



[What role has labour and social policy played in the recovery?](#)

[What are the remaining challenges?](#)

[What can be done to improve the labour relations climate?](#)

[How can labour market duality be reduced?](#)

[How well are labour market programmes working?](#)

[What about social assistance programmes?](#)

[And education and training?](#)

[How can much-needed programmes be financed?](#)

[Further reading](#)

[Where to contact us](#)

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Labour market reform and social safety net policies in Korea

Introduction and main policy recommendations

Korea has experienced one of the most impressive economic records of modern capitalism. Following the Korean War, from which the country emerged as one of the poorest in the world, the economy registered four decades of almost uninterrupted rapid growth. Today, per capita income has reached about 65 per cent of the OECD average (close to the levels in Greece and Portugal), while Korea has earned an international reputation as a successful exporter of technologically advanced goods, such as microchips and electronic equipment.

The financial crisis, which started at the end of 1997, brought the growth process to a sudden, unexpected halt. The crisis forced the government to agree to a rescue package with the IMF. Unemployment rocketed to a peak of 8-1/2 per cent in early 1999, and more than one million Koreans were thrown into poverty. The difficult economic and social situation forced the authorities to implement quickly a wide range of macro-economic and structural reforms, including in the areas of labour market policies and social safety nets. In response to these reforms, the economy has now turned the corner, permitting the unemployment rate to fall rapidly to about 5 per cent, and short-term prospects point to a continuation of the solid recovery.

In this context, it may be tempting to assume that the crisis was just a blip in an otherwise high-growth path and that, as a consequence, a pause in the reform agenda might be called for. On the contrary, while Korea has achieved a great deal in a very short period of time, much remains to be done to strengthen the social sustainability of the development process. Further action to consolidate the industrial relations system, reform labour law, and to improve the coverage and effectiveness of labour market and social safety-net policies. The recovery should not lead to any let-up in these policy reforms.

Indeed, future improvements in living standards will have to rest on using resources more efficiently, rather than more intensively as was the case before the 1997 crisis. A more qualitative approach to the development strategy may be called for, encompassing an increased emphasis on enterprise training, a reduced labour-market duality and the establishment of a well-functioning social safety net that covers all individuals.

It is particularly important to:

- improve the quality of education and foster enterprise training
- effectively expand the coverage of both the Employment Insurance System (EIS) and social assistance benefits, while scaling back programmes adopted as a temporary response to the crisis
- ensure that employers pay their contributions to the employment security and public pension systems and, provided that is the case, gradually reduce enterprise retirement allowances for regular workers, thereby reducing the marked duality that presently exists and laying the ground for higher productivity gains
- better target active labour market policies (ALMPs), enhance the quality of the Public Employment Services (PES) staff and undertake rigorous evaluations of the programmes; and
- make sure that work continues to pay in Korea.

Obviously, these measures need to be adopted in a context of full respect for basic workers' rights and, in this sense, resolving remaining industrial relations issues should rank high in the policy agenda. In a modern, productive economy, it is important that all social actors be involved in the reform process in a climate of mutual respect and trust.

This *Policy Brief* presents the summary and conclusions of a Review prepared by the OECD Secretariat and published in mid-2000 under the title *Pushing Ahead with Reform in Korea: Labour Market and Social Safety Net Policies*. ■

What role has labour and social policy played in the recovery?

The Tripartite Commission has been instrumental in achieving agreement between the social partners and the government on the response to the crisis. Thus, the Tripartite Agreement of February 1998 urged the major industrial conglomerates (chaebols) to improve the effectiveness and accountability of corporate governance and introduce greater transparency of their management and accounts. In addition, the agreement recommended a substantial reduction in the indebtedness of the chaebols. In order to facilitate enterprise restructuring, it was also decided to make it legally possible for firms to dismiss workers for "urgent managerial reasons", and greater flexibility was introduced in the area of temporary work through the legalisation of agencies for so-called "dispatched workers".

In addition, wage moderation has been substantial. In 1998, average nominal wages per employee fell by 2-1/2 per cent, equivalent to a cut by almost 10 per cent in real terms (which is unusually large by OECD standards), cushioning the effects of the crisis on unemployment. Such wage moderation was mainly attributable to the dramatic cut in bonuses and overtime payments, which account for a significant portion of Korean wages and are mainly determined by firms' economic performance. In 1999, as a result of increased overtime and bonus payments, real wages rose robustly (by over 10 per cent), so recuperating

their pre-crisis level. However, since in the meantime labour productivity has increased (by about 6 per cent, cumulatively, in 1998-99), real unit labour costs have been reduced, thereby improving business profitability and providing room for reducing corporate indebtedness. Together with the depreciation of the Won in 1998, these wage and productivity trends have enhanced the cost-competitiveness of the Korean economy, contributing to an export-led recovery.

Also, a wide range of labour market programmes was either strengthened or introduced since the start of the crisis. This has helped provide a degree of social insurance for job losers and their families and maintain the employability of many individuals who otherwise might have lost contact with the labour market. Reflecting these efforts, government expenditures on labour market programmes increased from negligible levels in 1997 to 2-1/4 per cent of GDP in 1998 and 3-1/4 per cent in 1999. Finally, an effort has been made to provide modest social assistance support to those who have fallen out of the social safety net, thereby alleviating social hardship and making the much-needed structural reforms socially sustainable. ■

What are the remaining challenges?

The Korean economy still faces several major labour market and social policy challenges as it seeks to consolidate the recovery and the social sustainability of its development

process. First, it is more necessary than ever to create a less confrontational and more consensual system of industrial relations if the Korean economy and society is to modernise and prosper. Unfortunately, past confrontational attitudes between the social partners have re-surfaced in a context of economic recovery. The result is that consensus on wage moderation and reforms of employment conditions and workforce practices are increasingly difficult to achieve.

Second, joblessness remains a problem. True, open unemployment is low by international comparison but, unlike the case of many other OECD countries, the majority of unemployed workers do not receive any unemployment benefits. In addition, the degree of labour market slack is significantly higher than suggested by the open unemployment rate, as indicated by the high number of discouraged workers (the total participation rate in 1999 was 1.7 percentage points lower than in 1997) and of participants in labour market programmes such as public works. Importantly, the youth (especially those with high-school education) are disproportionately affected by unemployment, suggesting that school-to-work transition is difficult in Korea.

Third, jobs tend to be much more precarious in Korea than is the case in most other OECD countries. Only 30 per cent of the employed have a “regular” (i.e. permanent) contract, which is the lowest figure in the OECD area, followed by Turkey. Another third have a temporary or daily job. As a result, job tenure in Korea is low by international comparison – on average, workers

stay with the same employer about six years, compared with over 11 years in Japan and 7-1/2 years in the United States. Importantly, the incidence of non-regular jobs in small businesses and among women is very high. As the recovery gets firmly established, the expectation is that employers will become more confident about the economic prospects and that, as a result, they will be less reluctant to convert non-regular jobs into regular ones. However, it should be stressed that the incidence of regular employment did not increase much in 1990-97, a period characterised by near-full employment. Job precariousness indeed seems to be a structural characteristic of the Korean economy, which is problematic not only from the social point of view, but also for reasons of economic efficiency. Job precariousness seems to be associated with a relatively low incidence of vocational training (in particular in small businesses), in turn inhibiting productivity growth.

Fourth, income inequalities have started to widen. Over the past three years, average incomes of the poorest 20 per cent of households have declined by over 8 per cent, while average incomes of the richest 20 per cent of households have increased somewhat.

Fifth, a large number of households live with very low incomes. In 1999, 8 to 12 per cent of Koreans (depending on the source) were officially estimated to live in poverty – based on a minimum monthly cost of living representing the equivalent of US\$ 350 (in purchasing power parity terms). Job-losers, the elderly and lone-parent households are disproportionately

affected by poverty. The extended family has long provided an effective source of income support in Korea – the so-called “Confucian social welfare.”

Finally, the productivity of the Korean economy is a matter of concern. Past economic growth performance rested on a formidable investment effort: during the 1990-97 period, share of national income devoted to real fixed capital accumulation averaged 37 per cent, a very high figure by international comparison. The returns from some of these investments, however, have turned out to be very small or even negative – one of the underlying factors behind the 1997 crisis. Reflecting the poor returns from many investment projects, multi-factor productivity (a measure of overall economic efficiency) stagnated over the period 1990-97, while it grew in nearly all other OECD countries. Clearly, in order to strengthen the growth process in the future, it is essential that resources are used more productively than hitherto. Addressing these challenges requires an improvement in the coverage and effectiveness of labour market and social safety-net programmes, while also making further progress in bringing industrial relations and labour laws into line with internationally agreed standards. ■

What can be done to improve the labour relations climate?

Addressing these key challenges requires, first, a consolidation of freedom-of-association and collec-

tive bargaining rights. It is useful to recall the context under which the issue of freedom-of-association rights has been discussed in the OECD. Aware of concerns regarding these rights, the OECD Council, when inviting Korea to join the organisation in October 1996, welcomed the commitments made by the Korean authorities “to reform existing laws on industrial relations in line with internationally-accepted standards, including those concerning basic rights such as freedom of association and collective bargaining”. The Council also instructed the OECD’s Employment, Labour and Social Affairs (ELSA) Committee to “monitor closely the progress made on labour law reforms in the light of that commitment”. In discussions on these issues in the Council, the ELSA Committee and other international fora (notably at the International Labour Organisation and its Committee on Freedom of Association), attention has centred on a number of areas where Korean law and practice in industrial relations was believed to be in conflict with internationally-accepted standards. These include issues of trade union pluralism, third-party intervention in collective bargaining, the right to organise of public servants and teachers, the right to strike in the public sector, trade union membership of dismissed or unemployed workers and the payment by companies of their full-time trade union officials. Concerns have also been voiced in these fora about the arrest and imprisonment of trade unionists for activities that would be regarded as pursuit of legitimate trade union goals in other Member countries.

Since the start of the monitoring process, there is no doubt that the legislative reforms have shifted Korean labour laws significantly in the desired direction. Major examples include the recognition of the principle of trade union pluralism, the legalisation of teachers’ unions, freedom for many civil servants to engage in workplace associations, the gradual reduction of the list of so-called “essential services” where compulsory arbitration applies, as well as the recent recognition of the KCTU as the second national trade union centre. In addition, the government has decided to allow, from 2002 onwards, trade union pluralism at the enterprise level.

However, there are some outstanding issues and resolving them would probably contribute to create a climate of trust between the social partners. First, civil servants are not allowed to join trade unions and bargain collectively. Second, trade unions face legal and practical impediments in deciding who to accept as members. Third, the law will, as of 2002, prohibit the payment of full-time union officials. On these three issues, the government, in consultation with social partners, should explore avenues for amending the relevant provisions of the law. Finally, over the past few years, waves of militant trade union action and subsequent arrests of trade unionists have succeeded each other. It will thus be particularly important for the Korean authorities to take all the necessary steps to avoid large-scale arrests and detentions of trade unionists engaged in pursuit of union activities. In particular, legal provisions, which are often used to arrest trade unionists for what other

OECD countries consider legitimate trade union activities, need to be revised or used with utmost restraint.

Alongside further progress on the legislative front, concern remains about the present climate of industrial relations in Korea at both the national and enterprise levels. The repeated withdrawals by both labour and business representatives from the Tripartite Commission and the lack of any agreed agenda and timetable for its discussions are disturbing. In order to foster social dialogue and mutual trust in the Tripartite Commission, the government could take the lead by presenting reform proposals for discussion in the Commission. Needless to say, the government should also make appropriate efforts to act upon compromises reached within the Commission (as required by the 1999 Tripartite Commission Act), while the social partners need to recognise the futility of “empty chair” attitudes and come forward themselves with constructive proposals rather than always looking to the government to solve deadlocks. Perhaps more importantly from the point of view of Korean productivity performance, tripartite agreements at the national level need to be supplemented by active labour-management consultation and effective co-operation at the enterprise level. ■

How can labour market duality be reduced?

Second, to the extent that the public pension system is made sustainable,

lay-off provisions could be revised. While the new lay-off provisions are clearly a step in the direction of increasing numerical flexibility in firms, “regular” workers still enjoy a relatively high degree of employment protection compared with their counterparts in other OECD countries. The one-month notice period, even for workers with high tenure, is low by international standards, but the legal severance pay requirements applying to regular workers would seem to be relatively onerous. In addition, the preconditions for dismissals based on economic reasons (advance notification to a trade union, verifiable efforts to avoid dismissal, etc.) make conditions in Korea resemble closely those in other high-protection countries such as Japan, Portugal, France or Germany. Finally, the new provisions on notification of collective dismissals to the Ministry of Labour correspond to the strict regulations in force in EU countries. Overall, the OECD has ranked Korea as the second strictest country out of 27 member countries in terms of protection of regular (or permanent) employment contracts. There would therefore seem to be room for easing the legal severance pay requirements for regular workers. This reform, however, should take place gradually, and be dependent on the Employment Insurance System (EIS) becoming more firmly established in coming years; and the public pension system being adequately funded, which is far from being the case at present, and pension benefits providing sufficient income support.

Relaxing relatively strict employment protection for regular workers, under the above conditions,

could also help ease job instability for temporary and daily workers (who form the core of “outsiders” in Korea). This would hopefully encourage employers to convert more non-regular contracts into regular ones, thereby reducing the degree of labour market segmentation, which is presently very pronounced, and laying the ground for greater investment in on-the-job training. In addition, the social protection of fixed-term and daily workers should be enhanced. ■

How well are labour market programmes working?

Labour market programmes have to be evaluated in the light of their twin objectives, namely to provide income support to the unemployed; and to foster the future employment and earnings prospects of unemployed workers, while minimising the dead-weight, substitution and displacement effects often associated with such policies. Regarding the first objective, the portfolio of labour market programmes has been expanded considerably in the past two years. However, official estimates show that only one in eight of the unemployed receive unemployment benefits (in addition, less than half participate in some type of labour market programme, the others being potential clients for social assistance benefits). It has recently been decided to expand the scope of the EIS to cover daily workers, but there remain serious implementation problems, in particular among small firms which often evade the payment of

social contributions. The current situation is not satisfactory and the government should assign a high priority to increasing the coverage of the EIS and make sure that vulnerable groups are not left unprotected, as is presently the case. ■

As to the labour market effects of labour market programmes, it is not possible to draw clear-cut conclusions in the absence of any systematic evaluations. However, based on the examination of specific design features of the programmes, the following observations can be made:

- there is a general lack of targeting in many of the programmes. As a result, it is unclear whether they really reach disadvantaged groups, such as unemployed workers not covered by the EIS and young unemployed workers. Targeting is especially important in the case of subsidies to SMEs, given that this programme is the largest in terms of government spending on active labour market programmes (ALMPs);
- despite a general lack of targeting, some of the programmes are not much used. This suggests that some regrouping of programmes may be called for, notably in the area of employment maintenance subsidies;
- now that a brisk recovery is underway, there is a strong case for scaling back substantially public works programmes. International evidence suggests that these programmes, unless they are well targeted on hard-to-place groups, are particularly susceptible to large dead-weight losses;
- there may be cases where work does not pay – leading to a risk

that some benefit recipients prefer to stay in the programme rather than look actively for a private-sector job. For instance, remuneration in public works programmes reportedly competes with market wages in certain unskilled occupations;

- training institutions have had difficulties in coping with the rapid and massive expansion of training programmes. In addition, the type of training provided by some of them may not be closely tied to the requirements of a complex, modern economy such as Korea. For these reasons, there is a good case for a greater involvement of social partners at the local industry level in programme design, while also expanding the training capacity; and
- the outcomes of the programmes should be carefully monitored and evaluated.

Finally, the role of the public employment service (PES) in the design and implementation of ALMPs could be enhanced. The concept of the “one-stop office” is a good one, and should be generalised by integrating the separate networks of Employment Security Centres and Manpower Banks. Also, while it may have been useful in the period of rising unemployment to operate another chain of placement offices under the authority of municipalities and other local governments, the rationale behind the co-existence of two types of “public employment services”, one under the Labour Ministry and the other under local government, that are involved in the same types of tasks (apart from benefit payment), may need to be reviewed.

As mass unemployment declines, PES officers will need to devote more efforts to counselling and monitoring of those job-seekers who are at high risk of long-term unemployment and benefit dependency – at present there is little “profiling”. Needless to say, the efficiency of the PES crucially depends on the quality of its staff and the high turnover of counsellors is problematic in this respect. In present circumstances, improving training and job stability of the staff might be more important than increasing the number of officers. The steep decline in unemployment should provide the necessary breathing space to concentrate on improving the quality of PES staff.

In addition, Korea should seek to take advantage of the extensive network of private employment agencies that presently exist. These agencies have an excellent inter-mediation record in the unskilled labour market and the PES could seek complementarities with them, for example by contracting out the placement of low-educated unemployed. ■

What about social assistance programmes?

After the crisis, given the relatively low coverage of unemployment benefits and other labour market programmes, demand for social assistance benefits increased dramatically. The authorities responded by expanding the existing programme and creating a new one, specifically targeted on low-income individuals of working age. In 1999, nearly 2 million individuals received social assist-

ance benefits. This, however, represents only about half of the estimated number of persons living in poverty in that year.

The weaknesses of the present social assistance system have prompted the Korean authorities to enact a new system, namely the National Basic Livelihood Security Law (NBLS), to take effect as from 1 October 2000. The concept underlying the new social assistance law is that of “productive welfare”, i.e. the purpose is to provide adequate income support while also encouraging benefit recipients to participate in the labour market. Thus, it is officially estimated that the proportion of individuals living in poverty that will receive benefits will be increased to two thirds after the new law comes into force. In addition, the level of benefits will be raised.

However, it is important to stress that many low-income individuals will remain unprotected under the NBLS. This might reflect the fact that benefit entitlement is subject to unusually strict income criteria, based on the income capacity (and not actual income) of the extended family. This particular provision of the law will have to be revised, if the official target of providing benefits of last resort to those in need is to be reached. Also, despite their increase, benefits will remain very modest. The authorities should consider raising them, perhaps in stages, so that they reach at least the poverty line.

In addition, making productive welfare a reality requires local government officials responsible for the delivery and administration of

the system to screen recipients on their work ability and provide employment-oriented counselling services. Based on the experience of other OECD countries, it is possible to identify certain policy avenues which could help meet these goals:

- at present, there are about 250 recipients to each welfare officer, compared with an OECD norm of 80 to 120 recipients per officer. Korean welfare officers simply do not have the time to screen and adjudicate clients on their work-ability or provide intensive job-counselling services. The authorities have undertaken to hire additional welfare officers so that the number of recipients per welfare officer declines to 200, but many more would need to be hired and trained. Welfare officers will require adequate funds to provide job-counselling or, in certain cases, offer social assistance recipients the possibility to attend training courses. In this regard, the authorities could consider the implementation of pilot projects, allowing private agencies to tender for the provision of employment services to NBS clients. To encourage job search, it may be helpful to introduce in the NBS a mechanism of earnings disregards which permits recipients to keep their benefits while at the same time earning an income, up to a certain threshold. Such a system would have to be rather different from the one embodied in the current set-up.

Current financial arrangements between different levels of government may be conducive to a waste of resources. At present, most of the budget for social assistance benefits comes from central

government, while local governments (and their welfare officers) are in charge of the delivery of benefits. In such a setting, local governments have a weak incentive to enforce the different eligibility criteria and they might therefore be inclined to provide benefits to whoever asks for them. Up to now, the central government has addressed this problem by announcing strict budget limits, effectively imposing hard-budget constraints on local governments. But, under the NBS, the plan is to provide social assistance benefits as of right. Even so, it seems desirable to maintain the current budgetary “grant-based” system and not give the certainty to local governments that their financial demands will always be satisfied. ■

And education and training?

The average educational attainment of the Korean population and work force has increased spectacularly over the past decades, contributing to the rapid growth performance. Practically one fifth of the total Korean population has a college degree, the highest figure in the OECD after the United States and the Netherlands. However, there is a need for improving the quality and relevance of education and training, in order to raise multi-factor productivity and allow Korean firms to compete effectively in the 21st century. ■

How can much-needed programmes be financed?

Some of the measures advocated above will exert upward pressures on government spending, raising the issue of how they can be financed. In the case of an expansion of the EIS, extending the coverage of benefits to workers of small enterprises, which often do not pay the social contributions, risks creating a deficit in the EIS. In order to prevent this, it is essential that the government step up its efforts to make all firms pay their social contributions. Otherwise, the government may face pressures for subsidising the EIS. In the case of programmes financed by central government, notably social assistance benefits for which an expansion is also planned, resources can be found by scaling down temporary programmes such as public works and unemployment loans. Further savings could materialise if rigorous evaluations of ALMPs were carried out, thereby reducing the risk of waste of existing resources. Should these savings prove insufficient, the government could consider raising tax revenues. Preferably, this should be done by enlarging the tax base (through an intensified campaign against tax evasion and a reduction of the generous tax allowances and exemptions that presently exist) rather than raising tax rates which, at between 10 and 40 per cent, are not particularly low by OECD standards. In any case, general government revenues represent about 25 per cent of GDP, which is, after Mexico, the lowest figure among OECD countries for which comparable data exist. ■

Further reading

- [Pushing Ahead with Reform in Korea: Labour Market and Social Safety Net Policies, 2000](#)
ISBN: 92-64-17685-3, US\$23, 180p.
- [Economic Survey Korea](#), 1999
ISBN: 92-64-16991-1, US\$26, 204p.
- [Economic Survey Korea](#), 2000 - *Forthcoming*
ISBN: 92-64-17539-3, US\$30, 197p.
- [OECD Economics Department Internet Site:](#)
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