

Labor Market Policy and the Social Safety Net in Korea: After 1997 Crisis ¹

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1. Introduction

Until November 1997, the Republic of Korea was widely regarded as one of the biggest success stories among developing countries. Since the financial crisis of November 1997, the economy has experienced a sharp downturn. A recent government report estimated that Korea's per capita GDP fell to \$6,823 in 1998 from \$10,307 in 1997, retreating back to the level of eight years ago. Real wages are expected to decline for the first time in almost 20 years.

The main purpose of this paper is to examine the following three questions. First, what have been happening in Korean labor market and industrial and labor relations since the 1997 financial crisis? Second, what have been the major government policies to cope with these new developments, such as rising unemployment and labor disputes. Third, have those policies been effective? Are any supplementary policies needed or is a fundamental shift required? I will examine these issues in turn and make some alternative policy recommendations and conclude by discussing the outlook for labor issues in Korea.

2. Rising Unemployment and the Policy Response

2-1: Overview

The rise in the unemployment rate has been quite dramatic since the beginning of the economic crisis. The unemployment rate had been rather stable before the crisis, between 2 and 3%, but it rose sharply to 6.8% in 1998. The number of unemployed rose from about 560 thousand to 1.46 million, a net increase of about 0.9 million, as shown in Table 1. The month to month increase is even more dramatic: in October 1997, one month before the economic crisis, the unemployment rate was 2.1%; by July 1998, it had risen to 7.6%; and in February 1999, it had risen to 8.7%. However, these unemployment figures (open unemployment) do not include those who are discouraged to looking for as well as those who are currently employed less than 18 hours a week but want to work more (i.e., involuntary short time workers). If we include those workers, then, as of 1998, the number of the

underutilized (unemployed +discouraged workers + involuntary short time workers) will be about 2.26 million (1.46 + 0.61+0.19), equivalent to about 10.5% of the total labor force.²

One recent study calculated the severity (social pain) of unemployment in Korea and compared it with other countries. It showed that the 8.7 percent unemployment rate in February 1999 produced the same level of severity or social pain, as did a 13 percent of unemployment rate in the U.S. and European countries. In other words, even the same unemployment rate generates more social distress in Korea than in other advanced nations. This is mainly because of the underdeveloped social safety net and relatively low labor force participation rate of women (as secondary bread winners) in Korea.³

The unemployment rate will continue to rise for a while. What is important is the fact that the sharp rise in unemployment in 1998 was mostly due to the bankruptcy of small and medium-scale industries, not to the restructuring of the large-scale industries. Small sized firms have suffered disproportionately more from the high interest rate policy imposed by the IMF as a conditionality of its rescue loans.

A further rise in unemployment is expected in 1999. But this time it will happen mainly because of the downsizing and restructuring of the largest companies, mainly the chaebol (family owned large conglomerate) and the public enterprises.

The government's recent efforts to boost domestic demand may temper the sharply rising unemployment. It may moderate the steepness but not the rising trend. Its rising trend will continue at least until the middle of 1999.

² The number of the discouraged workers were approximated by adding the annual average inflow to the economically active population (about 400 thousand) with the net reduction in economically active population between 1997 and 1998 (214 thousand) . Short time workers who wish to work more were defined as those who work less than 18 hours a week (475 thousand) multiplied by the average propensity to work more (about 40%).

³ Prof. Joh, Woo-Hyun did the analysis, see *Hankyoreh Shinmun*, April 16, 1999

Table 1: Korea's Labor Market Profile

(unit: thousand, percent)

	1997 (yearly avg.)	1998 (yearly avg.)
Population over 15 years of age	34,736	35,243
Economically Active Population	21,604	21,390
Labor Force Participation Rate	62.2	60.7
Employment	21,048	19,926
Unemployment	556	1,463
Unemployment Rate	2.6	6.8

Source: National Statistical Office, *Monthly Review on employment trend*, various issues, 1998

2-2: Major Features of Unemployment

The sharp rise in unemployment has not been indiscriminate among various types of workers. The changes in the composition of the unemployed are revealing.

First, the changes in employment by occupation show that technicians and unskilled workers have been the worst, about one million jobs lost in one year. Professional and managerial workers appeared to gain somewhat, but in fact, they also lost some jobs if we take into consideration the trend of rising employment in those occupations in the past several years. Clerical and service workers jointly lost about 291 thousand jobs. However, agricultural employment rose about one million, reflecting the fact that the

agricultural sector in Korea still serves as a buffer for rapid change in labor demand.

Table 2: Loss of Employment by Occupation (1997 vs 1998)

(Units: thousands, percent)

Professional/managerial Workers	50	1.3%
Clerical workers	-156	-6.1%
Service/sales workers	-135	-2.8%
Operatives/Labors	- 974	-12.7%
Farmers/fishermen	94	4.2%
Total	-1,122	-5.3%

Source: Author' s calculation based on the data of the National Statistical Office.

Second, the rise in unemployment is sharper for heads of household, as shown in Table 3, suggesting that the unemployment of middle-aged workers is rising more rapidly than that of young or older workers. In addition, male shows a steeper increase compared to that of women, partly because women tend to give up their job search and leave the labor market when their job prospects are not promising.

Table 3: Changes in the composition of the Unemployed

Units: thousands (percent)

	1997	1998/Sept.
Household-Head	192 (34.5)	719(47.0)

Non-Head	365 (65.5)	853(53.0)
Male	352 (63.3)	1,069 (68.0)
Female	204 (36.7)	503(32.0)
Total	556 (100 %)	1,572 (100 %)

Source: Same as Table 2

Third, Table 4 shows that temporary and daily workers account for the major portion of the unemployed. These marginal workers represented about 62.3 percent of the unemployed as of 1998. And Trend has accelerated over time. In other words, there is a strong tendency towards marginalization of the unemployed.⁴

Table 4: Changes in the Composition of the Unemployed by Previous Job Status.

Units: thousands,(percent)

	1997	1998
Self-employed and unpaid family workers	56 (17.5)	193 (16.1%)
Regular workers	79 (24.8)	258 (21.6%)
Temporary workers	128 (40.1)	399 (33.4%)
Day laborers	56 (17.6)	346 (28.9%)
Total	319	1,196

Note: Figures are only for those who responded to the survey

Source: Same as Table 2.

⁴ As of 1998, temporary and day laborers made up 47% of all wage and salary employment. But in the same year, they accounted for 74% of the unemployed originating from wage and salary employment. This shows that the unemployment incidence is much higher among temporary and day laborers than among regular workers.

Fourth, Table 5 reveals an important fact that the current unemployment situation is driven mainly by the economic recession, not by corporate restructuring. Corporate restructuring of the large-scale industries started from late 1998. So its impact has not been fully felt yet. Thus, most unemployment generated during 1998 was primarily due to bankruptcies of small and medium-sized firms as a result of the high interest rate policy imposed by the IMF right after crisis. In other words, the high unemployment of 1998 was mainly due to the economic recession triggered by the IMF's incorrect policy package, namely, deflationary package, such as high interest rate policy and fiscal austerity.⁵

Table 5 supports this observation. Among the unemployed during 1998 only 5.7% represented those who left jobs from firms with 300 or more employees. Those from firms less than 20 employees accounted for more than 74.2 % of the unemployed. We can conclude that the unemployment effect of the recession of 1998 has most severely hit workers in smaller firms.

Table 5: Job Losses by firm Size in 1998

(units : thousand persons, percent)

	Number of the unemployed	%
1-9 employees	731	61.0
10-19	158	13.2

⁵ IMF's policy failure occurred mainly due to its misunderstanding of the nature of Korean crisis. The fundamental character or nature of the Korean financial crisis of the November 1997 was a temporary liquidity problem, namely, a temporary shortage of foreign exchange triggered by a massive capital flight during a relatively short period of time. It was neither a permanent insolvency problem nor permanent structural problem. Basically it was a temporary capital account crisis, less related to any fundamentals in the domestic economy, but more associated with the weakness (volatility, uncertainty etc) in the structure of the global capital market. But from the beginning the IMF approached the Korean crisis not as a temporary crisis but as a permanent crisis, permanent current account crisis. Hence it imposed deflationary policies, namely, a high interest rate policy and fiscal austerity as well as a series of sweeping structural reforms as conditions for IMF bailout loans. They exacerbated the situation in two ways. One is to push the Korean economy into a deep recession through a deflationary policy package. And the other one is to give a false impression to a foreign lenders that the Korean economy was trapped with big structural problems.

20-49	120	10.0
50-299	121	10.1
300 and more	69	5.7
Total	1,196	100

Note: Figures are only for those who responded to the survey.
Source: Same as Table 2

2-3: Falling Wages and Rising Income Inequality

After the crisis the real wage level also showed a sharp drop from an annual growth rate (year to year average) of 2.4 percent in 1997 to -9.3 percent in 1998, as shown in Table 6. Looking at the quarterly changes during 1998, the wage level has declined sharply until the third quarter of 1998 and then showed no further decrease.

Since the economic crisis began in November 1997 the best figures to reveal the reduction in wages before and after the crisis was those figures in the third quarter of 1998 in Table 6. They show that nominal wages dropped by 8.1 percent and real wages plummeted by 14.2 percent respectively, compared to the third quarter of 1997. It reveals the degree of hardship Korean workers have gone through in the one year after the crisis. The reduction in nominal wages in 1998 was the first in Korea's economic history since wage data began to be collected.

Table 6: Wage Changes in 1997 and 1998

(units: thousand won and growth rate(%))

	Total monthly wages (thousand Won)	Nominal Wages(%)	CPI (1995=100)	Real Wages (%)

1997	1,463	7.0	4.5	2.4
1998 1/4	1,431	0.1	8.9	-8.1
2/4	1,385	-1.2	8.2	-8.6
3/4	1,417	-8.1	7.0	-14.2
4/4	1,475	-0.4	6.0	-6.0
1998	1,427	-2.5	7.5	-9.3

Note: The figures cover only the wage levels of workers in the firms employing more than 10 people in the non-agricultural private sector.

Source: Ministry of Labor, *Monthly Report on Labor Statistics Survey*, Various issues, 1998

Not only the general wage level has worsened but also household income distribution has deteriorated sharply since the crisis. Table 7 shows the household income reduction during 1998 by different income groups. The crisis has hit the lowest income group the most seriously. Nominal and real incomes have dropped by 17.2 % and 23.7% , respectively, for those in the lowest 20 % income group. In contrast, the highest 10% enjoyed the least reduction in household income. In fact, nominal income rose about 4% for the highest group even though real income declined slightly by 2.5%. There is little doubt that income inequality has risen acutely since the crisis.

Recently the press has begun to talk about the melting down of the middle class in Korean society. One study showed that after the crisis out of the 6 million middle class households,⁶ about 64% (3.84 million households) has moved down to lower class and only 6% (360 thousand) moved up to the upper class and about 30% (1.80 million) still remained in a very unstable situation.⁷ Another study revealed that those people under the absolute poverty level was 4.1% (1.64 million) of the total population in the third quarter of 1997, but jumped to 11.6% (4.64 million) at the end of 1998.⁸

⁶ Total number of households in Korea is about 13 million. .

⁷ Daewoo Economic Research Institute revealed the findings. See *Joong-Ang Ilbo*, March 12, 1999.

⁸ Korea Development Institute reported the findings. It assumed that a family of four that earns less than 803 thousand Won per month is under the absolute poverty level. See *Joong-Ang Ilbo* , March 12, 1999.

Table 7: Reduction in Household Income by Income Group in 1998

(unit: percent)

	Nominal Income	Real Income
1 st income group (Lowest 20%)	-17.2	-23.7
2 nd income group	-11.8	-18.3
3 rd income group	-9.9	-16.4
4 th income group	-8.8	-15.3
5 th income group (Highest 20%)	-0.3	- 6.5
Highest 10%	+4.0	-2.5
Average	- 6.7	-13.2

Source: National Statistical Office, *Quarterly Review on Urban Employees' Household Trend*, various issues, 1997, 1998

2-4: Unemployment Insurance Coverage

Against this rising unemployment and worsening income inequality, the government's major policy response has been a rapid expansion of unemployment benefits. Among the benefits package, the chief component has been the unemployment insurance program.

The government's approach, however, contains the following problems. Even though unemployment insurance has undergone a series of expansions, unemployment benefits still cover only a small fraction of the unemployed. Moreover, the current program tends to benefit relatively well-to-do workers laid off from large-scale firms rather than those workers dismissed from small and medium-sized firms.

Initially the program applied only to the firms with 30 or more regular employees. However, this ceiling has been lowered three times. First to 10 or more employees, then to five, and finally no restrictions since October 1998.

However, the unemployed become entitled to benefits only after minimum insured period of six months, thus, those workers laid off from small-scale firms can begin to receive benefits only after April 1999. So the full impact of the benefits expansion will be more visible in 1999. Meanwhile, unemployment insurance goes disproportionately to the relatively well-to-do unemployed. As shown in the Table 4, temporary and day laborers account for the majority of the unemployed, but currently are not covered by unemployment insurance.⁹ Table 3 reveals that non-household heads occupy 54.7% of the unemployed. Many are young workers, seeking jobs upon graduation from university or high school. These newcomers to the labor market also are not covered. In sum, the unemployment benefits coverage is still quite limited. As of June 1998, among the 1.5 million unemployed, only 7% (about 105 thousand) received unemployment benefits.¹⁰

The duration of the unemployment benefits period is too short and the level of benefits is quite paltry, especially for those who earned low wages before being dismissed. The duration of benefits depends on the worker's age at the time of becoming unemployed and the length of his/her insured period. For most unemployed, the benefits last about two months. Only for the period of January to June in 1999, a special benefit of two months can be added on. A worker under the age of 25, who has been insured less than three years, could receive only one month of benefits, but recently this was extended to two month. The maximum duration of seven months is only available to those who have been insured more than 10 years and are over the age of 50.¹¹ This short duration can be extended for workers undertaking vocational training approved by the government, but it is usually limited to three to six months.

⁹ The government decided to include day laborers into the scheme in October 1998, but as of this writing, this has not been implemented mainly due to the lack of administrative preparedness.

¹⁰ The corresponding figure was 36.0% in the U.S. (1990), 43.5% in Germany (1990) and 27.8% in Japan (1992).

¹¹ Note that unemployment benefits were introduced for the first time in Korea in July 1995. Thus, presently there are no workers who have been insured more than 4 years under this scheme.

The level of benefits is set at 50% of the worker's average earnings during the preceding 12 months, up to a maximum of 1.05 million won (roughly \$ 900) per month and a minimum of 250 thousand won (\$ 200) per month. The problem lies in the minimum level of benefit that is currently equal to 70% of the minimum wage. The present minimum wage is around one quarter of the average earnings in Korea. Thus, 70% of the minimum wage level seems to be quite low for adequate social protection.

In sum, the unemployment insurance scheme in Korea is still in its infancy and is skewed very much toward prevention of the potential negative effect of unemployment benefits on work incentives rather than genuine reduction in the hardship of the unemployed. Policy makers appeared to worry too much about the possibility of the so-called European "welfare disease" when they introduced the unemployment program in Korea.

2-4: Workers not covered by Unemployment Insurance

The social safety net for those who are not qualified for the unemployment insurance is extremely limited. Only a few of those workers are eligible for public assistance. The public assistance program does not require previous work experience but it requires a means-test and the means-test is quite strict. Those who are classified as having the ability to work can not receive cash transfers even though very poor and are eligible only for some in-kind transfers like medical and education subsidies and subsidized loans. In addition, to qualify for public assistance, the beneficiary's income and assets cannot exceed a certain level and he or she must be without family members capable of providing assistance.

Even for those who can receive cash transfers, the amount is extremely low, 122,000 won (about \$100) per month, which is equivalent to less than 9% of average monthly earnings. There is little doubt that 9% of average monthly earnings is inadequate for covering basic living expenses. As of June 1998, about 8.8 % of the unemployed (about 143,000) were receiving public assistance. However, most were not eligible for cash transfers, only for in-kind support, because they were classified as able to work.

Another example vividly supports the extreme underdevelopment of the social safety net in Korea. In September 1998 the Korean government conducted a special survey to examine the structure of unemployment. One finding is summarized in Table 8. How is the unemployed household head providing the livelihood of his or her family? Table 8 reveals that as of September 1998, only 2.4 % of the unemployed live off the social safety net, either by unemployment insurance or public pension or by public assistance. It should be noted that September 1998, when the data was collected, was almost one year after the crisis. Even almost one year after the crisis the social safety net covered only 2.4 % of the unemployed household heads. The rest, 97.6 %, of the unemployed are all managing their livelihood through private safety nets. Among them, 52.5% are dependent on personal savings, 27.0% are living on the income of other family members, and 9.7% are receiving support from relatives and friends. Even those living on loans from private source explains 7.0% of the unemployed, a much larger percentage than those covered by the social safety net.

Table 8: The Means of Livelihood of Unemployed Household Heads: As of September 1998.

	Unemployed	%
Income from other family members	194,000	27.0%
Support from relatives and friends	70,000	9.7%
Savings, retirement allowance, selling real estate	362,000	50.3%
Income from property (interest, rent etc)	18,000	2.5%
Public pension	2,000	0.3%
Private loan	50,000	7.0%
Unemployment	10,000	1.4%

insurance		
Public assistance	5,000	0.7%
Other	7,000	1.0%
Total	719,000	100 %

Source: National Statistical Office, *Monthly Review on Employment Trend*, October issue, 1998.

As mentioned, about 7% of the unemployed are covered by unemployment insurance and about 8.8 % by public assistance program as of June 1998. These figures were calculated based on the government's plan decided by the top decision-makers. However, the data directly corrected from the unemployed reveals that even in September 1998 only 1.4% of the unemployed had received unemployment insurance and only 0.7% had received some kind of public assistance.¹² This shows that there is still a substantial gap between what the government promised to do and what is actually taking place, between legal eligibility and practical implementation of social safety net¹³. However, one thing is very clear, that is, the social safety net in Korea is still in its inception and an absolute majority of the unemployed should rely on the private safety net more than one year since crisis.

From the above discussion, one thing becomes very clear, that is, the social safety net in Korea is quite in the beginning stage of development, so the absolute majority of the unemployed can not but relying on private safety

¹² Even these figures seem to overestimate the real situation because Table 8 covers only the unemployed household heads. There could be some systematic differences between head and non-head unemployed with respect to the eligibility for unemployment insurance and public assistance. Unemployed household heads would be more likely to receive both. To the extent that it is true, Table 8 overestimates the real situation of the social safety net in Korea by representing only household heads.

¹³ This could happen because the eligible person simply did not know his/her eligibility or gave up due to complicated procedures for receiving assistance. Or this could happen because, even though the government at the top decided on the expansion of the social safety net, the delivery system (bureaucratic capacity at the local level) might not be ready for actual implementation.

net for their living. But this private source of support would deplete sooner or later as the duration of joblessness continues to grow. Then the issue becomes what shall we do for those not covered by any kind of social safety net before their unemployment duration grows too long. Putting somewhat differently, there is a huge “blind spot” or “dead zone,” of social safety net for the people in Korea who are covered by neither unemployment insurance scheme nor public assistance programs. Thus, the highest policy priority must be given to minimizing this blind spot as soon as possible.

2-5: Proposed Changes

To reduce this “blind spot,” I recommend the following policy package. First, we must speed up the expansion of unemployment insurance coverage and extend the duration of the benefits up to at least six months.

Second, we should relax the conditions (for example, the means-test) of the public assistance program, which is currently too restrictive, so that a more broad range of people who are in desperate need could be helped. Moreover, the benefit level should be raised to the poverty line, say half or one third of median income. These two policies will definitely contribute to narrowing the blind spot. But a huge spot will remain even after the above two policies, so we need a third policy.

Third, most importantly, we should increase the public works program. In the absence of an adequate social safety net, direct job creation by the public sector is indispensable. Thus, the public works program should be expanded quickly. The government is beginning to recognize the importance of public job creation and decided rightly on a large increase in the public works program for the 1999 budget.

However, a few warnings about the public work program are in order.

(1) The public works program should focus on constructive works, such as environmental cleanup, community service, and infrastructure development. And hopefully these constructive public works should be geared to the improvement of the living conditions of the poor. For example, a priority should be given to the cleaning up and rebuilding of social infrastructure,

such as road and sanitation, etc especially in the residential areas of the urban poor.

(2) The program should target those workers genuinely unable to find work elsewhere and especially those with long-term unemployment records. In this regard, the decision on the level of wage rate at the public work program is very important. If it is too high, near to the wage level of unskilled workers, then substitution of employment might occur. Namely, some workers, already employed, may leave the unskilled labor market and seek jobs in public work program simply because the public work program is rather loosely managed. Especially unskilled agricultural workers may want to switch to the urban public work. Then public work program only generates loose labor market in the agricultural sector without creating any additional employment in an economy as a whole. So wage level should be kept low to make the program unattractive to the non-poor employed. Of course, it should not be too low. If it is too low, it loses the very meaning of helping the poor unemployed.

(3) It should include some training features wherever possible, no matter how basic the skills may be. And it is very desirable if the training aspects could be related to the improvement of the private sector employability of the beneficiaries.

(4) The real challenge facing Korea is whether the Korean government has the administrative capacity to carry out these policies effectively. As already discussed, high unemployment is a new phenomenon in Korea. So in tackling unemployment not only the government's capacity for formulating policies but also its capacity for implementing them are quite limited and insufficient. Especially the challenge of the latter, namely the insufficient administrative capacity to carry out the anti-unemployment policies, is more difficult to overcome in a relatively short period of time. It is mainly because to improve the administrative capacity new institutional building as well as human capital investment is needed but these changes usually take quite considerable time to be effective. In the last section we will discuss again this issue of insufficient administrative capacity and will recommend some policy alternatives to overcome this issue.

2-6: Indirect Active, Direct Active, and Passive Remedies

How should Korea tackle rising unemployment? To find out the correct labor market policy to reduce unemployment, we have to know what type of unemployment is currently dominant in Korea. Since different types of unemployment necessitate different types of labor market policies for its reduction.

In theory, there are three types of unemployment. The first type of unemployment is **structural unemployment** that takes place when there is a skill mismatch between the job offered and the job seeker. There is the job and the job seeker, but they do not match each other because the skill or experience the job requires is different from that which could be supplied by the job seeker. So with such unemployment the problem is not shortage of job opportunities but lack of skills or experience.

The second type unemployment is **frictional unemployment** that happens when the job provider and the job seeker simply do not know each other. The job provider does not know that there is a job seeker who can provide the labor service he or she wants. And the same is true for the job seeker too. So This type of unemployment occurs because a search for the right match was unsuccessful.

The third type of unemployment is **demand deficiency unemployment** (or frequently called cyclical unemployment). It appears because of a lack of aggregate demand. In simpler terms, because of economic recession. Firms simply find out that their products are not sold in the market anymore and decide to downsize their operation, thus laying off their workers and not wanting any new hires.

Just for analytic convenience, I will classify the labor market policies into three types. The first one is **indirect active labor market policy** (or indirect employment creation policy). It includes education and training and employment service activities. It provides skills or vocational training for the unemployed to increase their employability and also provides various job placement activities to promote easy and speedy job matching. The second one is **direct active labor market policy** (or direct employment creation policy). It covers direct creation of jobs in the public sector and various

employment subsidy programs. Public works programs, government subsidies to private employer, and government support for the unemployed to start new businesses are all included in this category. The third type is **passive labor market policy** that directly helps the livelihood of the unemployed by in cash or in-kind benefits. Unemployment compensation and early retirement benefits belong to the passive labor market policy.

The best way to deal with structural unemployment is to provide skills training to the unemployed to reduce skills mismatch in the labor market. The best way to reduce frictional unemployment is to intensify public employment service activities for speedy job placement. Both ways are indirect active labor market policies. In other words, an indirect active labor market policy is a major policy instrument for combating structural as well as frictional unemployment.

However, for the reduction of demand deficiency unemployment, indirect active labor market policy does not aid much. To tackle demand deficiency unemployment, the best labor market solution is through direct employment creation in the public sector and various employment subsidies for the private sector. In other words, a direct active labor market policy is a major policy tool for reducing demand deficiency unemployment.

On the other hand, a passive labor market policy is designed to alleviate the burden of unemployment; namely, the financial distress of the unemployed. It does not contribute to employment creation directly, but acts to reduce the hardship of unemployment regardless of the types of unemployment. Thus, it is used as an important supplementary policy tool to deal with the unemployment problem in general. Especially when high unemployment occurs in a sudden and unexpected manner, the only viable policy tool would be this passive labor market policy.

An unemployment phenomenon in a country is in fact a mixture of the aforementioned three types of unemployment. So the appropriate policy mix would be determined depending on the relative importance or weight of the different types. Thus, in order to examine whether or not the government's anti-unemployment policy is appropriate, we have to sort out which types of unemployment are most dominant. Table 9 contains valuable information from which we can decompose the Korean unemployment problem by its different types.

Table 9: Reasons for Not Finding Jobs: As of September 1998

(unit: thousands, percent)

	All unemployed	%	New graduates unemployed	%
Inappropriate education, skills, experience	272	17.3	30	27.8
Inappropriate wages	46	2.9	4	3.7
Inappropriate working hours	42	2.7	2	1.8
Inappropriate working conditions	98	6.2	7	6.5
Lack of education, skills, experience	43	2.7	8	7.4
Old age and illness	67	4.3	0	0
No job	858	54.6	55	50.9
Not ready for self-employment	123	7.8	0	0
Other reason	23	1.4	2	1.0
Total	1,572	100	108	100

Source: Same as Table 8

Table 9 contains several interesting findings.

- (1) Structural unemployment accounts for about 20 percent of unemployment. Unemployment due to inappropriate skills or lack of education or experience all belong in structural unemployment.
- (2) Frictional unemployment could be at most 11.8 percent of unemployment. Unemployment due to inappropriate wages, work hours, and working conditions could be interpreted in two different ways. It can simply mean that the job seeker confronts only inappropriate jobs, mainly due to a lack of proper labor market information. In this case we can categorize it as frictional unemployment. Or it can mean that the job seeker voluntarily chooses unemployment because his or her expectations (for example, reservation wage) are too high. In such a case, we cannot call it frictional unemployment but rather voluntary unemployment.¹⁴ Two possibilities may coexist simultaneously, but we do not know the relative weight of each component. If we assume that the voluntary unemployment component is small, then most of the 11.8 percent could be interpreted as frictional unemployment. Of course, this is definitely an overestimation.
- (3) Demand deficiency unemployment seems to explain at least 54.6 % of the total unemployment. If we include those who want self-employment, but are not ready for it, into the category of demand deficiency unemployment, then it rises up to 62.4%.
- (4) For new graduates, the whole picture becomes a little different. The importance of structural unemployment rises to 35.2%, and demand deficiency unemployment declines to 50.9%. In other words, structural unemployment becomes relatively more important for the unemployed young while demand deficiency unemployment becomes relatively more important for the middle-aged or old unemployed.

From the above findings we can conclude that the most important policy instrument to tackle the unemployment problem in Korea should be the direct active labor market policy. This is because the dominant source of the

¹⁴: Voluntary unemployment is virtually a transitory phenomenon, so it is not dealt seriously with in any public labor market policy.

unemployment in Korea has been aggregate demand deficiency. This is from the sudden recession after the crisis introduced by the IMF's deflationary policy. In addition, a passive labor market policy should be stressed in Korea because unemployment has occurred in such a massive and sudden manner that the alleviation of the hardship and strain of the unemployed becomes an extremely urgent social task.

Examining the composition of the Korean government's budget directly related to unemployment and social safety net shows that in the first half of 1998, the government's policy was somewhat inappropriate. They did not clearly understand what types of unemployment they were dealing with. In the beginning relatively high priority was placed on the indirect active labor market policy, namely, training and job placement, and the importance of a passive labor market policy, especially that of unemployment insurance, was relatively neglected.

However, in the second half of 1998, the government quickly learned that the correct policy response was some combination of direct active policy and passive labor market policy, because the major source of unemployment was aggregate demand deficiency.

Thus, there was a drastic policy shift in this direction from the second half of 1998. However, the importance of direct active labor market policy, for example, public work creation, was not fully acknowledged even in the second half of 1998 and only after entering into 1999 did its importance begin to be stressed.

Table 10 clearly shows this trend. In the first half of 1998, the passive labor market policy was relatively neglected and the indirect active policy was overstressed. But from the second half of 1998, the government correctly increased the budget for passive labor market policy and reduced the budget for indirect active policy. This trend seems to be continuing into 1999. However, it is only in 1999 that a direct active labor market policy has begun to receive the proper policy attention and corresponding budgetary support.

Table 10: Changes in the Labor Market Budget: 1998 and 1999

(unit: billion won, percent)

	Total Budget	Indirect Active Labor Market Policy	Direct Active Labor Market Policy	Passive Labor Market Policy
1998 1/2	3,177.0	24.3%	30.3%	45.4%
1998 2/2	5,326.6	10.5%	21.9%	67.6%
1999	7,262.8	8.3%	28.8%	62.9%

Note: 1998 1/2 figures were based on the government's first comprehensive policy package released on March 26, 1998.

Indirect active labor market policy = vocational training + job placement activities

Direct active labor market policy = public work program + various employment subsidies

Passive labor market policy = unemployment insurance + livelihood subsidies for the unemployed.

Source: Author's calculation based on the data of the Ministry of Labor

Having stated the importance of both a direct active approach and a passive approach in dealing with the current unemployment problem in Korea, a few words about the improvement of indirect active policies are in order. The reason to discuss the policy improvement of an indirect active approach is that as the economy revives in coming years, structural and frictional unemployment will become an increasingly more important component of Korean unemployment. Thus, indirect active policies will become more important policy tools in the future, even if they are relatively less important at this moment.

First, with respect to employment service activities, inadequate attention has been paid to the quality of the staff who actually carries out these

services. Generally speaking, the demand for employment services has far outstripped their administrative capacity both in terms of quantity as well as quality.

The major component of the current job placement service has been a simple provision of information on job vacancies. Vocational guidance counseling has been almost nonexistent. Vocational guidance counseling, based on an in-depth analysis of future changes in occupational demand patterns, has become increasingly important in modern job placement services. But in Korea, there has been no staff training whatsoever in this respect.¹⁵

The quality of employment services provided by the central government, i.e. the Ministry of Labor, is much better than that offered by local governments, simply because of the difference in human capital. Contracting out the program to local governments, which is frequently claimed by academicians to be the solution, should be accompanied by simultaneous investments to improve the administrative will and capability of local governments.¹⁶ Contracting out to the private sector is also very desirable but it should be accompanied by increased transparency and accountability. Otherwise, private job placement activities could be misused.

Second, with respect to vocational training, little attention has been given so far to the changes in labor demand. In some cases, the content of training provided has nothing to do with the skills demanded in the labor market. The in depth analysis of the changes in skill demand in the labor market has not yet been systematically incorporated into the vocational training program.

In addition, the vocational training provided by the government has involved little actual workplace training, because the private sector's involvement in the program has been quite insignificant. Thus, the training program tends to have weak linkages to the real needs of the workplace.

Another important question is how to develop a meaningful vocational training program for temporary and day laborers who usually account for the majority of unemployed persons. Training programs for those workers may not require a high level of sophistication. Some basic skills training, within a

¹⁵ There is no curriculum on vocational guidance in Korean colleges and universities.

¹⁶ In many cases, local governments do not consider employment services to be their responsibility.

short period of time in focused fashion, could greatly raise their employability as well as their job satisfaction.

In sum, vocational training programs should be more demand determined. Industries should participate more actively in the curriculum designing process as well as in the actual teaching and training process. In addition, vocational training program should be amalgamated with job placement programs. Otherwise, training could produce workers with skills hardly demanded by industries.

3: Improving Labor Market Flexibility

A widely held view is that the Korean labor market is very rigid due to employment practices, such as lifetime employment, and aggressive unions¹⁷, and that this labor market rigidity has been one of the major hurdles towards smooth industrial restructuring in Korea. This view is quite pervasive, but is simply incorrect or at least insufficient.

The Korean labor market as a whole is neither more rigid nor more flexible compared to any other countries. From an international perspective, the Korean labor market should be classified as a flexible rather than a rigid one. Many empirical studies support this argument. One comparative study shows that wage flexibility in Korea is quite high, far surpassing the level of the United States, Great Britain, Germany, and even Japan.¹⁸ The same study also revealed that employment flexibility in Korea was higher than in Japan and Italy, but slightly lower than the U.S., Great Britain, and Germany during the 1972 to 1983 period. But during the 1983 to 1991 period, employment flexibility in Korea was substantially higher than the U.S., Great Britain, and Germany, not to speak of Japan.

Another empirical study concluded the following: historically the effect of unions on employment adjustment has been minimal in Korea. The increased labor union activities in the late 1980s had only a limited impact on labor market flexibility. The employment response to demand shocks has

¹⁷ Many western scholars and journalists share this view. Some Koreans also support it .

¹⁸ In -Soo Jung , “Employment Adjustment Policy and Its Problems: Comparing Korea with Other OECD Countries” *Journal of Labor Economics*, December 1997, pp. 255-276

been quite large, while the wage response has been rather modest. Labor mobility across different sectors is quite free. However, the labor mobility across firm size appears less flexible than across industries.¹⁹

Why is there a difference between these research findings and the popular perception that the Korean labor market is very rigid? The answer lies in the fact that the Korean labor market is dualistic and highly segmented. Different labor market practices exist across different firm sizes and different types of workers in the Korean labor market.

Large-scale firms usually provide long-term secure employment on a seniority-based wage and promotion system. Workers in such firms are relatively well paid and enjoy high unionization rates. Within these firms a dual career track exists. University graduates are hired as middle level managers and high school graduates are hired for the production lines. There is a sharp distinction between them but production workers also enjoy employment security and promotion based on seniority.

To some degree these practices are present throughout the entire industrial system, but the degree is much lower in smaller firms. Job security is very low and the earnings profile is nearly flat. Wages are relatively low and unionization is rare. As of 1993, the unionization rate at firms with 10-29 workers was 0.9% and with 30-99 workers was 5.4%, whereas unionization rate of the firms with 5,000-15,000 workers was 62.1% and with 15,000 or more workers was 76.0%.

These differences between different sized firms overlap with another trend, namely, the type of workers employed: regular, temporary, or day laborers. As of 1998, regular workers make up 54% of all wage and salary employment, temporary workers 32%, and day laborers 14%.

Regular employment reflects permanent jobs with protection provided by labor laws and with relatively generous policies by the enterprises. This includes restricted layoffs, health care benefits, various fringe benefits, and lump sum severance pay. Workers with regular jobs are better paid and are expected to be promoted regularly.

¹⁹ Ju-Ho Lee and Dae-Il Kim, "Labor Market Developments and Reforms in Korea," KDI Working Paper No.9703, March 1997, Korea Development Institute, pp.18-25.

In contrast, temporary employment includes workers with fixed contracts of less than one year. Temporary workers are paid much less and are generally found in less skilled jobs. They are not covered by labor laws, which prohibit dismissal without a valid reason. They are also not entitled to the fringe benefits provided by the enterprise. Daily employment represents casual workers, hired on a daily basis. They enjoy no public or private benefits.

Generally speaking, the Korean labor market can be divided into two broad segments. One covers mainly regular workers in large-scale firms and the other one includes all workers in small-scale firms and temporary and day laborers in large-scale firms. The former can be called the primary sector while the latter can be named as the secondary sector²⁰.

It is only the primary sector that enjoys legal protection of labor laws, such as prohibition of unwarranted collective dismissal.²¹ Some unions in large-scale private firms and some public enterprises have shown strong resistance to massive dismissals in the industrial restructuring process. One of the major reasons for this reaction is undoubtedly the inadequate social safety net in Korea. Their militant resistance, shown in a few highly visible cases, has been exaggerated by the mass media. And it provided a false impression that the Korean labor market as a whole is very rigid and inflexible due to aggressive and militant unions.

There is obviously a small segment in the labor market which enjoys relatively higher wages and various protections of labor laws and at the same time includes militant unions. Those in this segment are actually privileged workers who can share some economic rents with employers. Since large-scale firms and public enterprises enjoy monopoly rents in the market, their employers tend to share some of it with employees as an incentive for hard

²⁰ My rough conjecture is that about 2 to 3 million workers belong to the primary sector out of 13.2 million wage and salary workers.

²¹ According to the new labor law passed in 1998, the conditions for a legally justifiable collective dismissal are as follows. (1) There should be an urgent managerial need for collective dismissal. Takeovers, mergers and acquisitions are all among such urgent needs. (2) Firms should make efforts to avoid collective dismissal in advance. (3) Reasonable and fair standards should be set to select the dismissed workers. (4) 60 days notice must be given to union. (5) Firms should make efforts to reemploy dismissed workers.

The above conditions had been supported as case law by the Korean court over the years before they were enacted into written law early this year. Note that Japan also has a very similar case law on the mass dismissals, but has not enacted it into written law. Note that the German labor law is more restrictive than the Korean labor law with respect to mass dismissals. In Germany the firms must get permission from the government to launch mass dismissals. Some people argue that the Korean labor laws recently passed are excessively protective against dismissal. But by international standards, this argument is simply incorrect.

work, industrial peace, or simply for improvement of public image. But this is only the story in a small segment of the Korean labor market. It should be pointed out that unionized workers represent only 12-13 percent of the wages and salary workers; about 1.5 million out of 13.2 million workers.²²

Workers in the secondary sector are freely dismissed at the employer's discretion. Most workers in this sector are subject to mass dismissals at any time simply by the non-renewal of their labor contract. In this respect, employment in the secondary sector is very unstable. In other words, this market is too flexible and basic labor rights are seriously under-protected.

In relation to this dualistic structure, one interesting trend is the changes in wage differentials over time. All the wage differentials by sex, age, education, industry, and occupation have declined over the years since the mid-1970s. But, interestingly enough, the wage differential by the size of firm has risen during the 1980s and has remained high up to present. This vividly shows that dualism has at least been persisting, if not widening in Korea.

Besides the structural side, there are other sources of flexibility in the Korean labor market. First, wages have been quite flexible in Korea to a degree far surpassing other countries. Wages have shown significant flexibility since the crisis began. As of the third quarter in 1998, wage dropped by 14.2% in real terms compared to the same period in 1997. This wage flexibility is possible because the Korean wage system is composed of several elements, some are fixed but others vary over the course of the business cycle. Base pay is fixed, but bonuses, overtime allowances and other fringe benefits, which make up a significant portion of total earnings, are flexible and usually discretionary.

Second, overtime is quite flexible in Korea. Unions are less reluctant to accept a cut in working hours. Hours of work have declined about 5 to 6% between mid-1997 and mid-1998.

Third, even in large firms, employment flexibility can be secured through outsourcing production to smaller firms with more flexible employment practices. Another source of adjustment is of course the large number of

²² About two third of the union workers are engaged in large-scale establishments.

temporary and daily workers they have, for whom there is no protection from dismissal.

All this suggests that the popular notion of Korean labor market rigidity has been biased and exaggerated, and is far from being real. How can we say that the labor market is rigid when real wages dropped about 14.3% in one year and the unemployment rate tripled in less than a year? However, I do agree that there is some rigidity in the primary sector and that labor market flexibility in that sector needs to be improved²³. But I think this effort should be balanced or compensated by the simultaneous effort to improve the labor protection in the secondary sector.

4: Industrial and Labor Relations

4-1: Developmentalism

The dominant feature of the Korean government's industrial relations policy has been "developmentalism" over the past 30 years. Industrial relations policy has not been one toward the establishment of industrial democracy or social development. Rather, these goals have been subordinated to the achievement of rapid economic growth. Industrial relation policy became a mere subset of the country's overall economic development strategy. The dominant development strategy has been low cost production expansion for export. Therefore, it was not necessary to stimulate local demand. The adverse impact of the low wage policy on local demand was not a concern. Thus, the primary objective of Korea's industrial relations policy had been to create and maintain hard working, disciplined, low cost labor.²⁴

Against this backdrop, Korean labor relations could be characterized as "authoritarian paternalism." It was authoritarian in the sense that free

²³ Not all primary sector, about 2 to 3 million workers, demonstrates labor market rigidity. Only some unionized primary sector, which covers approximately 0.5 to 1 million workers, shows some rigidity in Korea.

²⁴ It had been particularly true before June 1987 when the government instituted democratic reforms, including the adoption of presidential election by direct vote.

collective bargaining at the enterprise level was not permitted. The government has frequently adopted “quick fix” solution through direct intervention rather than waiting for the results of free collective bargaining. Thus one expert correctly describe it as “unionism without collective bargaining.”²⁵ Authoritarianism also meant that independent representation of the political and social interests of organized labor was suppressed. Thus, the rules and policies concerning industrial relations were drafted, implemented, and if necessary, changed by the government with little prior consultation with unions.

On the other hand, Korean labor relations were paternalistic. It was paternalistic in two different senses. One was that at the micro level, the government tried to supervise the working conditions of individual firms directly without help from unions and frequently issued administrative orders to improve them. The other one was that at the macro level, the government chose a development strategy that benefited labor greatly through rapid employment creation. In other words, the government adopted the labor-intensive technology and outward-looking development strategy that greatly helped labor by way of fast employment expansion.

In sum, labor relations were paternalistic in that the government included labor economically even though they excluded labor politically. In other words, the government did not want to share political power with organized labor, but allowed the labor to share the economic benefits of rapid growth, especially in the form of expanding employment. Thus, we may say that labor relations in Korea had been politically exclusive, but economically inclusive.²⁶

²⁵ :Mario Bognanno,” Collective Bargaining in Korea: Laws, Practices and Recommendations for Reform”, Korea Development Institute, 17 Consultant Paper Series (1980).

²⁶ In the previous page, it was stated that Korean government had followed a low wage policy. Some may question that the low wage policy seems inconsistent with the argument for economic inclusion of labor presented in this page. The answer is as follows. Korean government had maintained low wage policy in the sense that it had not allowed unions’ impact on wages. In the early stage of development, wage level tends to be low, if there is no active union intervention, mainly due to the oversupply or unlimited supply of labor. However, as economic development continues and economy moves from a labor surplus one to a limited supply of labor one, so-called in the second stage of development, wages tend to rise by market forces, even without unions’ influence. The Korean government has been economically inclusive in two ways. The first way is that the government has not interfered in the labor market and allowed market forces to work in favor of labor in the second stage of development. In other words, the government has intervened in the union activity in the first stage of development to keep low wage policy but has not interfered in the market in the second stage of development to allow wage to rise as a result of increasing employment.

The second way is that the government has adopted labor-intensive technology for outward looking development strategy that has benefited labor greatly in the way of rising employment. For a more detailed

This long tradition of “authoritarian paternalism” was attacked and seriously weakened in 1987 when the government accepted democratic reforms, including the adoption of a presidential election by direct vote, after a series of militant anti-government demonstrations by students and middle-class urban dwellers. Since then, the government’s long-standing suppression of labor union activities has been relaxed substantially. Free collective bargaining was attained so that working conditions were to be determined without the government’s intervention.

4-2: Tripartite Commission: Political Inclusion of Labor

However, interestingly enough, the government has maintained the political exclusion policy toward labor until recently. This political exclusion of labor was lifted for the first time in May 1996. At that time, the government decided to establish the Presidential Commission on Industrial Relations Reform to revise labor laws and invited union leaders, from both the conservative (the official Federation of Korean Trade Unions) and more liberal unions (rival Korean confederation of Trade Unions) to join the Commission.

Another significant step toward political inclusion of labor took place in January 1998 when the government established a Tripartite Commission in which labor, management, and government leaders joined together to discuss ways to overcome the current economic and financial crisis.

In February 1998, the Tripartite Commission agreed upon a major agenda and declared a Social Agreement. The Social Agreement covered almost all essential reform issues to overcome the current economic and financial crisis. It ranged from the issue of corporate governance and accounting transparency, improvement of labor market flexibility, extension of the social safety net, and even the issue of reinventing the government. An important accomplishment was the union leaders’ acceptance of mass layoffs in the corporate restructuring process. Through intensive discussion at the Tripartite Commission, union leaders came to understand the

discussion, see Park, Se-II, “The Role of the State in Industrial Relations: The Case of Korea” *Comparative Labor Law*, Vol. 14, No.3, Spring 1993, pp.321-338

inevitability and urgency of mass layoffs in the process of corporate restructuring. After the Social Agreement, the National Assembly quickly revised the labor laws and stipulated the dismissal conditions based upon the Agreement.

However, soon after, the progressive Korean Confederation of Trade Unions encountered strong criticism from the rank-and-file members against the acceptance of mass layoffs. As a result, new leadership emerged and replaced the old one that participated in the Tripartite Commission. The new leadership declared its withdrawal from the Commission because of illegal and excessive mass dismissals became common after the revision of the labor laws. They argued that excessive dismissals were against the spirit of the Social Agreement based on the equal burden-sharing among the three parties, labor, management, and government. But later, under immense pressure from the public, the Korea Confederation of Trade Unions rejoined the Commission in August 1998. But they again withdrew from the Commission in February 1999. They complained that the restructuring of the economy had been carried out on the sole burden and sacrifice of the labor. They denounced that the burden sharing had been extremely unfair. Thus, the Tripartite Commission has lost its vigor and dynamics lately.

4-3: Looking Ahead

Two policy-related questions will be discussed. The first is how volatile Korean industrial relations will be in the foreseeable future. Will the industrial relations be a real impediment to a smooth industrial restructuring in Korea? The second question concerns the policy toward the Tripartite Commission. Should we reactivate it or can we afford to neglect it? If we have to reactivate, what are the ways to do it?

I do not think Korean industrial relations will be very explosive and become a real threat to corporate restructuring. Basically, labor union leaders, including the radical unions, are pragmatic. They are not oriented ideologically. Their primary concern is the improvement of the living standards of their rank-and-file members. They know that globalization is inevitable and accordingly restructuring is unavoidable. So what they demand is a fair and even sharing of the burden of globalization.

The rank-and-file members also believe in economic unionism, not political unionism. They are more concerned with their economic stake rather than political power. Most middle class urban dwellers, who determine the direction of public opinion, do not like to see unions seeking political power, but are very sympathetic about unions' struggle for better working conditions.

Table 11: Major Indicators of Industrial Relations

Years	Union membership(thousands)	Penetration Rate (%)	Number Of labor Disputes	Number Of Participants (thousands)	Loss of days (thousands days)
1980	948	14.7	206	49	61
1985	1,004	12.4	265	29	64
1986	1,036	12.3	276	47	72
1987	1,267	13.8	3,749	1,262	6,947
1988	1,707	17.8	1,873	293	5,401
1989	1,932	18.6	1,616	409	6,351
1990	1,887	16.2	322	134	4,487
1991	1,803	15.9	234	175	3,271
1992	1,735	15.0	235	105	1,528
1993	1,667	14.2	144	109	1,308
1994	1,659	13.5	121	104	1,484
1995	1,615	12.7	88	50	393
1996	1,598	12.2	85	79	893
1997	1,484	11.2	78	44	445
1998	1,405 * (Sept.98)	12.5	129	146	1,452

* Union membership of 1998 is not an official date, but a self- claimed one by two rival unions.

Source: Ministry of Labor, *Yearbook of Labor Statistics*, various issues.

Table 11 shows the long-term trend of union membership and labor disputes over the years. The year of 1987, when the former President Rho Tae-Woo declared a drastic policy reform to democracy, was clearly a turning point in the history of Korean industrial and labor relations.²⁷ Just after the declaration, union membership and the total number of labor disputes skyrocketed. The number of disputes soared from about 200 cases per year to 3,700 cases in 1987. Union membership also rose from 1 million to more than 1.9 million in 1989. But after two or three years of adjustment, both unionization rate and dispute occurrences continued to decline gradually. Union membership has declined from 1.9 million in 1989 to 1.5 million in the recent years. The number of disputes also has dropped sharply from 3,700 in 1987 to less than 100 cases lately. However, there has been no significant departure from this long-term trend after the economic crisis of 1997. I do not see any reason for a significant change in this trend in the foreseeable near future.

Concerning the second question, I think it is important to reactivate the Tripartite Commission because its formation was a very significant step toward the political inclusion of labor, which is indispensable not only for successful economic restructuring but also for the advancement of democracy in Korea. After a long history of authoritarian rule, it is not easy to establish mutual trust between labor, management, and the government. So the government should be more patient and should know that it will take quite some time to make the Commission work smoothly.

Meanwhile, several improvements are needed in the organization and operation of the Commission. First, more individuals representing the public interest should be added as Commission members. In particular, those scholars and journalists, who are respected by both labor and management due to their integrity and expertise, must be included. Unfortunately after a long experience of government-driven developmentalism, the government is frequently not considered as a neutral partner, especially from labor's point of view. We need those who can freely criticize both labor and management from the perspective of the public interest.

Second, honest and constant information sharing among members is the most important job to carry out in the Commission. Information sharing

²⁷ For detail discussion, see Park, Se-II (1993)

creates mutual trust among the members and generates common understanding about the global and local realities facing the Korean economy. It will be then much easier to come to terms.

Lack of trust has been the most important hurdle in the operation of the Commission. It can be overcome only through an honest exchange of information and constant sharing of opinions among labor, management, and the government. Thus, improving transparency and accountability in Korean corporate governance is required not only for restoring international confidence in the Korean economy but also for building up mutual trust between employer and employees, thereby establishing industrial peace.

Third, the role of the government in the Commission is very important. It must play a dual role. In the case of “rights” issues (such as unfair labor practices), it should exercise prompt and strong intervention to uphold the law. But in the case of “interest” issues (such as wage negotiation), it should adopt a strictly neutral and noninterventionist approach. The government could encourage compromise but should not take sides. Otherwise, employers and employees will not engage in free collective bargaining and instead compete for getting the government’s support, and never overcome the problem of “unionism without collective bargaining” in Korea.

The government should reorient its past authoritarian and paternalistic approach into one of setting rules and strictly monitoring their observance. In this respect, the recent handling of the Hyundai case, a dispute over mass layoffs was inappropriate. There can be no doubt that the authoritarian approach must be overcome, but at the same time, we should keep in mind that populism can be another pitfall on the way toward genuine democratization.

5: Prospects and Conclusion

5-1: unemployment outlook

A few final words and suggestions about the future of the Korean labor market are in order. The unemployment rate will continue to rise, at least in 1999. There are several reasons behind this projection.

First of all, small and medium-sized industries will continue to experience hardships for the time being. Even though the government has been relaxing monetary policy recently, little new credit will be channeled to the small- and medium-sized firms. Most of credit will flow into the large industries. But it is the smaller companies that could generate relatively larger employment opportunities.

Secondly, Restructuring and downsizing of large-scale industries began in late 1998. Thus, its full-scale disemployment effect will be realized in 1999. The public sector is also scheduled to begin its restructuring from 1999.

Thirdly, the Korean economy experienced a negative growth rate of GNP of about -5.9 percent in 1998, but it expects a positive growth rate in 1999, around 2 percent, mainly due to the government's fiscal and monetary expansion.²⁸

However, this positive growth rate will not generate much corresponding employment for two reasons. The first reason is that the improvement of the labor market condition will be reflected more likely in the form of higher wages rather than expanded employment. It will be partly due to the labor unions' strong preference for higher wages to new employment and partly due to firms' discretion to avoid complications in future employment adjustments. And the second reason is that as the economy revives, more people who used to be out of the labor market as so-called discouraged workers, will move into the labor market for active job seeking. So even as the economy begins to rebound, the unemployment rate will tend to remain at relatively high level.

Fourthly, the decade-old wage system, which shows a steep rise in the age-earning profile (wages are closely tied to the worker's age), tends to discourage the reemployment of mid-career workers. Once they are laid off, it is extremely difficult to find jobs except for dead-end positions in the informal service sector. Given such a situation, the human capital of mid-career workers tends to depreciate rapidly after being laid off. As a result,

²⁸ Recently some economic research institutes, including KDI, revised their prediction of the GNP growth rate for 1999, from about 2 percent up to 3 to 4 percent. However, it does not hamper the basic reasoning of our argument.

they are likely to continue to be structurally unemployed, even as the economy recovers.

Therefore, we can predict that the relatively high unemployment rate will persist in the foreseeable future in Korea even as the economy recovers its previous growth path within the next 2 to 3 years.

Table 12 shows the unemployment outlook projected by the Korean government for the next 2-3 years. It indicates that unemployment is expected to rise continuously up to 7.9 percent in the first half of 1999, and it is expected to slow down from the second half of 1999. But unemployment will stay relatively higher level at 5.5 to 7 for the next 2 to 3 years. I think it is a somewhat optimistic scenario but the general trend will not be far from what is presented in Table 11.

Table 11: Unemployment Outlook: 1998-2002

(Unit: thousand, percent)

	GNP growth rate	Unemployment	Unemployment rate
1998 1/2	-5.4	1,334	6.3
1998 2/2	-6.4	1,593	7.4
1998 average	-5.9	1,463	6.8
1999 1/2	0.8	1,698	7.9
1999 2/2	3.3	1,566	7.1
1999 average	2.0	1,632	7.5
2000	4.7	1,514	6.8
2001	5.1	1,401	6.2
2002	5.3	1,281	5.5

Source: Ministry of Labor etc, *99 Jonghap Silup Daecheck*, (Comprehensive Unemployment Measures for 1999), January 1999

Not only will the unemployment rate continue to rise in 1999, but three qualitative changes will also occur. The first one is the rise of long-term unemployment and the second one is the rise of youth unemployment, especially unemployment of new school graduates. The third one is the rise of an economically inactive population. In other words, discouraged workers tend to rise.

As the economic recession continues, the average duration of unemployment tends to rise. Those unemployed for six months or longer represented 7.8 percent (about 104,000) of total unemployment in the first half of 1998, but it increased to 19.8 percent (about 312,000) in the second half of 1998. Again, it is expected to continue to rise up to 31.2 percent (about 520,000) in 1999.

Youth unemployment will become more serious. As of December 1998, the unemployment rate in the age cohort of 15 to 19 was 27.7 percent and those 20-29 was 13.1 percent, being more than three times higher than the average rate of 7.9. Not only has the rate been relatively high, but there has also been a rising trend of youth unemployment because large-scale firms and public enterprises have refrained from hiring new employees, as they restructure and downsize.²⁹ Conventionally, large-scale industries and public enterprises hire new employees right after school graduation. Therefore, no new hiring during the restructuring period implies rising unemployment of new school graduates.

Another phenomenon will be those who give up job seeking due to poor prospects and leave the labor market. This population is likely to rise very rapidly. As the economic recession continues with high unemployment rates, people tend to abandon job search activities so that the economically inactive population tends to soar sharply. During the past six months from August 1998 to February 1999, the net increase in the inactive population was 1.057 million.

²⁹ ; The unemployment in the age cohort of 15 to 19 was 21.8 % in September, 17.4% in October, 22.3% in November, and 27.7% in December 1998.

The average annual trend increase in the inactive population had been about 200,000 before the crisis, meaning at least 800,000- 900,000 persons were discouraged and left the labor market during the past six months.³⁰

These rising trends of long-term joblessness, youth unemployment, and inactive population all will aggravate the seriousness of the unemployment problem in Korea. The upswing movement of long- term joblessness and youth unemployment could become politically explosive. If economic distress is combined with political discontent, the situation could easily become volatile. On the other hand, the sharply rising inactive population could become socially implosive. It could generate increasing crime rates and rising social unrest. In any case, the unemployment problem will be potentially a dangerous and difficult task to handle in Korea. This will be especially true in 1999.

In March 19, 1999, the government decided to increase the labor market budget of 1999 from the 7.7 trillion Won, which was passed by the National Assembly last December, to 16 trillion Won. Net increase is about 8.3 trillion Won, which is more than a doubling of the originally planned budget. The budget for the public work programs has increased substantially. The government's decision seems appropriate in view of the rising seriousness of the unemployment problem in Korea.

Now the problem is how to use this increased budget more efficiently and effectively. In this regard, one policy suggestion could be made. Theoretically speaking there are two ways to carry out public work programs. One is the traditional public delivery model and the other one is a relatively new private delivery model. The former is a scheme implemented by the government and the latter one is implemented by the private sector outside the normal bureaucracy.³¹

In Korea, all the public work programs have been implemented by the government. However, this public delivery model has several drawbacks. It could be susceptible to political influence or political considerations rather than economic efficiency or effectiveness. It also tends to be driven by the

³⁰ In the same six month period, the employed has reduced by 955 thousands but the unemployed has risen by 207 thousands.

³¹ For a general discussion of the topic, see K. Subbarao ed. *Safety Net Programs and Poverty Reduction: Lessons from Cross-country Experience*, The World Bank, 1997. For an in-depth analysis of the topic, see Carol Graham, *Safety Nets, Politics, and the Poor: Transitions to Market Economies*, The Brookings Institution, 1994

supply conditions rather than demand conditions. In other words, the bureaucrats' capacity in the government, not the actual needs of the unemployed poor, determines the content, direction, and quality of program. Moreover, in managing the program, incentives for producing better programs and better services are relatively low. All these factors are likely to generate the inefficiency and ineffectiveness of the public work program.

The private delivery model usually does not suffer the above drawbacks³². Of course it has its own shortcomings,³³ but I think it is highly worth trying in Korea. There are several different versions of the private delivery model, but the model I would recommend is that the government remains as fund provider and the private entity, the private contractor (hopefully from business background) plus NGOs or grass root community groups, design, organize, and implement the public work programs. The government only provides the funds and evaluates the performance record, but does not intervene in managing the program. The management of the program, from designing to implementation, should be under the control and responsibility of the private entity. This private delivery model can be an important policy alternative, especially when the institutional capacity (i.e., manpower as well as organization) of the government in the field of the social safety net is quite limited. The private delivery model could make the program more efficient and effective because it can mobilize private initiatives and private incentive systems as well as organize NGOs' flexibility and grass root orientation.

However, as an intermediate stage, it might be a better idea in Korea to allow two models, the public delivery and private delivery, to coexist simultaneously, side by side, and let them to compete for effectiveness and efficiency.

³²Another important aspect of the private delivery model is that those private persons or organizations involved in the delivery scheme could develop into a political base supporting for the program. So if the program(social safety net program) is formulated as an integral part of overall reform package (i.e., corporate governance reform + banking reform + public sector reform etc), then the private delivery model in the social safety net could imply enhancing the political sustainability of the overall reform package by broadening political supporting base.

See, Carol Graham, *op cit.*, PP 268-271.

³³ One important shortcoming is that it tends to bias against the poor because the poor are often less ready and active than the non-poor to articulate their need. So when the private organization designs and develops the public work program, funded by the government, heavily based on the demand of the unemployed, the opinion or interest of the unemployed poor is less likely to be reflected in the program than the unemployed non- poor.

5-2: Industrial and Labor Relations Outlook

Industrial relations by itself will not be a serious real threat to the restructuring of the Korean industry and economy. The unions in large-scale firms and those in public enterprises will continue to be vocal, but cannot afford to be too extreme. In the spring of 1999, they may call one or two nationwide strikes, but it will not last long. Basically, middle class urban dwellers will not tolerate unions' extreme demands or collective action. In addition, unions themselves are virtually ready to compromise if the burden sharing is reasonably fair.

However, the problem is that there are signs that workers' frustrations are growing these days. They think that the burden sharing has been increasingly unfair and uneven and the cost of restructuring has been unduly concentrated only on workers in the form of mass layoffs, with no costs for corporate owner-managers and government officials. They criticize the corporate governance reform and public sector reform, for example, downsizing the government sector, have been much too delayed and compromised. They also complain that the way of handling restructuring at the enterprise level has too frequently ignored the due process depicted in labor standards law. The workers have filed 112,000 complaints, mostly unfair labor practice cases, in 1998, which is about twice as high as in the previous year. In 1997, it was only 62,000 cases.

In this respect, five things are worth mentioning. First, the government should always uphold the labor law in a strict and prompt manner. Breaches of unfair labor practices by the management must especially be handled firmly and severely. At the same time, any illegal labor strikes should be dealt with the same firmness and promptness. Establishing the rule of law in industrial relations is the first thing to do. Otherwise, both sides do not perceive the rules of the game as given and instead attempt to bargain with the government for its change. Traditionally, the execution of the labor law has been rather soft in Korea. This tolerant attitude of the government in upholding the law has made things difficult and worse in most labor disputes.

Second, as mentioned before, the reforms in the corporate governance toward more transparency, accountability, and clear disclosure as well as

more power for professional managers will definitely help Korea's industrial relations to overcome the current lack of mutual trust between employers and employees, thereby greatly contributing to the industrial peace. We can say the same thing about public sector reform, too. At this moment, public sector restructuring, including downsizing the government, lags behind the most and is the most sluggish in Korea. Without more serious corporate reform and public sector reform, the laborers will not perceive that the burden sharing of the economic crisis is fair and even.

Third, more investment for the expansion of the social safety net will ease not only the hardship of workers in the restructuring process, but also the rising tension in industrial relations. Without an adequate social safety net, workers' resistance to mass layoffs will be unavoidable. Building an effective social safety net will be an increasingly important issue in the future for two reasons. The first is that, as discussed above, the unemployment rate in Korea will remain relatively high even as economy restores to the previous growth path. The second reason is that as the duration of unemployment lengthens, the private sources of self-support will inevitably depleted. So the social safety net should play a more important role in supporting the unemployed.

Fourth, reactivating the Tripartite Commission is extremely important not only in handling current labor issues but also for successful future management of the state in the age of globalization. One important challenge of globalization for most new democracies is to build an effective institutional framework to deal with rising social conflicts and economic frictions. As is well known, globalization tends to increase inequality between different sectors of the economy as well as different segments of population. Thus, it is very important to develop institutional capacity of the government to manage these frictions and conflicts in consensual approach. So it is very desirable to develop the current Tripartite Commission into an effectively working consensual instrument for solving social and economic problems in the coming age of globalization.³⁴

³⁴ Rodrik clearly and persuasively explains the importance of institutions for conflict management in the age of globalization. Institutions include participatory political institutions, civil and political liberty, high quality bureaucracies, an independent judiciary, the rule of law, and effective social insurance such as social safety net, etc.. He pointed out two reasons for the rising importance of these institutions: one is the increasingly turbulent environment of the global economy which necessitates rapid policy changes of readjusting or rearranging the vested interest structure of a society. The other one is possible widening of social and economic cleavages and inequalities that globalization tends to bring about.

Fifth, even though industrial and labor relations by itself is not that serious a problem, it always could turn into a social and political threat if economic discontent in the work place is combined with political and social resentment. In this regard, what is important is the attitude of the middle class. If middle class urban dwellers turn their backs to the government, whatever the reason may be, and align with unions, then industrial and labor relations could become highly explosive politically. As unemployment lasts longer and the jobless young rises, this possibility of sudden conversion will also increase.

So what is needed is an inclusive policy by the ruling elite to ask for cooperation of all segments of society as well as regions. This is particularly important because the current president himself is from a minority region and the Korean economy is still in the middle of a crisis. But, recently there is growing concern that regional sentiment might have intensified after the new government came into power. If so, definitely more non-partisan and non-regionally-biased management of state affairs is called for to create a government of national unity, supported by all segments of the population as well as regions.

5-3: Needed Global Coordination

Last but not the least, a point worth highlighting: As mentioned before, the dominant type of the Korean unemployment is demand deficiency. Thus, unless aggregate demand grows rapidly it will be difficult for the Korean economy to reduce unemployment substantially. However, there is a limit to expanding domestic aggregate demand for two reasons. One is small market size usually determined by population and per capita income. The other one is the decade-old export oriented structure of Korean economy. Thus, for a restoration of the Korean economy to its previous growth path and for a substantial reduction of its unemployment, it is a must for foreign aggregate demand to expand rapidly. Otherwise, it will be very difficult for the Korean economy not only to revive but even pay back its foreign debts, which have substantially increased after the crisis.

For details, see, Dani Rodrik, *The New Global Economy and Developing Countries: Making Openness Work*, Overseas Development Council, 1999.

To a great extent, the same argument could apply not only to Korea but also other countries hard hit by the recent Asian financial crisis. Thus, what is seriously needed is a huge growth stimulus at the global level, a la the Marshall Plan after the World War II. And this stimulus is only possible through a concerted international effort among the major economic powers, namely, the U.S., EU, and Japan, in which the U.S. should take the initiative. Concerted action could include a further cutting of interest rates, raising government spending or reducing taxes, increasing foreign aid, and not only rescheduling debt but substantial debt relief, etc. In other words, what we need is a huge increase in global aggregate demands for the crisis-hit and debt-ridden countries to revive their economies sufficiently to pay back their increased debts and reduce the extremely high unemployment down to an endurable level.

Another area needed for international coordination among major economic powers is inventing new global governance, including a new financial architecture to regulate the global capital market. The recent Asian financial crisis provided an ample evidence that the vulnerability of small, open economies to short term capital movements is a real threat regardless how robust its macroeconomic fundamentals are.³⁵ Thus, we need new global governance to discourage speculative short-term capital flows. Among the needed national and international arrangements are restricted capital controls, exchange controls, transaction taxes (including a Tobin Tax), and some regulations on the capital flow in industrialized countries (for example, risk-weighted capital charges on pooled fund, etc.)³⁶ These arrangements would restore greater national policy autonomy and encourage stable long-term foreign investment. However, these arrangements would be possible as well as effective only when the major economic powers take the initiative in such global coordination to this effect.

³⁵ I think the fundamental nature of the Korea's 1997 crisis was a temporary liquidity problem, namely, temporary shortage of foreign exchange triggered by a massive capital flight during a relatively short period of time. And this capital flight was related, less to any macro fundamentals in the Korean economy, but more to the weakness in the structure of the global capital market. This weakness means two things: one is rising volatility, instability, and uncertainty in the nature of the global capital market, and the other is the lack of appropriate global governance to effectively regulate these new phenomena. Thus, unless appropriate global governance appears, there is always chance for a small open economy, like the Korean economy, to be attacked by global short term capital, regardless of how well Koreans manage their domestic economy.

³⁶ For detail discussion, see Robert A. Blecker, *Taming Global Finance*, Economic Policy Institute, 1999

Without such coordination among the major economic powers to increase global aggregate demand as well as reinventing the global governance over the financial market, it will be extremely difficult for those countries currently facing economic turmoil to overcome it and return to their prior normal growth paths. If it were not for such global coordination, generating sufficient job opportunities to reduce current high unemployment in crisis-hit countries would be out of the question. What we need now is not only individual country efforts but also strong global leadership that spearheads the necessary global coordination.