtually full employment was maintained, the mix of jobs improved greatly, real earnings increased by a factor of six in twenty-five years, earnings inequality fell, and *poverty* plummeted (Fields, 1995; World Bank, 1998; Fields and Yoo, 2000).

Progress in these areas was abruptly reversed with the macroeconomic crisis beginning at the end of 1997. The recession was felt in the labor market in a variety of ways.

Open unemployment, which is an important part of Korea's employment problem, tripled, from an average of 0.57 million in 1997 to 1.56 million in 1998 (Moon *et al.*, 1999, p.4). In percentage terms, the rise in unemployment in Korea was much larger than in the Philippines or Malaysia (Knowles *et al.*, 1999, p.2). The hazard rate out of unemployment dropped from 23.0% in 1996 to 17.4% in 1998, implying that the duration of a spell of unemployment increased by about two months (D.Kim, 1999, pp.22-23). At the depths of the crisis, more than 20% of the unemployed had been unemployed for at least six months (Phang, 1999, Figure 5, based on National Statistics Office, *Monthly Report on the Survey of the Economically Active Population*, 1999).

Though important, open unemployment is only the tip of the proverbial iceberg. Labor market declines were registered in many other dimensions:

Although about five percent of workers lost their jobs, the great majority suffered declines in real earnings. Real monthly earnings, adjusted for inflation, dropped by 9.3% in 1998 (Park, 1999, p.8), and were 12.3% lower

in July, 1998 than they had been a year earlier (D.Kim, 1999, p.26). In Korea, labor market earnings are comprised of base earnings, overtime pay, and bonuses, with bonuses amounting to about 30% of base pay, depending on the year. Comparing the third quarter of 1998 with the third quarter of 1997 (i.e., just before the crisis), although base earnings exhibited a slight increase (+3.2%), overtime payments fell by 16.5% and bonuses by 33.8% (Moon *et al.*, 1999, p.16, based on data from the Ministry of Labor's *Monthly Report on Labor Statistics Survey*).

There was a marked increase in informal employment, reversing the previous improvement in job mix. Employment in the agricultural, fishery, and forestry industries, which are at the bottom end of the pay scale, increased from 2,547,000 in July, 1997 to 2,652,000 in July, 1998. As another sign of informalization, in that same one year period, the number of unpaid family workers rose from 1,957,000 to 2,120,000 (D.Kim, 1999, p.23). A third indicator of informalization is the growth of part-time work. The number of workers working fewer than 36 hours per week increased by 36% while those working fewer than 18 hours per week increased by 87% (D.Kim, 1999, p.25).

Overall, the number of permanent wage workers shrank by 10.6% in 1998, and the number of temporary wage workers shrank by 9.2%. At the same time, self-employment fell by 2.3% and unpaid family work actually increased by 1.2% (Moon *et al.*, 1999, p.18).

The high unemployment caused many potential workers to leave the labor force, and thereby cease being counted as unemployed in the official statistics. Between 1997 and 1998, the economically inactive population increased by 5.5%, while the economically active population decreased by 0.9% (Moon *et al.*, 1999, pp.9 and 54, based on data from National Statistics Office, *Monthly Review on Employment Trend*, various issues).

The proportion of workers' households in poverty jumped during the crisis. By one estimate, the number of people living in absolute poverty rose from 1.6 million before the crisis to 4.6 million one year later (Korea Development Institute, cited in Joong-Ang Ilbo, 1999 and reported by Park, 1999, p.9). Another study, using a different poverty definition, also showed a tripling of the poverty rate – this, among urban worker households (Moon *et al.*, 1999, p.25, based on a poverty line estimated by the Korea Institute for Health and Social Affairs).

Income inequality increased in the crisis. The Gini coefficient of income inequality rose from .301 in the third quarter of 1997 to .322 a year later (Moon *et al.*, 1999, p.54). Thus, the increase in poverty was caused not just by the fall in mean income, but also by the rise in inequality (D.Kim, 1999, p.29; Moon *et al.*, 1999, pp.22-23).

## 2.2. Disparate Impact on Different Groups

The impact of Korea's labor market crisis was by no means uniform. Some groups were affected considerably more than others:

- Much of the decrease in employment took place in the formal sector, where employment decreased by 7.8% (Moon *et al.*, p.19).
- By industry, the largest changes in employment were in construction (minus 21.3%) and manufacturing (minus 13.3%) (Moon *et al.*, p.9).
- Most of the unemployed (61%) had worked in small establishments employing fewer than ten workers, while only 5.7% had worked in establishments with more than three hundred employees. Hence, the increase in unemployment was concentrated in the smaller establishments (Moon *et al.*, 1999, p.14; Park, 1999, p.7).
- About one million jobs for technicians and unskilled workers were lost (Park, 1999, pp. 4-5). Production workers and laborers lost jobs at higher rates than others (D.Kim, 1999, p.17).
- By age, the employment decline was concentrated in the two youngest age groups, 15-19 and 20-29 (Moon *et al.*, p.10).
- The sharpest rise in unemployment was recorded among heads of households (Park, 1999, p.5).
- Those who previously were temporary and daily workers accounted for the bulk of the unemployed (Park, 1999, p.6; Moon *et al.*, 1999, pp. 12-13).
- Those with the lowest levels of education (less than upper secondary education) were hit the hardest by the crisis, their share in the unemployed increasing from 21.3% in 1997 to 28.0% in 1998 (Moon *et al.*, 1999 p.14).
- Unemployment fell most heavily on lower-income families and on the least-educated (Choi, 1998, pp.34 and 37).

- The increase in unemployment was concentrated in urban areas, with the two major cities in Korea (Seoul and Pusan) displaying the largest increases in unemployment (4.7 and 5.4 percentage points, respectively). Furthermore, the disparity of unemployment rates across geographic regions increased by 60% (D.Kim, 1999, pp.28-29).
- As would be expected, new entrants to the labor force had much more difficulty in obtaining jobs, reflecting the strong position of insiders vis-à-vis outsiders in Korea.
- The decline in earnings varied by labor force group. The largest percentage wage declines were registered for men, for workers in manufacturing, retail and wholesale trade, and personal services, for workers in the largest firm size category, for production workers, and for the least-educated (D.Kim, 1999, pp.26-28).

### 2.3. Social Consequences

The deterioration of labor market conditions led to severe social strains. Crime was up by 11.7% in 1998 compared to the previous year (Moon *et al.*, 1999, p.34.). Some 2,500 homeless people are estimated to be living in Seoul subway stations (D.Kim, 1999, p.30). The middle class is estimated to have shrunk in size by as much as 64% (Daewoo Economic Research Institute, cited in Park, 1999, p.9). The number of dropouts and absentees in elementary schools increased seven-fold since the crisis began, and kindergarten enrollments fell by 7% (Ministry of Education, *Educational Statistics Yearbook and Handbook of Educational Statistics*, cited in Moon *et al.*, pp.26-27). More than 10,000 school students in Seoul are reported to be skipping lunch because of inability to afford them (Chosun Daily Newspaper, reported in D.Kim, 1999, p.30). Spending on tutoring is down 24% overall, 39% among the lowest-income group (Knowles *et al.*, 1999, p.5). Health care expenditures have declined sharply, especially among the poorest (Knowles *et al.*, 1999, p.6.). Sexual harassment and abuse in the workplace have risen (Knowles *et al.*, 1999, p.7). The divorce rate is up by 30% (National Statistics Office, cited in Moon *et al.*, p.35). Older persons in Korea have suffered a relatively heavy labor market impact along with a loss of independence (Knowles *et al.*, 1999, p. 7).

"Pain" is the word often used, justifiably, to characterize the current social situation. It may take a long time to recover the social capital lost during the crisis.

### **3. SHORT-RUN POLICY RESPONSES: THE SOCIAL SAFETY NET**

In March 1998, the government of Korea responded to the unemployment crisis by declaring a four-part program consisting of job keeping, job creation, job placement and training, and social protection (KLI, 1999; Phang, 1999). The *job keeping component* involved a) providing credit and bailout funds to viable small and medium sized firms to protect them from bankruptcy and b) supporting and subsidizing firms to adopt qualitative adjustments (including job-sharing, reduced work hours, temporary shutdown, paid and unpaid leave, dispatching and reassignment of workers) rather than quantitative adjustments (i.e., layoffs) when employment reductions are required. The *job creation component* included support of new business start-ups and provision of temporary work opportunities through public works programs. The *job placement and training component* provided for expanded public employment services, a labor market information system, and revamped job training schemes. Finally, the *social protection component* included extensions of the Employment Insurance System and the Livelihood Protection Program.

In 1998, the government of Korea spent 10 trillion won on these and other measures. These expenditures were allocated as follows:

In the balance of this section, we examine in some detail three of the most important elements of the social safety net – the Employment Insurance System, the Livelihood Protection Program, and public works – followed by an overall assessment.



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Job creation	38%
Expansion of SOC investments	
Support for venture enterprises	
Employment security	21
Employment maintenance subsidies	
Support for small and medium companies	
Job training and job placement services	9
Livelihood protection for the unemployed	32
Public works projects	
Unemployment benefits	
Loan projects for the unemployed	
Livelihood protection, etc.	
Total	<hr/> 100%

Source: Ministry of Labor, *White Book on Labor*, 1999.  
(No later figures are available yet.)

### 3.1. Employment Insurance System

Korea's Employment Insurance System, established in 1995, provides for traditional unemployment insurance, job training for the unemployed, and a job information service. At its inception, the EIS covered firms with thirty or more regular employees. The restriction to large firms was to permit experimentation and for ease of administration. The system was expanded in January 1998 to firms with at least ten regular employees, in March 1998 to firms with at least five regular employees, and in October 1998 to all firm size categories, to temporary workers who had been employed for at least one month, and to part-time employees who work more than 18 hours per week.

The payroll tax for unemployment insurance is nominally divided equally between the worker and the employer. The rate began at 1.5% of earnings and has since been increased to 3.0%. After six months of contributions, the worker becomes entitled to unemployment benefits. The benefit amount starts at 70% of the national minimum wage, rises to 50% of the worker's average earnings during the preceding twelve months, and reaches a maximum of 1,050,000 won, which is about 80% of the average manufacturing wage. The

duration of benefits depends on the worker's age at the time of becoming unemployed, on the length of his/her insured period, and on the state of the business cycle. In 1998, for most of those eligible, benefits lasted for two months. Starting in 1999, the maximum was increased to four months. In the future, this will be lengthened to seven months. The government reckons that presenting 1999, almost 8.6 million workers – 70% of all employees – were covered by employment insurance (KDI, 1999, p.30).

Korea is one of the few East Asian economies with an unemployment insurance system. However, the Korean system exhibits four major problems. First is the inadequacy of coverage. In June 1998, at the depths of the crisis, there were 1.5 million unemployed, of whom only 7% received unemployment benefits. Since then, coverage has been expanded but it remains quite partial. According to the latest figures, 60% of wage workers are covered by the EIS (the major omissions are civil servants and teachers, according to Phang, 1999), but in the first quarter of 2000, just 8% of the unemployed were receiving unemployment insurance benefits (KLI, 2000). The second problem is the inadequate duration of benefits. Even before the crisis, unemployment spells averaged more than five months in length (D.Kim, 1999, p.37), which means that unemployment benefits do not cover the average unemployment spell. Third, even for those covered, the benefit amounts are low, not permitting recipients to attain what the Koreans deem an adequate standard of living. And fourth, those who are least able to provide for themselves – temporary workers, workers in small firms, new entrants and reentrants to the labor force – remain left out.

At the time that the system was initiated, some observers forecast that by failing to include firms of all sizes and all categories of workers, a large part of the labor force would suffer severely in the event of an economic downturn. This, alas, is exactly what came to pass.

There seems to be some doubt at this point about what the true purpose of the employment insurance system is. Is it social insurance, an income maintenance scheme, or a job creation program? Agreement is widespread in the international literature that unemployment insurance is most appropriately conceived of as social insurance, linking benefits paid out to the group of insureds to the contributions made directly by them and by their employers on their behalf; see, for example, Burgess and Stern (1991). In order for

unemployment insurance to be true social insurance, two conditions must be fulfilled. First, it must cover everyone. Including only a minority of the working population, and those who are the best-positioned to start with at that, is a recipe for social disaster. And second, the aggregate benefits paid out by the system must bear some relationship to contributions, if not in any given year, then over the long run. Korea's employment insurance system did not have an adequate prior set-aside of funds, which is why the Employment Insurance Fund budget was increased by 54.1% from 1998 to 1999 (Ministry of Labor, *Overview of 1999 Policy Measures to Protect the Unemployed*, January 1999).

Reforms of Korea's EIS are in order. See the report of a Korea Labor Institute Task Force (KLI, 2000) for recommendations along these lines.

### **3.2. Livelihood Protection Program and Other Social Assistance**

Many categories of people do not qualify for unemployment insurance, which is intended to assist previously-employed workers who are temporarily without income. For others – new entrants to the labor force, retirees, the long-term unemployed, the sick, and the infirm – it may be possible to receive benefits through the Livelihood Protection Program (Ministry of Health and Welfare, 1998). Benefits are paid in one of three categories: home care, institutional care, and self-support. Home care and institutional care recipients receive a cash benefit, while those in self-support receive in-kind transfers and subsidized loans only. Strict means tests are applied to these programs; at present, only those with incomes below 230,000 won per person per month and property worth less than 29 million won are eligible (Phang, 1999).

In 1998 the Livelihood Protection Program provided benefits to some 1.5 million people in Korea which, in view of their limited duration, means at most 200,000 beneficiaries or so at any given time. Those unemployed who are judged able to work are eligible to receive in-kind benefits only. As for cash recipients, the amount of these transfers for those who receive them is just 9% of the average monthly earnings level in Korea. Only around 9% of the unemployed were eligible to receive benefits of any kind, cash or other (Park, 1999, p.12).

In 1999, a new program was created for job-losers with the capacity to

work. This was a new subsidized loan program called the Life Stabilization Fund. Those unemployed whose assets fell below a certain level became eligible for assistance with living costs, children's school expenses, medical fees, and housing costs. These loans for the unemployed were made at a below-market interest rate with a two-year repayment period beginning two years after the loans were disbursed.

A recent survey showed that only 2.4% of unemployed household heads lived off the social safety net. By contrast, 50.3% lived from savings, retirement allowance, and selling real estate, 27.0% from income from other family members, and 9.7% from support from relatives and friends (National Statistical Office, *Monthly Review on Employment Trend*, October 1998).

Recognizing the limitations of the current Livelihood Protection Program, the Korean National Assembly passed the National Basic Livelihood Guarantee Act, which took force in October 2000. This act will guarantee income support to all Koreans living below the poverty line regardless of their earning capacity. The number of poor beneficiaries is expected to reach two million, as compared with half a million Livelihood Protection Program beneficiaries currently (World Bank, 1999). This program will have to be watched carefully to make sure that those who are able to work are making every effort to do so.

The Korean government has also assigned top priority to a so-called "Productive Welfare Program" which, instead of focusing on ex post redistribution of income, concentrates on expanding employment opportunities and empowering the disadvantaged to make use of these opportunities. Expanded access to education, medical services, and housing are the main means of achieving this objective (K.Kim, 1999, p.3).

### **3.3. Public Works**

With the huge increase in unemployment in 1998, the government instituted public works programs for those unemployed who could not qualify for unemployment insurance benefits and for the spouses of the unemployed whose unemployment benefits are below 300,000 won. Jobs are provided in such activities as street-sweeping, traffic control, parking guides, forest conservation, and repair of public buildings. Participants can receive benefits

for up to nine months (Phang, 1999). At first, the level of the benefit was 1.5 times the minimum wage (D.Kim, 1999, p.39); although the benefit has since been cut twice, it remains above the minimum wage rate (Phang, 1999). About 440,000 workers participated in public works programs some time in 1998 (KDI, 1999, p.31) – seemingly a large number but small in relation to the average number of unemployed in any given month of that year (1.5 million).

### 3.4. An Overall Assessment

At first, I was tempted to entitle this section "Patching the Social Safety Net." However, as the data just reviewed have shown, the holes are so gaping that a more apt title might be "Weaving a Social Safety Net." Koreans call it "the huge blind spot" – this, despite the government's doubling of the labor market budget in March, 1999 (Park, 1999, p.38).

The social safety net system in Korea is still immature, growing, and being redefined. Looked at as a whole, here are the figures. In 1998, there were 35.2 million Koreans aged 15 and over. Of these, 19.9 million were employed and 1.5 million were unemployed on average. At some time during the year, 1.5 million Koreans received livelihood protection benefits and 0.4 million participated in public works programs. In a typical month (June 1998), 0.1 million Koreans received unemployment benefits.

These figures highlight the first problem: the existing programs cover only a small fraction of the population at risk. Taken together, the public assistance programs covered only about 3.3% of the total population (Moon *et al.*, 1999, p.50). Thus, the great majority of Koreans were simply left out.

Second, the benefit amounts, when paid, are quite unsatisfactory relative to the economic risk being insured against. Take, for example, the risk of unemployment. At the bottom end of the distribution, even the unemployed who do qualify for benefits receive much less than the poverty line, and those in the middle of the benefit range have replacement rates of 50% lasting just four months.

Many suggestions have been made by Park (1999) and others. Among them: (1) Since October 1998, firms in all size categories have in principle been required to participate in the employment insurance system. However,

fewer than 20% of small companies (those with five employees or fewer) were enlisted at the end of 1998. (Ministry of Labor, cited in D.Kim, 1999, p.38). Furthermore, those workers who became unemployed because their firms went bankrupt were left out. Therefore, make the coverage of the EIS more comprehensive. (2) Now that unemployment insurance benefits are available for all who have worked at least six months, extend the duration of benefits from four months to six. (3) Relax the conditions on public assistance programs so that more of the truly needy are eligible. (4) Raise the benefit level up to the poverty line. (5) Further expand the public works program. (6) Redesign the public works program by a) focusing on constructive projects, b) setting the wage rate low enough so that only the truly needy self-target into the program, c) providing training for private sector employability, and d) improving the administrative capacity of the government.

If these suggestions were to be implemented, Koreans would indeed have much more economic security than at present. The big question is: How is this to be paid for? A country in the throes of economic crisis is not in a good position to raise generosity of benefits or extend coverage to those left out. These changes needed to have been made before the crisis arrived. Now is the time to think about how to redesign the benefit and financing structures to provide the Korean people with adequate protection against future contingencies.

#### **4. COPING WITH THE EMPLOYMENT PROBLEM IN THE LONGER RUN**

The twin challenges for employment policy in Korea are to return the economy to full employment and to restore broad-based earnings growth. To consolidate the progress made in the last two years and move ahead, conditions in the product market and the labor market must be strengthened. In this section, I present a few thoughts on four major issues: macroeconomic growth, fighting unemployment and low earnings, improving the industrial relations climate, and establishing appropriate labor market flexibility.

#### 4.1. Stimulating Macroeconomic Growth

In the past, economic growth in Korea has brought about a continued tightening of labor markets. It is a truism, but nonetheless a truth, that the demand for labor is derived from the demand and supply for product. Thus, if the employment problem is to be remedied, the Korean economy will need to continue to grow.

Other have detailed how to restructure the Korean economy to promote economic growth, so I shall be quite brief on this point. I just wish to say that the growth challenges confronting Korea in today's globalized world are different in detail but similar in concept to what they were ten, twenty, or thirty years ago. The Korean economy has followed a model that has worked for decades: produce world-class products at attractive prices so that those in Korea and in the rest of the world who have the purchasing power will want to buy goods made in Korea. That prescription is equally valid today.

#### 4.2. Fighting the Principal Cause of Unemployment and Low Earnings

Economists classify unemployment into three major groupings. *Structural unemployment* arises when jobs are unfilled and workers are unemployed, but supply and demand are mismatched in such dimensions as geography or skill. *Frictional unemployment* arises because of the time it takes for workers to find jobs and for employers to locate suitable workers. *Deficient demand unemployment* arises when the total demand for workers is less than the total available supply.

Slack earnings for the employed may be classified similarly. First, the *structural* explanation for low earnings is that the only jobs available for certain types of workers are poor ones. Second, the frictional explanation for low earnings is that considerable time is required for workers to find "good" jobs, so they make do with "bad" jobs in the meantime. Third, low earnings may have a deficient demand basis: in this case, employers can find all the workers they want, even if they reduce total earnings (base wage, overtime pay, bonuses), but not all workers can find jobs.

All of the available evidence indicates that the primary problem in Korea was (and still is) deficient aggregate demand – simply put, too few jobs

available for all who want them. It was not that firms sought workers of a certain type and that the available labor pool was of a different type, nor was the problem one of getting unemployed workers together with employers with unfilled positions. A government study revealed that both among new entrants to the labor market and among experienced workers, "no job" was cited as the main reason for unemployment – more important than all other reasons combined (National Statistical Office, *Monthly Review on Employment Trend*, October, 1998). This result has been confirmed by more recent investigations.

The appropriate set of policies to deal with unemployment and low labor earnings caused by deficient aggregate demand are strong macroeconomic conditions, increased competitiveness, a market-friendly environment, and (temporarily) public works and employment subsidies. These are the policies that should be the focal point of Korea's efforts to deal with the nation's employment problem.

The policies aimed at structural or frictional elements are not the ones that merit additional resources in today's Korea. Structural policies are such things as worker training and retraining, geographic mobility allowances, improved transportation systems, and adapting working hours and other job conditions to the desires of potential workers. Frictional policies include improved job information, a public employment service or improved private employment services, and job placement assistance.

Job training, placement services, and other such services have been criticized in Korea on many grounds. Maybe the reason they don't work well is that they focus on the wrong problem.

### **4.3. Improving the Industrial Relations Climate**

The trade union movement remains an important force in Korea, even though only 12-13% of wage and salary workers in Korea are members of trade unions. One important reason for the power of the unions is that they are concentrated in large companies, where their penetration rate is about 70%, and barely of significance in small companies, where the unionization rate is just 1% (Park, 1999, pp.25 and 27). Unions have the ability to shut down highly visible Korean companies, which adds not only to their bargaining power with major employers but also to their political influence.

Trade unions have been able to extract economic rents for their members. (An "economic rent" is a payment in excess of the supply price of a factor.) In addition to higher wages, these take the form of greater employment stability, higher prestige, and other advantages.

Trade unions belong to two federations: the old-line Federation of Korean Trade Unions (FKTU) and the newer Korean Confederation of Trade Unions (KCTU). I believe, and have so written (Fields, 1995), that as a matter of workplace rights, workers in Korea should be allowed to join whichever unions they want and individual unions should be allowed to join whichever federation they want. At the same time, the government can and should regulate what unions and federations may and may not do on the one side and what employers must and may not do on the other.

It is important that organized labor be allowed to play a central role in the national development dialogue, and indeed they have done so through the Tripartite Commission; see below. At the same time, it should not be forgotten that organized labor still represents only a small minority of working Koreans, and that the interests of those not in unions also need to be considered.

Disruptive industrial relations can poison a country's development prospects. Korea does not seem destined to have a European-style "social partnership" approach to industrial relations any time soon. Still, if a more consensual, less confrontational system could be developed (Park, 1993), the country's social and economic development might be enhanced.

#### **4.4. On Flexibility in the Labor Market**

Once the financial crisis hit, the Republic of Korea and the International Monetary Fund agreed to a number of measures aimed at promoting industrial restructuring and attracting needed foreign investment. At the start of 1998, then-President-Elect Kim Dae Jung promptly established a Tripartite Commission, consisting of union, employer, and government representatives, the purpose of which was to shape a labor market policy response to the crisis. Since then, the importance of the Tripartite Commission has ebbed and waned (Campbell, 1999)

In February 1998, the Tripartite Commission announced a Social Agreeeme-

nt aimed at overcoming the economic and financial crisis. This agreement provided for measures aimed at reforming corporate governance, heightening accounting transparency, improving labor market flexibility, extending the social safety net, and reinventing government (Lee, 1998, p.97).

In the area of labor market flexibility, the most important point of agreement within the Commission was the acceptance by trade union leaders of a system of redundancy layoffs, which was immediately enacted by the National Assembly. For the first time firms were given the right to lay off workers in cases of "urgent managerial need." The agreement also provided for temporary work agencies to operate for the first time (as of July 1998). Regulations on private job placement agencies were eased. In order to minimize the number of job losses, a number of measures were adopted including sharing work through reduced work hours, reducing wages and bonuses, suspending recruitment, redeploying workers to affiliated companies, and pressuring older workers to consent to earlier retirement. The government expanded the systems of employment insurance, vocational training, and public works jobs to better assist those who were laid off, and wage subsidies were made available to firms that cooperated with these arrangements.

The newly-introduced layoff system was bitterly opposed by rank-and-file labor union members. Consequently, the leadership of the Korean Confederation of Trade Unions was removed from office and replaced by a new set of leaders, who withdrew from the Tripartite Commission on the grounds that mass dismissals had become excessive and illegal, violating the spirit of the Social Agreement, which held that the burden of the adjustment should be shared equally among labor, management, and government. But in the face of intense social pressure, the KCTU rejoined the Commission in August 1998, only to withdraw again early in 1999. Shortly thereafter, the more conservative Federation of Korean Trade Unions also withdrew from the Commission. At this writing, the Tripartite Commission continues to operate, but no more big changes are occurring.

All in all, it would seem that Korea has about the right amount of labor market flexibility. The vaunted lifetime employment system applies to only a minority of workers: at most three million of Korea's 13.2 million wage and salary workers belong to the modern sector (Park, 1999, p.26). Wage flexibility was higher in Korea than in the United States, Great Britain,

Germany, and Japan and, after 1983, so too was employment flexibility (Jeong, 1997). With layoffs now permitted in modern sector firms (informal sector firms never had prohibitions against layoffs in the first place), employment flexibility is even greater.

## 5. CONCLUSIONS AND IMPLICATIONS

Korea suffered mightily at the end of 1997 and throughout 1998. Fortunately, the worst of Korea's economic crisis appears to be over and a recovery is under way. Unfortunately, the labor market has not yet recovered its previous levels and much hardship remains.

What is to be done? I would draw out four lessons.

The first task is to define the labor market problem correctly. Korea has an employment problem, not just an unemployment problem. Attention should be focused on the majority whose earnings have dropped, often below the poverty line, rather than on the minority who are openly unemployed. Once the problem is redefined, policies aimed at raising earnings are called for in addition to policies aimed at creating jobs.

Second, the employment problem is best seen in terms of deficient aggregate demand rather than in frictional or structural terms. Given this diagnosis, some policies are called for: among them, macroeconomic growth, increased competitiveness, a market-friendly environment, public works, and employment subsidies. Others diminish in importance: these include worker training and retraining, geographic mobility allowances, improved transportation systems, adapted work hours, improved job information, expansion of employment services, and job placement assistance.

Third, other policies are conducive to employment generation. These include an improved industrial relations climate and appropriate flexibility in labor markets.

Fourth, for those who are left out of employment in the short run, the various elements of the social safety net in Korea – the Employment Insurance System, the Livelihood Protection Program, and public works – can be strengthened and redesigned.

In each of these areas, Koreans will need to ask some tough questions in

order to decide how to allocate a limited budget for dealing with the employment and social problems. What has caused the problem? What are the policies and expenditure patterns aiming to fix? Are the available resources going to those who most need them? Can the current interventions be better targeted? Are there any programs that can be reduced in size or even cut out, because they are demonstrably not the most important?

In the past, the Korean people have shown a remarkable knack for responding to difficult times and moving steadily ahead. There is good reason to believe that the depths of the crisis have passed and that Korea is once again on an upward development course. It would not surprise me if a decade from now, we will find that real earnings in Korea will again have doubled among a virtually fully employed labor force. Perhaps a strong social safety net will have been woven by then as well. That would be very good news indeed.

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