
Addressing Labour Market Duality in Korea

David Grubb, Jae-Kap Lee and Peter Tergeist

61

Unclassified

DELSA/ELSA/WD/SEM(2007)16



Organisation de Coopération et de Développement Economiques
Organisation for Economic Co-operation and Development

05-Oct-2007

English text only

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DELSA/ELSA/WD/SEM(2007)16
Unclassified

**OECD SOCIAL, EMPLOYMENT AND MIGRATION WORKING PAPERS No. 61
ADDRESSING LABOUR MARKET DUALITY IN KOREA**

David Grubb, Jae-Kap Lee and Peter Tergeist

JEL Classification: J20, J21, J30, J53, J64, J65, J68, J71

JT03233388

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ACKNOWLEDGEMENTS

This report was drafted mainly by Jae-Kap Lee, with contributions by David Grubb and Peter Tergeist and statistical assistance by Sylvie Cimper. An earlier draft of this report was presented to a joint Ministry of Labor/OECD seminar on “Labour Market Duality in Korea: An international perspective”, held in Seoul/Korea on 29 June, 2006.

David Grubb and Peter Tergeist are working as economists in the Employment Analysis and Policies Division of the OECD Directorate for Employment, Labour and Social Affairs. Jae-Kap Lee worked in the same Division between 2003 and 2006, and is currently Director-General of the International Co-operation Bureau of the Korean Ministry of Labor.

The authors wish to thank all those who commented on earlier drafts of this working paper, in particular Chang-Hun Han, John P. Martin and Raymond Torres.

The views expressed in this paper are those of the authors and do not necessarily reflect those of the OECD or its member countries, or of the Korean government.

SUMMARY

The Korean labour market has created many jobs over the past several decades, accompanying rapid economic growth. More recently, this favourable job performance has gone hand-in-hand with a rapid increase of temporary employment and other flexible or atypical work arrangements (usually called “non-regular” work in Korea). This trend has raised much concern in Korean society about the risk of persistent labour market duality and the various downsides associated with such a development.

Temporary employment increased from 17% of total wage and salary employment in 2001 to 29% in 2006 – the fastest rate of increase among OECD countries in recent years. Women are overrepresented in temporary employment. In contrast to most other OECD countries, the incidence of temporary employment is not much higher among youths than it is among prime-age workers, but it rises sharply for older workers – a feature related to companies’ mandatory retirement practices. Less-educated workers and small enterprises have high levels of temporary work.

Surveys report substantial wage gaps and large differences in access to non-wage benefits between “regular” and “non-regular” workers. The available research suggests – despite some variation in findings, depending on data sources and definition – that a considerable proportion of non-regular workers may be trapped in this type of job. It also suggests that hiring and human resource management practices by Korean firms, aiming to circumvent relatively strict employment protection legislation (EPL) for permanent workers and to profit from labour-cost differentials between different categories of worker, have been the main causes of the growth in temporary employment.

The Korean government has already introduced a number of relevant measures and policy proposals, ranging from anti-discrimination legislation to revisions of EPL and the expansion of the social safety-net. These measures have been rather fragmented, however, resulting in few synergy effects. Some reform measures – such as the recent legislation to reverse the trend towards temporary employment – have met with strong objections from trade unions and/or business groups, taking a considerable time before being passed by the National Assembly.

Continuing reform of EPL, so as to achieve greater balance in the treatment of regular *versus* non-regular forms of employment, is essential for combating labour market duality. Strict EPL for regular contracts should be eased, thus making the hiring of permanent workers more attractive, while non-regular workers are protected from overt discrimination in terms of pay and access to other benefits. Greater efforts should be made to convert the existing type of severance pay (which takes the form of a retirement allowance) to a corporate pension scheme, and to extend it to employees with less than one year of tenure. Further measures should include encouraging firms to raise their company-specific mandatory retirement ages towards the official retirement age; and promoting equal access to continuing training for non-regular employees. In addition, the public employment service (PES) needs to ensure better access of temporary and other non-regular workers to its services.

Finally, atypical employment can be reduced by promoting further transition towards a salaried economy, ensuring that *all* employers report wages and salaries correctly, including those for short-term workers, and pay the necessary social insurance contributions. For this purpose, co-operation between social insurance administrations and the tax authority is desirable. The PES also has a role in promoting the conversion of undeclared work into legally declared jobs.

RÉSUMÉ

Dans la foulée d'une croissance économique rapide, le marché du travail coréen a, depuis quelques décennies, créé de nombreux emplois. Mais récemment, cette évolution positive de l'emploi s'est accompagnée d'un développement rapide des emplois temporaires et autres types d'emplois flexibles ou atypiques (généralement dénommés en Corée emplois « non réguliers »). Cela a suscité dans la société coréenne beaucoup d'inquiétude quant à la persistance d'un marché du travail à deux vitesses et aux divers inconvénients que cela comporte.

L'emploi temporaire est passé de 17% du total de l'emploi salarié en 2001 à 29% en 2006 – c'est le rythme de croissance le plus rapide des pays de l'OCDE ces dernières années. Les femmes sont surreprésentées dans ce type d'emplois. Contrairement à ce qui se passe dans la plupart des autres pays de l'OCDE, son incidence n'est pas beaucoup plus élevée chez les jeunes que chez les travailleurs d'âge très actif – mais elle augmente fortement chez les travailleurs âgés, du fait des pratiques de retraite obligatoire en vigueur dans les entreprises. Les taux d'emplois temporaires sont par ailleurs élevés parmi les travailleurs peu instruits et dans les petites entreprises.

Les enquêtes font apparaître entre les travailleurs « réguliers » et « non réguliers » d'importantes disparités de salaires et d'accès aux prestations non salariales. Les études semblent indiquer – même si les conclusions varient quelque peu en fonction des sources et des définitions de données – qu'une proportion considérable de travailleurs non réguliers peuvent se trouver piégés dans ce type d'emploi. Elles montrent aussi que les pratiques de recrutement et de gestion des ressources humaines utilisées par les entreprises coréennes afin de contourner une législation de protection de l'emploi qui est relativement stricte pour les travailleurs permanents et de tirer profit des différentiels de coûts de main-d'œuvre entre différentes catégories de travailleurs ont été les principales causes du développement des emplois temporaires.

Le gouvernement coréen a déjà mis au point un certain nombre de mesures et de propositions qui vont d'une législation anti-discrimination à des révisions des lois de protection de l'emploi et à l'élargissement du filet de sécurité sociale. Cependant ces mesures sont assez fragmentées, de sorte qu'il y a peu d'effets de synergie. Certaines réformes telles que la récente loi visant à inverser la tendance à la multiplication des emplois temporaires ont rencontré de la part des syndicats et/ou des entreprises de vives objections, et il a fallu du temps avant qu'elles soient votées à l'Assemblée nationale.

Il est indispensable de poursuivre la réforme de la législation de protection de l'emploi afin de mieux équilibrer le traitement des emplois réguliers et non réguliers si l'on veut lutter contre la dualité du marché du travail. Il y a lieu d'assouplir la protection de l'emploi pour les contrats réguliers, afin de faciliter le recrutement de travailleurs permanents, tout en protégeant les travailleurs non réguliers contre une discrimination flagrante en termes de salaire et d'accès aux prestations. Davantage d'efforts doivent être faits pour convertir l'indemnité de départ actuelle (allocation de retraite) en régime de pension d'entreprise, et l'étendre aux salariés qui ont moins d'un an d'ancienneté. Il y aura lieu en outre d'encourager les entreprises à rapprocher l'âge de retraite obligatoire qui leur est propre de l'âge officiel de la retraite, et d'encourager l'égalité d'accès à la formation continue pour les salariés non réguliers. En outre, le service public de l'emploi (SPE) doit offrir un meilleur accès à ses services pour les travailleurs temporaires et autres travailleurs non réguliers.

Enfin, on peut réduire l'emploi atypique en encourageant le développement de l'économie salariée, de façon que *tous* les employeurs déclarent correctement les salaires, y compris ceux des travailleurs temporaires, et paient leurs cotisations d'assurance sociale. Ceci suppose une coopération entre l'administration de l'assurance sociale et les services fiscaux. Le SPE a lui aussi un rôle à jouer pour encourager la conversion du travail non déclaré en travail légalement déclaré.

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ADDRESSING LABOUR MARKET DUALITY IN KOREA

1. INTRODUCTION

1. The Korean labour market has created many jobs over the past several decades, accompanying rapid economic growth. Even after the financial crisis of 1997/98, which led to a sharp hike in the unemployment rate, the recovery of employment was rapid and strong. However, the recovery went hand-in-hand with a rapid increase of *non-regular* or *atypical* forms of employment. This trend has raised much concern in Korean society about the risk of persistent labour market duality or segmentation.

2. Although the term *non-regular workers* is widely used in Korean economic literature, among policy makers and in the media, a full consensus on the definition is lacking, as different data sets are collected and published *via* different surveys. Elements of the definition may include the temporary nature of employment, part-time work, and the lack of entitlement to bonus pay and various employer allowances. The various uses of the term in Korea are discussed in the Annex, and the report itself presents data using these variable definitions. For purposes of international comparison, it also tries to distinguish the temporary element separately.

3. Temporary employment and other flexible or atypical work arrangements may have beneficial as well as adverse effects. They may increase employment levels by enhancing employment flexibility for enterprises, and some workers may even prefer temporary work because it permits them to combine work with other activities. Temporary jobs often also serve as a first step towards permanent jobs. However, they may also imply considerable employment and income insecurity, or even the risk of alternating between short-term jobs and unemployment or inactivity. Further, growth of temporary employment may lead to reduced investment by firms in their workers' human capital and widen wage and income dispersion.

4. The purpose of this report is to *i*) shed light on the causes of the high incidence of non-regular employment in Korea, and *ii*) examine how policy reforms may help reduce labour market duality while also supporting employment growth. The report is organised as follows. Section 2 analyses the extent of duality in the Korean labour market and presents trends in the incidence of non-regular employment and in employment conditions and career dynamics of temporary workers, with a focus on how the Korean labour market compares with other OECD countries. Section 3 identifies the main institutional features of labour market policy in Korea, which impact on the incidence of non-regular employment, including labour-management relations and wage determination practices. Section 4 explores a range of policies to address labour market duality, including more uniform treatment of regular and non-regular workers in a number of policy areas. The final section presents a number of policy recommendations.

2. LABOUR MARKET DUALITY IN KOREA

2.1. The recent labour market situation

5. The Korean economy recovered very quickly from the 1997/98 financial crisis and the subsequent economic recession. GDP grew by almost 10% per annum in 1999 and 2000. In 2003, however, due to weak domestic consumption and lower economic growth rates worldwide, the economy went into a slowdown, accompanied by relatively sluggish labour market performance. At the same time, concern about *jobless growth* emerged, since employment declined in 2003 for the first time after recovery from the financial crisis (Table 2.1). This led to the agreement on a *Social Pact for Job Creation* in the Tripartite Commission in early 2004. After 2003, employment has grown again, particularly among women, but at a relatively modest rate. By 2006, the employment rate among the population aged 15-64 had fully recovered to its pre-crisis level (although it is still much below OECD average).¹

6. The unemployment rate has declined continuously from its peak of over 7% during the financial crisis, but the rate remains at around 3.5%, one percentage point above its level in 1997.² The brunt of slow job creation has fallen on youths and young adults (aged 15-24), whose unemployment rate increased from 8.5% in 2002 to 10% in 2006, three times the rate for prime-age adults. In contrast to practically all other OECD countries, unemployment continues to be lower among the lesser-educated. The incidence of long-term unemployment, defined as unemployment of over 12 months duration, is still quite insignificant (around 1% of total unemployment). However, a large number of young graduates drop out of the labour market altogether after leaving school and become inactive for a considerable length of time (OECD, 2007a); also, the Korea Labor Institute (KLI) recently found that the rate of transition from unemployment to out-of-the labour force status has doubled since the mid-1990s (Nam *et al.*, 2005a).³

7. Figure 2.1 shows long-term trends in employment growth since the early 1970s. These data seem to confirm the analysis in the *Social Pact for Job Creation* to the effect that the Korean economy's ability to create additional jobs has been falling (OECD, 2004a). Manufacturing industry has not created any employment over four of the last five years, due to increased productivity resulting from technological and structural changes and a shift from labour-intensive to capital-intensive production. In this context, the Korean government has begun to shift the main focus of its employment policy from fighting unemployment to fostering employment growth.

-
1. The employment rate (employment/population ratio) of the working-age population (15-64) increased from a little over 60% in 1998 to 64% in 2005, identical to the 1997 value, while the rate for age 15 and above remains a little below that level. Reflecting low employment rates of women and youth, the overall employment rate in Korea remains much below the OECD average. For example, in 2005, while the rate for males was about the OECD average, the rate for women was almost 4 percentage points and that of youth (15-24) about 13 percentage points below OECD averages.
 2. The definition of survey unemployment was recently brought in line with that used by the OECD and the ILO, by changing the reference period for job search from one week to four weeks.
 3. In contrast to the extremely low incidence of long-term unemployment in Korea, in 2006 the average incidence for OECD countries was 32%, and almost 45% for OECD Europe.

Table 2.1. Trends in GDP, employment and unemployment in Korea, 1997-2006

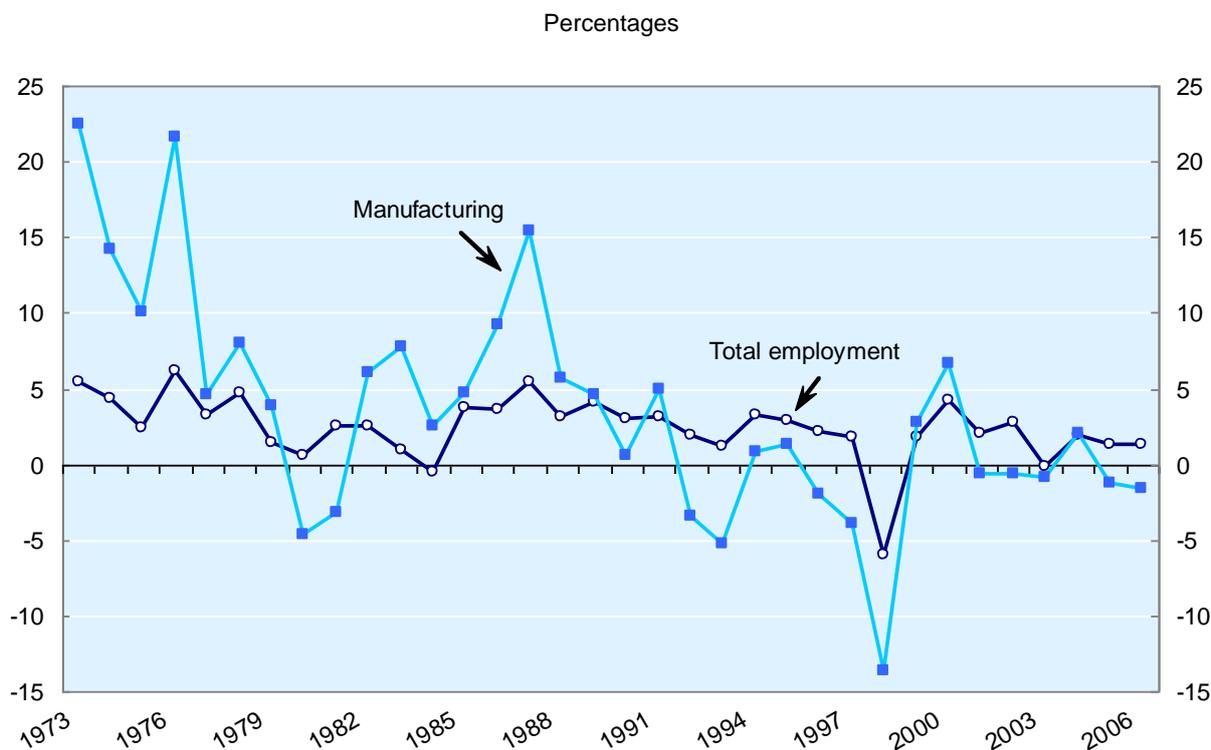
Percentages

<i>Panel A. Annual growth rates</i>						
	1997	2000	2003	2004	2005	2006
GDP (at constant prices)	4.7	8.5	3.1	4.7	4.2	5.0
Labour force (population aged 15-64)	2.1	1.9	0.2	1.6	1.0	0.7
Employment (population aged 15-64)	1.4	4.0	-0.1	1.5	0.9	1.0
Agriculture, forestry and fishing	-1.6	-2.6	-5.8	-6.4	-0.5	-1.7
Mining and manufacturing	-3.9	6.5	-0.9	2.0	-1.3	-1.6
Construction	2.2	7.3	4.0	0.2	-0.3	1.2
Wholesale and retail trade, restaurants and hotels	3.2	4.0	-2.4	0.2	-1.0	-0.8
Electricity, transport, storage/telecom and finance	4.2	3.8	0.1	1.3	2.7	3.9
Business, personal, public services and others	6.6	5.2	3.4	6.8	5.6	4.7
<i>Memorandum item:</i>						
Employment OECD (population aged 15-64)	1.6	1.5	0.5	1.3	1.3	1.7
<i>Panel B. Employment/population ratios</i>						
	1997	2000	2003	2004	2005	2006
Total (population aged 15-64)	63.7	61.5	63.0	63.6	63.7	63.8
Men	76.2	73.1	75.0	75.2	75.0	74.6
Women	51.6	50.0	51.1	52.2	52.5	53.1
Total (population aged 15 and over)	60.9	58.5	59.3	59.8	59.7	59.7
<i>Memorandum item:</i>						
Total OECD (population aged 15-64)	65.0	65.6	64.8	65.1	65.5	66.1
<i>Panel C. Unemployment rates</i>						
	1997	2000	2003	2004	2005	2006
Total	2.6	4.4	3.6	3.7	3.7	3.4
Men	2.8	5.0	3.8	3.9	4.0	3.8
Women	2.3	3.6	3.3	3.4	3.4	2.9
<i>Memorandum item:</i>						
Total OECD	7.0	6.2	7.0	6.9	6.6	6.1

Break in series: from 2000, data are based on the new Korean Standard Industry Classification.

Source: OECD Economic Outlook database for economic growth; OECD Labour Force Statistics database; National Statistical Office (NSO), *Annual Report on the Economically Active Population Survey (EAPS)*, 2004; and KNSO Website for 2006 data.

8. The impact of the economic slowdown since 2003 has varied across industrial sectors. Apart from *Agriculture, forestry and fishing*, whose share has been declining consistently over the past few decades, the category *Wholesale and retail trade, restaurants and hotels* has been most adversely affected, due mainly to weak domestic consumption (Table 2.1). By contrast, employment growth has been strong in business and personal services, as well as the public sector. The composition of the workforce by employment status has also been much affected throughout the post-crisis decade. The share of non-wage workers (*i.e.* the self-employed and unpaid family members) declined by 4 percentage points during the past decade – a phenomenon closely related to the decline of employment in the trade, restaurants and hotels sector. Nevertheless, the incidence of self-employment (together with family workers) remains almost twice the OECD average and is one of the highest in the OECD area, along with Turkey, Greece and Mexico. In Korea, the transition to a *salaried economy* is far from being complete (Table 2.2).

Figure 2.1. **Employment growth in Korea, 1973-2006**

Source: OECD (2006), *Labour Force Statistics, 1985-2005*, Paris; and NSO website for 2006 data.

Table 2.2. **Composition of employment by worker status in Korea, 1997-2006**

Percentages

	1997	2000	2003	2004	2005	2006
Total	100.0	100.0	100.0	100.0	100.0	100.0
Non-wage earners	36.8	36.8	34.9	34.0	33.6	32.8
Self-employed	27.8	27.7	27.3	27.1	27.0	26.5
Unpaid family members	9.0	9.1	7.7	6.9	6.6	6.3
Wage and salary earners^a	63.2	63.1	65.1	66.0	66.4	67.2
	(100.0)	(100.0)	(100.0)	(100.0)	(100.0)	(100.0)
Regular employees	34.3	30.2	32.8	33.8	34.6	35.4
	(54.3)	(47.9)	(50.5)	(51.2)	(52.1)	(52.8)
Temporary employees	20.0	21.8	22.6	22.5	22.1	22.2
	(31.6)	(34.5)	(34.7)	(34.1)	(33.3)	(33.1)
Daily workers	8.9	11.1	9.6	9.7	9.7	9.5
	(14.1)	(17.6)	(14.8)	(14.7)	(14.6)	(14.2)
<i>Memorandum item:</i>						
Wage and salary earners, OECD average	81.0	82.2	82.5	82.5	82.9	..

.. Data not available.

a) The definition of regular and temporary employees and daily workers is from the Economically Active Population Survey.

Source: NSO, Economically Active Population Survey; and OECD (2006), *Labour Force Statistics, 1985-2005*, Paris.

9. As to the age composition of employment, available data show that the share of youth (both 15-24 and 15-29) in employment has been gradually shrinking, while that for older workers (50+) has substantially increased since the latter half of the 1990s, although the employment rate for older workers actually declined

(Table 2.3). This implies that the Korean labour force is ageing rapidly; in fact, Korea is the fastest-ageing society in the OECD.⁴ The employment rate for older workers in Korea is still relatively high (in the upper third of OECD countries for the age group 50-64, and among the highest of all countries in the age group 65-74). Nevertheless, in conjunction with the seniority-based wage structure, mandatory retirement at a relatively low age remains a common practice among Korean firms. According to survey results from mid-size and large firms, the most common mandatory retirement age is 55, while the average age is somewhat higher at about 57 years (OECD, 2004b). Although some of the employees leaving companies fully withdraw from the labour market, about three-quarters of them move into self-employment. Among those older workers continuing to work as dependent employees, roughly two-thirds are working as *non-regular* employees (temporary and daily workers), as defined in the labour force survey (the Economically Active Population Survey, EAPS) (OECD, 2004b and 2005a).⁵

Table 2.3. **Employment trends by age group, 1997-2006**

	Percentages											
	1997		2000		2003		2004		2005		2006	
Persons aged 15-29 (15-24)												
Share in total employment	25.2	(11.2)	23.1	(9.7)	20.8	(9.1)	20.3	(8.8)	19.5	(8.0)	18.4	(7.0)
Employment growth	-1.3		4.0		-4.0		-0.6		-2.8		-4.0	
Persons aged 30-49												
Share in total employment	52.4		54.0		55.2		54.9		54.4		54.2	
Employment growth	2.3		4.6		1.2		1.4		0.3		0.9	
Persons aged 50 and over												
Share in total employment	22.4		23.0		24.0		24.8		26.2		27.4	
Employment growth	4.0		3.6		0.3		5.2		6.9		6.0	
Employment/population ratio												
Persons aged 15-29 (15-24)	45.6	(32.2)	43.4	(29.4)	44.4	(30.8)	45.1	(31.2)	44.9	(29.9)	43.4	(27.2)
Persons aged 50 and over	54.7		50.8		50.1		50.7		50.9		51.6	
<i>Memorandum item:</i>												
OECD average E/P ratios												
Persons aged 15-29 (15-24)	54.7	(45.0)	55.4	(45.6)	52.8	(42.7)	53.1	(42.9)	53.3	(42.9)	54.0	(43.3)
Persons aged 50 and over	35.9		36.8		37.5		37.7		38.3		38.8	

.. Data not available.

Source: OECD Labour Force Statistics database.

10. One of the more significant trends in the Korean labour market since the financial crisis is the increase in *job precariousness*, in particular those jobs that do not offer workers the prospect of a longer-lasting employment relationship. Although a survey tool to measure the extent of precarious employment in Korea was not developed until 2000, labour market duality became a controversial issue in Korea on the basis of labour force survey data published by the National Statistical Office which showed that the share of non-regular workers among all wage and salary earners increased to over 50% following the financial crisis (Table 2.2).⁶ Considering that the EAPS was not designed to measure precarious jobs and that

4. The OECD's report on *Ageing and Employment Policies: Korea* has confirmed that Korea will have one of the oldest populations and highest old-age dependency ratios in the OECD by the year 2040. The share of workers aged 50 and over in the total labour force is projected to double from 23% in 2000 to over 45% in 2040, while the share of young workers aged 15-24 is expected to decline to below 6% (OECD, 2004b).

5. This refers to the category of *non-regular* workers under the Economically Active Population Survey, not to the category of *temporary workers* as defined later on in this paper (see Section 2.2 below and the discussion of statistical definitions in the Annex).

6. The EAPS has collected data on employment status since 1989, categorising dependent employees as *regular employees*, *temporary employees* and *daily workers*. Regular employees are defined as those who *i*) work more than one year at a firm, thus benefiting from the retirement allowance, and *ii*) are paid standard wages, *plus* bonuses and overtime. All other employees are defined as *non-regular* and divided

it seemed to considerably overestimate their extent, the Korean government began to implement an annual EAPS supplement to better measure various “non-standard” employment categories starting from the autumn of 2000.

2.2. Temporary employment

A. Definition of temporary employment

11. Although various non-traditional employment patterns, in particular short-term and temporary work, have been spreading throughout OECD member countries over the past several decades, there is no commonly accepted definition which could represent these new arrangements. Terms such as *atypical*, *casual*, *non-standard* or *non-permanent* forms of employment – including the Korean and Japanese variant of *non-regular* employment – have been much in use. The US Bureau of Labor Statistics, for example, has since 1995 periodically collected data on *contingent workers and alternative work arrangements*, where contingent workers are defined as those who do not perceive themselves as having an explicit and implicit contract for ongoing employment, and alternative work arrangements are defined as employment arranged through intermediaries or for which the place, time and quantity of work are potentially unpredictable (Hipple, 2001; Murtough and Waite, 2000; Ahn, 2004). To take another example, researchers at the Italian Statistical Institute (ISTAT) have developed a new classification of *atypical employment arrangements*, based on three main dimensions: *i*) the stability of the work relationship (permanent *vs.* temporary jobs); *ii*) the length of the working-time regime (full-time *vs.* reduced time regimes); and *iii*) the extent of workers’ entitlements to social rights associated with the working arrangement (Tronti *et al.*, 2004).

12. To allow better international comparisons, the OECD maintains a database on *temporary employment*. Under the OECD definition – as well as Eurostat guidelines – temporary jobs are those forms of dependent employment which, by their nature, do not provide the prospect of a long-lasting employment relationship. The definition includes employees under fixed-term contracts, seasonal workers, temporary agency jobs, and those with a training contract of limited duration. While in many cases the temporary nature of a job is evident – for example, when there is a written contract specifying that the job lasts a specific amount of time – other cases are less clear-cut and the characteristics of employment arrangements that might be considered temporary can differ across institutional legal and policy settings. As a result, caution is required in international comparisons of the incidence of temporary employment (OECD, 1996 and 2002; and EIRO, 2002).⁷

13. In Korea, the term *non-regular workers* is widely used, although there is disagreement among scholars on its definition and measurement. The Annex outlines several definitions currently in use, the most important of which are those from the regular labour force survey (EAPS) and the supplementary labour force survey that was designed to throw more light on the issue of labour market *duality* or *precariousness*. The present report relies mainly on the OECD/Eurostat definition of temporary employment as outlined above, which allows a degree of international comparison and can provide a solid framework for analysis of labour market duality. The definition used in the supplementary labour force

into temporary employees and daily workers by the length of their respective employment relationships. This non-regular workforce was measured as 45% of dependent employment in 1989, declining steadily to 41% by 1993. The share then rose significantly after 1997 to over 52% in 2000. This figure overestimates the extent of precariousness of employment, since many employees in SMEs, who are not entitled to the retirement allowance and do not receive bonus payments, are likely to be included, although they are in fairly stable jobs.

7. It should also be noted that countries with a high incidence of temporary or fixed-term employment (as reported by employees based on their contract or expected job tenure) may nevertheless have high labour turnover (measured for example by the incidence of employment with less than one year’s job tenure).

survey is closest to, but not identical with, the OECD's definition. Among the various categories used in the supplementary survey, this report classifies the following as "temporary workers": workers under fixed-term contracts, those who do not expect their jobs to last for involuntary and non-economic reasons, temporary agency workers and on-call workers. However, it excludes permanent part-time workers and categories (such as contractors) that would normally be classified as self-employed.⁸ This definition has also been used in recent OECD Economic Surveys of Korea (OECD, 2004a and 2005a) (see the Annex for more detail).

B. Trends in the incidence of temporary employment

14. Table 2.4 shows the share of temporary employment in total dependent employment in Korea since the summer of 2001, when the supplement to the EAPS started to collect data on specific types of employment.⁹ According to this survey, the share of temporary employment stood at 28.8% in 2006, almost twice the 2001 share, but a bit below the 2004 and 2005 levels. The largest subcategory is workers with a fixed-term contract (in most cases with a duration of one year or less), followed by workers without such a contract who for involuntary reasons do not expect their employment to continue.¹⁰

Table 2.4. Share of temporary workers in Korea, 2001-06

		Percentages					
		2001	2002	2003 ^a	2004 ^a	2005 ^a	2006 ^a
Workers with a fixed-term contract	Less than or equal to 1 month	5.6	5.2	6.7	5.6	5.5	5.2
	More than 1 month to less than 1 year	2.8	2.7	4.9	4.7	4.8	4.9
	Exactly 1 year	1.5	1.9	3.3	4.4	5.3	5.0
	More than 1 year to less than 3 years	0.6	0.6	1.3	1.7	1.7	1.7
	3 years or more	0.5	0.6	0.7	0.8	0.8	0.9
Subtotal		11.0	10.9	17.0	17.1	18.2	17.7
Workers without a fixed-term contract, where employment is not expected to continue due to involuntary reasons		2.9	3.8	4.3	7.6	5.9	5.9
			(1.8) ^b	(2.6) ^b	(3.6) ^b	(3.9) ^b	..
Temporary agency workers		1.0	0.7	0.7	0.8	0.8	0.9
On-call workers		2.2	2.9	4.2	4.6	4.8	4.3
Total^c		16.6	18.1	25.9	29.7	29.4	28.8
<i>Memorandum item</i>							
Total dependent employment (000s)		13 659	14 181	14 402	14 894	15 185	15 531

.. Data not available.

a) There have been several changes in the survey from 2003 on requiring caution in interpreting trends. The entire sample of households for the Economically Active Population Survey was replaced in January 2003, and the question structure in the supplementary survey was partially modified.

b) Since 2002 the category *Workers without a fixed-term contract, where employment is not expected to continue due to involuntary reasons* includes a subcategory of workers whose contract is being renewed on a regular basis, but who assess the durability of their employment to be limited. The figures in parenthesis exclude this subcategory.

c) Total is adjusted for overlapping categories.

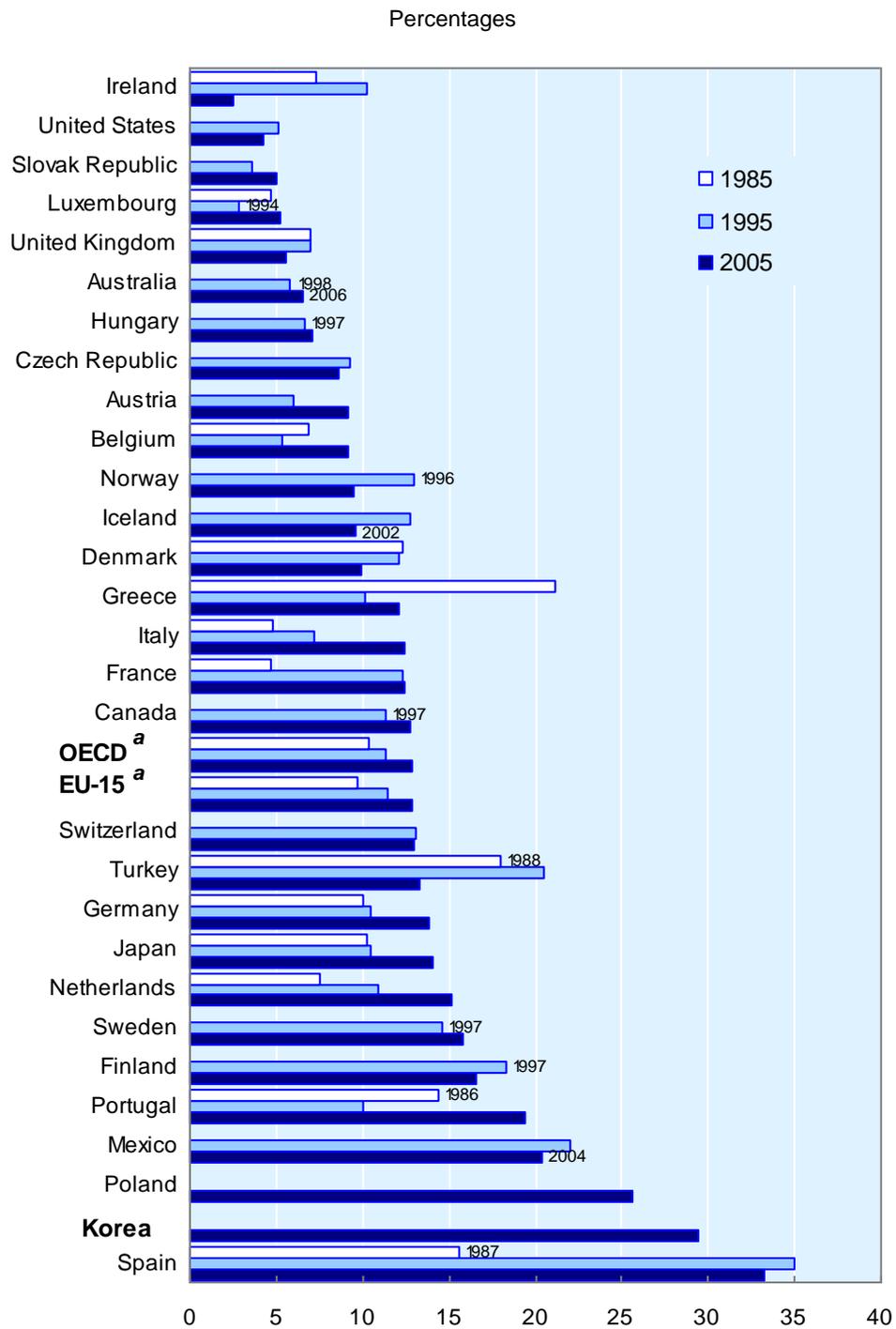
Source: EAPS Supplement, various years, as reported by the Korean Ministry of Labor; and OECD Labour Force Statistics database.

8. Temporary workers represent about 80% of non-regular workers, as identified in the supplementary survey.

9. The survey was first implemented in 2000, but the survey questions were redesigned in 2001.

10. The sum of these two categories is defined as the *contingent workforce* by the Korean Ministry of Labor.

Figure 2.2. Incidence of temporary employment in OECD countries, in the mid-1980s, mid-1990s and 2005



a) Unweighted average of countries and years shown.

Source: OECD Temporary Employment database; and EAPS Supplement, August 2005, for Korea.

15. Figure 2.2, based on the OECD's annual comparative data set on temporary employment, shows that the Korean share of temporary employees in total dependent employment is second only to Spain's, where it is around one-third. It also highlights considerable diversity across OECD countries. In 2005, this share was below 5% in Ireland, the United States and the Slovak Republic, and was above 20% in Korea, Mexico, Poland and Spain. The (unweighted) average incidence of temporary employment in 2005 was 12.8% both in the OECD and in the European Union (EU-15).

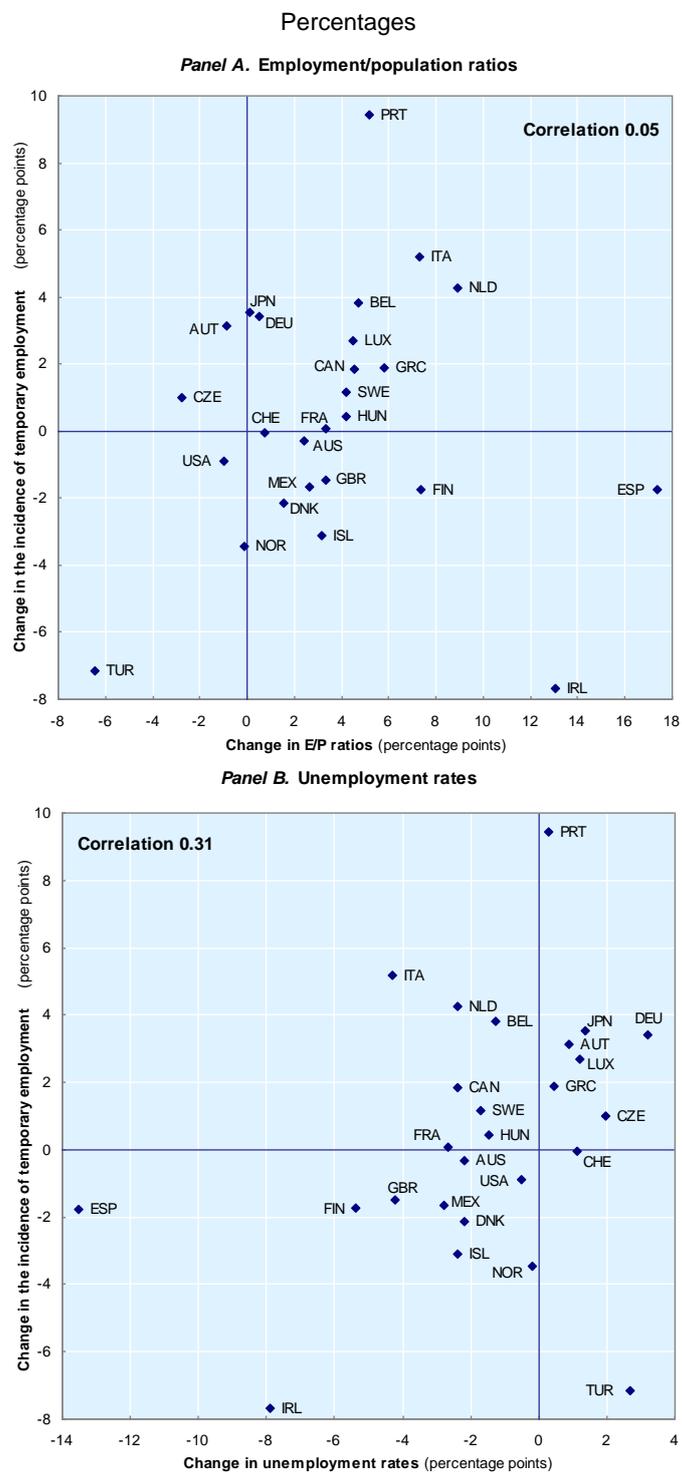
16. The OECD database provides ample material for studying the evolution of temporary employment and its subcomponents over the past two decades. On average, temporary employment has increased steadily in OECD countries, from about 10% in the mid-1980s to almost 13% in 2005. However, the trends remain diverse. From the mid-1990s to 2005, temporary employment increased in 15 of the 27 countries for which full data are available, and declined in 12 of them. The temporary workforce increased most significantly in Belgium, Italy, the Netherlands and Portugal, while it declined markedly in Iceland, Ireland, Norway and Turkey. It also declined somewhat in Spain (the country with the highest level of temporary employment). Overall, the trend towards a high level of temporary employment in the OECD area is thus not as universal and clear-cut as is sometimes alleged. For example, the increase in the OECD average between 1995 and 2005 would have been much less, if it had not been for the addition of Poland and Korea to the database, where the share is over 20%.

17. When analysing the relationship between changes in the incidence of temporary employment and changes in unemployment and employment rates in OECD countries over the past decade, no systematic link can be established (Figure 2.3). However, in Ireland and Spain large increases in employment and declines in unemployment were associated with decreasing temporary-worker shares in the workforce.

18. The OECD dataset indicates that Korea is the OECD country where the temporary workforce has increased the most rapidly in recent years – from a share of 16.6% in the 2001 survey to 29.7% (*i.e.* almost twice the initial value) in the 2004 survey and 28.8% in 2006. This may suggest that many previously permanent positions have been transformed into fixed-term employment relationships. However, there are several caveats to the data shown in Table 2.4. First, the incidence of “workers with a fixed-term contract” increased by over 6 percentage points between the 2002 and 2003 surveys, raising an issue of data consistency. Part of this increase may be explained by significant changes in the household sample between 2002 and 2003. Also, written contracts are still not universal in Korea. This poses measurement problems, since it is often not apparent whether the duration of a contract is limited or not. The steady increase between 2001 and 2004 in the category *Workers without a fixed-term contract, where employment is not expected to continue due to involuntary reasons* may therefore reflect changes in the subjective assessment of employment duration based, for example, on perceptions of security or insecurity against the background of the business cycle. While the increase in the temporary workforce has certainly been significant, it is not clear that the number of temporary workers really increased to the extent shown by the survey.

19. Based on the supplementary survey, the number of on-call workers in Korea seems also to have increased considerably since 2001 (no comparable data are available from other OECD countries). By contrast, the incidence of temporary agency workers has not changed much, and remains below 1% of all wage and salary earners (corresponding to 0.6% of total employment). Due mainly to the continuing restrictions on the number of industrial sectors and occupations where temporary agency work is allowed, the Korean level is relatively low compared to levels in either the United States or European Union countries. According to the latest European survey, temporary agency workers were 1% to 2% of total employment in most of the EU-15 countries, with levels above 2% in Belgium, France, the Netherlands and the United Kingdom. At the other extreme, temporary agency work in Greece and Denmark (at 0.3% each) was less developed than in Korea (Arrowsmith, 2006).

Figure 2.3. **Changes in the incidence of temporary employment and employment/unemployment rates, 1995-2005^a**



a) 1998-2004 for Australia; 1997-2005 for Canada, Finland, Hungary and Sweden; 1998-2005 for the Czech Republic; 1995-2002 for Iceland; 1996-2005 for Luxembourg and Norway; and 1995-2004 for Mexico.

Source: OECD Temporary Employment database; OECD (2006), *Labour Force Statistics, 1985-2005*, Paris, for employment/population ratios and unemployment rates, with the exception of national figures for Hungary, Norway and Switzerland.

C. Composition of temporary employment

Composition by age, gender and educational attainment

20. Table 2.5 shows the incidence of temporary employment by gender and age in OECD countries. In Korea, 27% of male and 33% of female employment was temporary in 2005. With a few exceptions (particularly Mexico, Poland and Turkey), this overrepresentation of women arises in most other OECD countries. Often, the higher incidence among women makes up for their lower employment rate, so that they constitute on average almost half of all temporary employees. In Belgium, Italy and Japan, they even represented 60% or more of the total in 2004. By contrast, in Korea, reflecting the particularly low employment rate of females, their share in total temporary employment was 46% in 2005 (Ministry of Labor, 2006).

Table 2.5. **Incidence of temporary employment by gender and age in selected OECD countries, 2005^a**

Percentages of dependent employment

	Men				Women				Total			
	15-24	25-54	55+	Total	15-24	25-54	55+	Total	15-24	25-54	55+	Total
Australia	..	..	..	5.0	..	..	..	6.1	..	..	..	5.5
Austria	38.9	4.1	3.9	9.4	30.0	5.0	3.3	8.8	34.7	4.6	3.7	9.1
Belgium	26.7	5.0	3.4	6.7	32.8	9.8	10.1	12.0	29.6	7.2	5.8	9.1
Canada	29.4	8.6	11.7	12.5	30.3	10.1	11.6	13.9	29.9	9.3	11.7	13.2
Czech Republic	17.1	5.3	13.3	7.6	20.0	6.8	24.8	9.8	18.3	6.0	17.7	8.6
Denmark	32.9	4.7	4.6	8.9	25.2	9.4	5.9	11.0	29.4	7.0	5.2	9.9
Finland	41.4	9.8	6.4	13.0	46.8	18.5	7.1	20.1	44.2	14.2	6.8	16.6
France	46.5	7.8	4.4	11.6	46.4	10.6	5.6	13.3	46.5	9.1	5.0	12.4
Germany	60.4	8.2	5.0	14.0	53.2	8.6	3.6	13.6	57.0	8.4	4.4	13.8
Greece	26.2	8.9	7.6	10.2	28.9	13.3	13.8	14.7	27.3	10.7	9.3	12.1
Hungary	18.2	6.7	5.8	7.6	15.9	5.8	4.5	6.4	17.2	6.3	5.2	7.0
Iceland	22.8	6.3	7.7	9.5	20.2	7.9	6.1	9.7	21.5	7.1	6.8	9.6
Ireland	6.6	1.3	2.5	2.4	7.2	1.7	2.5	2.7	6.9	1.5	2.5	2.5
Italy	34.9	8.5	7.0	10.6	39.1	13.4	6.3	14.8	36.5	10.6	6.7	12.4
Japan	27.1	4.1	13.0	8.2	28.7	20.4	24.8	22.3	27.9	10.8	17.4	14.0
Korea	..	..	..	27.1	..	..	..	32.5	36.1	26.2	46.1	29.4
Luxembourg	31.8	3.1	0.0	4.9	25.7	4.3	3.6	5.8	29.2	3.6	1.4	5.3
Mexico	31.4	22.2	26.8	24.9	17.2	10.3	7.7	11.9	26.4	17.9	21.9	20.3
Netherlands	41.3	9.1	6.0	13.8	41.2	11.6	8.4	16.7	41.3	10.3	6.9	15.2
Norway	26.0	5.5	2.6	7.5	29.7	10.3	3.9	11.6	27.8	7.8	3.2	9.5
Poland	63.4	23.4	18.4	26.5	70.3	20.8	15.4	24.7	66.5	22.2	17.3	25.7
Portugal	44.2	15.9	8.9	18.7	45.6	18.0	10.6	20.3	44.8	16.9	9.7	19.5
Slovak Republic	14.1	3.7	6.5	5.1	11.1	3.2	22.7	4.9	12.8	3.4	11.3	5.0
Spain	66.3	29.0	13.1	31.6	63.9	33.0	16.2	35.5	65.3	30.7	14.2	33.3
Sweden	47.9	10.7	6.8	13.9	62.5	13.9	6.2	17.6	55.3	12.3	6.5	15.8
Switzerland	51.7	6.2	10.7	12.8	47.1	6.9	8.1	13.2	49.4	6.5	9.5	13.0
Turkey	16.5	12.5	22.1	13.5	10.4	13.2	40.6	12.7	14.6	12.7	24.2	13.3
United Kingdom	11.3	3.6	6.3	5.2	10.8	4.8	6.0	5.9	11.1	4.2	6.1	5.5
United States	8.5	3.5	3.5	4.2	7.6	3.4	4.4	4.2	8.1	3.5	3.9	4.2
OECD Europe^b	34.2	8.7	7.5	11.5	34.1	10.9	10.2	13.3	34.2	9.7	8.2	12.4
Total OECD^b	32.7	8.8	8.4	12.0	32.1	10.9	10.5	13.7	32.7	10.4	10.4	12.8

.. Data are not available for this specific age groups breakdown.

a) Data refer to 2003 for Germany and Luxembourg, 2002 for Iceland and 2001 for the United States.

b) Unweighted average of countries and years shown.

Source: OECD Temporary Employment database; EAPS Supplement, August 2005, for Korea.

21. Although temporary work is more often than not involuntary, some women may prefer temporary employment due to its association with flexible scheduling. Indeed, with few exceptions, temporary workers in OECD countries are more likely to work in part-time jobs than permanent workers. In 2000, in 10 OECD countries over one-third of temporary workers, and in two countries (the Netherlands and Ireland) over half of them, worked part-time schedules (see OECD, 2002). The incidence of part-time jobs for temporary workers in Korea is significantly lower: in 2005, 14.0% of temporary workers and 4.1% of permanent workers worked part-time. This suggests that in Korea the employment of women in temporary jobs is less related to the need to secure working-time flexibility.

22. As Table 2.6 on the incidence of non-regular work suggests, in Korea, many female workers who left the labour market for marriage and/or child-birth have difficulty finding permanent employment and need to take up temporary jobs when they return to the labour market. When analysing data collected by the EAPS Supplement, Jeong (2005) found that the incidence of non-regular work for females increases beyond the age of 30.¹¹ By contrast, the incidence of non-regular work for males only increases after age 40. This positive correlation of temporary employment among women after the age of 30 was confirmed in an analysis by Jeong (2006) of data concerning women moving back to work from unemployment or inactivity, collected by the *Korea Labor and Income Panel Survey* (KLIPS). Consistent with this finding, married women who work are more often employed in temporary jobs than non-married women.

Table 2.6. **Incidence of non-regular employment by gender, age and marital status in Korea, 2005**

Percentages			
	Men	Women	
Age	15-19	78.3	64.1
	20-29	32.0	33.4
	30-39	25.3	40.1
	40-49	29.2	46.7
	50-59	35.0	55.2
	60 and over	60.0	75.7
Marital status	Not married	36.7	35.0
	Married	28.5	46.4
	Separated	48.1	56.5

Source: EAPS Supplement, August 2005, quoted in Jeong (2005).

23. Data on the incidence of temporary employment by age group, presented in Table 2.5, show that, across the OECD, male youths are almost four times as likely as prime-age men, and female youths almost three times as likely as prime-age women to hold a temporary job, suggesting that these jobs tend to serve as entry ports into the world of work. One significant characteristic in Korea emerging from Table 2.6 is that the incidence of temporary employment among youths (apart from teenagers) is not much higher than among prime-aged employees. Another significant feature in Korea, compared to other OECD countries, is that the incidence of temporary employment rises sharply for older workers. This feature (which is also characteristic of Japan) is related to mandatory retirement practices in Korean firms. Particularly striking is the large difference between the incidence of temporary employment for employees aged 55 and over in Korea and the OECD total. Gender is again a decisive factor, as after the mandatory retirement age the rate for males increases much more sharply than for women.

11. Jeong (2005) defines non-regular workers as the sum of contingent, part-time and atypical workers (see definition B in the Annex).

24. Available data (Table 2.7) also indicate that in Korea, as in most other OECD countries, the incidence of temporary employment is almost twice as high for workers with low educational attainment as for workers who have completed upper secondary education. This helps explain the relatively lower youth incidence of temporary work, since Korean youths have above-average educational attainment, in particular a higher rate of tertiary education.

Table 2.7. **Incidence and distribution of temporary employment by educational attainment**

Percentages

		Korea (2005)	EU-15 average (2005)	OECD average (2000)
Incidence	Low	46.6	21.3	15.7
	Medium	30.2	11.3	10.4
	High	20.4	12.5	9.3
Distribution	Low	28.4	37.8	35.2
	Medium	44.9	38.7	44.3
	High	26.7	23.4	20.5

a) In Korea, *low* educational attainment refers to lower than high school graduate, and *high* educational attainment refers to college and higher education, while for the OECD average, *low* refers to ISCED 0/1/2 and *high* refers to ISCED 5/6/7.

Source: EAPS Supplement, August 2005, for Korea; European Union Labour Force Survey; OECD (2002), *Employment Outlook*, Paris; and OECD Temporary Employment database.

Composition by industry and establishment size

25. Consistent with the pattern in other OECD countries, temporary employment in Korea is concentrated in service industries rather than manufacturing and in small rather than large establishments (see Table 2.8). This concentration is even more pronounced in Korea than in the rest of the OECD. While the incidence of temporary employment in industry (mining, manufacturing and construction) is twice as high as the OECD average, it is three times as high in services.

Table 2.8. **Incidence and distribution of temporary employment by industry and establishment size**

Percentages

		Korea (2005)	EU-15 average (2005)	OECD average (2000)	
Industry	Incidence	Agriculture	75.0	Agriculture 35.4	21.9
		Industry	18.7	Industry 13.2	9.6
		Services	32.1	Services 14.0	10.8
	Distribution	Agriculture	2.5	Agriculture 4.1	6.4
		Industry	15.0	Industry 25.6	24.1
		Services	82.5	Services 70.3	69.6
Establishment size	Incidence	Less than 10 persons	37.3	Less than 20 persons 13.3	14.4
		10-29 persons	28.9	20-49 persons 11.1	10.9
		30-99 persons	25.1	50 persons and over 9.4	9.1
		100 persons and over	20.8	Less than 20 persons 42.4	52.2
	Distribution	Less than 10 persons	46.2	20-49 persons 16.4	14.7
		10-29 persons	21.0	50 persons and over 41.2	33.1
		30-99 persons	16.8		
		100 persons and over	16.0		

Source: EAPS Supplement, August 2005, for Korea; European Union Labour Force Survey; and OECD (2002), *Employment Outlook*, Chapter 3, Paris.

26. According to data provided by the Korean Ministry of Labor, within the service sector the incidence of temporary employment is over 30% in *Wholesale and retail trade, restaurants and hotels* and *Finance, insurance, real estate and business services*. Meanwhile, with 26% of total civilian employment in 2005, Korea has one of the largest shares of employment in *Wholesale and retail trade, restaurants and hotels* among all OECD countries (although total employment in services is still below the OECD average) (OECD, 2007b). These characteristics of the industrial structure may be one factor explaining the high incidence of temporary employment in Korea, along with the concentration of temporary employment in small establishments.

27. In sum, across OECD countries, temporary employment is overrepresented among younger workers, less-educated workers, females, small enterprises and lower-skilled service sector jobs (OECD, 2002). These features are also characteristic of Korea, although the concentration of temporary employment on youth is somewhat less, and on women somewhat more pronounced. In addition, its concentration on employees above the age of 50 is striking.

D. Terms and conditions of employment

Pay levels of temporary workers

28. A number of theoretical arguments suggest that temporary workers receive lower wages than their permanent counterparts. Human capital theory, which emphasises the importance of personal characteristics for pay levels, suggests that workers without proper skills or experience are paid less than those equipped with higher skills or more experience. From this point of view, lower pay levels for temporary workers are said to reflect their lower productivity due to either inferior skills or short tenure. Efficiency wage theories, which emphasise the incentive character of wages, imply that permanent workers are paid more than temporary workers to provide them with incentives to work longer. Dual labour market theories argue that workers in the secondary labour market are paid less than those in the primary segment as a result of labour market segmentation, which poses both economic and non-economic obstacles to passing from the former to the latter. However, it may also be the case that certain policies and labour market institutions, such as minimum wages and equality of opportunity legislation, have the effect of equalising the wages between the two categories of employees, if the legislation is consistently enforced in both sectors.

29. According to the supplementary labour force survey, non-regular workers in Korea were paid 71% of the hourly wages of regular workers as of August 2005 (Table 2.9).¹² While this relatively large wage gap has given rise to concerns about inequality in Korea, more or less substantial gaps between the wages of permanent and temporary workers can also be found in most other OECD countries.¹³ OECD (2002) has calculated wage gaps in 13 European countries by dividing mean hourly wages of temporary workers by those of permanent workers. According to these calculations, wage gaps in Europe varied from 17% in Germany to 47% in Spain. With a wage gap of close to 30%, Korea occupies a middle position when compared to these countries, close to the rates in France (29%) and the United Kingdom (26%).

12. On a monthly basis, the wages of non-regular workers were 63% of those of regular workers. Non-regular workers in the supplementary labour force survey correspond to definition B in the Annex.

13. By contrast, in Australia within a given occupation “casual” workers tend to earn above-average wages. This is due to supplementary “casual loading” components in the wage which are paid to compensate for certain other disadvantages.

Table 2.9. **Hourly wage of regular and non-regular workers by firm size and union membership^{a, b}**

	Won				
	Total	Firm size ^c		Union membership	
		Small firms	Large firms	No	Yes
Regular workers	9 263 (100.0%)	7 994 (86.3%)	14 046 (151.6%)	8 679 (93.7%)	12 351 (133.3%)
Non-regular workers	6 256 (67.5%)	6 032 (65.1%)	10 572 (114.1%)	6 382 (68.9%)	9 513 (102.7%)

a) Hourly wages are calculated as average monthly total wage / (average weekly working hours x 4.3 weeks), using data from the EAPS Supplement, August 2005.

b) Figures in brackets denote the ratio of wages in a particular category to average wages of regular workers.

c) *Small firms* are firms with less than 300 workers, and *large firms* are those with 300 workers and over.

Source: Kang (2005).

30. Against the background that the Korean labour market is characterised by large wage differentials across sectors, Table 2.9 shows two further interesting aspects related to the wage gap. First, while non-regular workers working at large firms (with more than 300 employees) are paid less than regular workers working in the same firms, they are actually paid more than regular workers working at smaller firms (less than 300 employees). This implies that wage differentials between small and large firms are larger than wage differentials between regular and non-regular workers.¹⁴ Second, unionised non-regular workers are paid less than unionised regular workers, but are paid more than regular workers who are not members of trade unions. Due to the combination of strong union effects and strong establishment size effects (Kang, 2005), non-regular workers who work at smaller firms are paid less than half of hourly wages of regular workers at large firms, while non-regular workers who are not trade union members are paid only 52% of hourly wages of regular workers who are unionised. The fact that few temporary workers are unionised (about 5% according to recent calculations) reinforces wage differentials.

31. Further, against the background of the prevailing seniority-based wage system in Korea, Hwang *et al.* (2005) estimate age and tenure effects on wages using data collected by KLIPS (see definition D in the Annex). The main findings are as follows: wages for regular male workers increase continuously up to their late forties, while those for non-regular male workers start declining in their mid thirties. In comparison, wages for regular female workers begin to decline in their mid-thirties, and those for non-regular female workers already in their late twenties. As to the tenure-earnings profile, wages for both male and female regular workers increase rapidly and consistently with tenure, while wages for non-regular workers start to stagnate after about three or four years of tenure. Based on these findings, the authors conclude that strong tenure effects and (more modest) age effects on regular workers' earnings reflect the seniority-based wage system prevailing in Korean enterprises. The male/female differences are, again, due to the frequent withdrawal of female workers from the labour market for reasons of marriage and/or childbirth.

Decomposition of wage gaps

32. The wage gap cited above of 30%, as determined by the supplementary labour force survey, does not take into account differences in individual or job characteristics, although Table 2.9 has shown the impact of two such features. For example, if youths were a large proportion of temporary workers, this alone would explain much of existing pay differentials. OECD (2002), using multivariate regression techniques, estimated the *independent* impact of temporary employment on wages by standardising for pay differences due to other characteristics. The wage penalty associated with holding a temporary job was always partly, but never fully, attributable to these other characteristics.

14. For example, according to the Wage Structure Survey the ratio of average wages in firms with 500 or more employees to those with 10 to 29 workers increased from 1.1 in 1985 to over 1.7 in 2005.

33. For Korea, Ahn (2004) decomposes the wage gap between regular and non-regular workers (based on data from the 2003 EAPS Supplement) by estimating wage equations for different types of employee with the purpose of measuring differentials that are due to a number of independent factors and those due to discriminatory treatment. The variables used by the author are length of tenure, occupational skill level, establishment size, gender, marital status, educational attainment and age. The econometric results showed that statistically 81% of the wage gap between regular and non-regular workers¹⁵ could be explained by these observed variables, implying that the remaining 19% of the wage gap might be caused by discriminatory treatment. Among the observables, short job tenure and working in low-paid occupations accounted together for almost half of the existing gap. However, it is open to debate whether some of the other factors – not only the unexplained 19% – might not also be measures of the impact of discriminatory treatment and labour market segmentation. Policy measures against wage and other imbalances remain on the agenda even if deliberate discrimination plays only a small part.

34. More recently, Nam *et al.* (2005b) estimated even smaller wage gaps caused by discriminatory treatment. Using again the EAPS Supplement from 2002 to 2005 and after controlling for differences in job tasks and trade union presence, in addition to the factors listed above, the residual wage gap fell to below 5%.

Employee welfare benefits

35. In most OECD countries, there is a risk that temporary workers have more limited access to non-wage benefits, such as paid vacations, maternity or parental leave, unemployment benefits and retirement pensions, than permanent workers. In particular, this is the case in countries where many employee welfare benefits are not provided on a legislated, universal basis, but rather voluntarily by employers. Even in countries where temporary workers have the same *de jure* entitlement to these employee benefits, they may have sometimes limited *de facto* access due to specific eligibility criteria (OECD, 2002). In Korea, a number of employee benefits are regulated by law on a universal basis. However, entitlement to or participation in these employee benefits is sometimes conditional on a minimum working period or a working hour threshold, although the importance of these pre-conditions has recently been reduced.

36. Mandatory employee benefits which are regulated by law in Korea include unemployment insurance, national health insurance, public pensions, industrial accident and sickness compensation insurance, severance pay, annual leave and paid maternity or unpaid child-care leave. Social insurance schemes which were initially introduced with relatively limited coverage have expanded their coverage in recent years, to the extent that most workplaces and workers are now covered. However, part-time workers with less than 60 or 80 monthly working hours and daily workers engaged for less than one month still tend to be excluded from most social insurances, despite the fact that daily workers began to be covered by the Employment Insurance System (EIS) as from 2004. Part-time workers and daily workers are allowed to join the national health insurance and the public pension scheme through regional affiliation, rather than the regular workplace-based membership.

37. Paid annual leave has in the past been granted by the Labor Standards Act to workers who register more than 80% of attendance throughout the year. In addition, a special regulation for employees who have served for less than a year was introduced in 2003 (one day's leave per month for employees who work over 15 hours a week, on the condition that there have been no absences from work). However, this regulation only becomes effective in several stages from 2004 through 2011. Unpaid child-care leave for up to one year is granted to workers who have worked for over a year for the same employer. The same minimum of one-year tenure also applies to severance pay (the so-called *retirement allowance*). By contrast, paid maternity leave is granted without any condition related to length of tenure or minimum working hours.

15. Ahn's definition corresponds to definition B in the Annex.

38. In spite of the recent expansion in entitlement to statutory employee benefits, *lack of compliance by employers* remains an important obstacle to temporary workers' ability to take advantage of these benefits. Table 2.10 shows that according to survey data less than 40% of non-regular workers are protected by the main social security schemes. However, there is some evidence to the effect that the extent of non-compliance is, to some degree, exaggerated by these survey results. Concerning coverage under the EIS, for example, the Ministry of Labor provides different results, based on actual reporting data from administrative statistics (Table 2.11). Broken down by establishment size, these statistics (which, however, omit daily workers) show that more than three out of four employees are reported to the EIS, while the EAPS survey data imply that only one out of two are covered. The survey-based compliance rate for workers in small enterprises is particularly low and makes up the largest difference between the survey results and administrative data.¹⁶

Table 2.10. **Rate of compliance with social insurance schemes based on survey results (2005 EAPS Supplement)**

Percentages			
	Employment Insurance	Public Pension	National Health Insurance
Regular workers	63.8	75.7	75.9
Non-regular workers	34.5	36.6	37.7

Source: Kang (2005).

Table 2.11. **Compliance with the EIS, according to survey and administrative data^a**

Percentages		
	2005 EAPS Supplement	MoL administrative data
Total	53.1	77.3
Workplaces with less than five workers	15.2	64.0
Workplaces with five and more workers	62.5	80.5

a) Daily workers are not included in the administrative data from the Ministry of Labor.

Source: Ministry of Labor.

39. It is not surprising that there are also important differences in access to non-mandatory fringe benefits between regular and non-regular workers. Based on 2005 data collected by KLIPS on the beneficiaries of mandatory and non-mandatory benefits, Bahn (2006) comes to the conclusion that there are usually large differences in the availability of such benefits (including subsidised meals, education cost for children, housing support, child-care facilities, employee-ownership schemes, or life insurance) between regular and non-regular workers.

Training and human capital investment

40. One concern relating to the temporary workforce is the possible lack of investment in its human capital. To what extent do temporary workers in fact benefit from employer-provided training? Several hypotheses can be put forward. On the one hand, employers may provide less training to temporary workers knowing that they will leave the firm in the foreseeable future. On the other hand, employers would need to provide temporary workers with at least some minimal training, since they need orientation or start-up training to perform well on their jobs just like any other employee, and since some temporary jobs serve as a

16. In the same vein, concerning public health insurance and national pension insurance, Kim (2005) has estimated, based on analysis of data collected by the 2000 *National Survey of Household Income and Expenditure*, that about 9 out of 10 households whose main bread-winner worked in a non-regular job are covered by public health insurance and 1 out of 2 by the national pension. Both these shares exceed those reported in Table 2.10.

probationary period for permanent jobs. In addition, temporary work agencies may wish to provide training to workers they place with other employers, thus collecting information about the workers' abilities that are valued by their customers. In any event, OECD (2002), based on an assessment of training data available from several surveys, concluded that temporary employees receive less employer-provided training than permanent employees and that the training gap between temporary and permanent workers tends to be larger for formal training courses than for informal on-the-job training. Using pooled data for 12 European countries, the estimated effect of holding a temporary job was to reduce access to training by 6%.

41. Consistent with international research, several Korean authors have found a negative relationship between non-regular employment and investment in training. Chung and Lee (2004) estimate the impact of firms' flexibility-oriented personnel policies on labour turnover and training investment, using survey data from the *Workplace Panel Survey* (WPS) conducted by the KLI in 2002 and 2003, as well as establishment data obtained from the Employment Insurance Database. The analysis showed that in firms which tend to use more non-regular workers, labour turnover and the so-called "churning flow rate"¹⁷ are significantly higher, and that both have a negative impact on investment in training by employers. The authors conclude that there is a trade-off between flexibility-oriented personnel policies and investment in human capital.

42. Other analyses based on data collected through employee or employer surveys have produced similar results. For example, Jang (2001), based on analysis of data collected by the WPS on training for production workers in manufacturing industry, finds that manufacturing employers provide non-regular workers with fewer training opportunities. His results showed that 44% of responding companies provided training to regular workers, while the share of companies providing training to non-regular workers was only half of this in the case of full-time non-regular workers, and only about 5% for either part-time non-regular workers or temporary agency workers. Even larger differences were found by Ahn (2006), based on 2004 data collected by KLIPS: about 15% of regular workers, but only 2% of non-regular workers had participated in some job training over the previous 12 months.¹⁸

43. In sum, non-regular/temporary employees in Korea receive significantly less job training, not only compared with permanent workers in Korea itself, but also compared to temporary workers in other OECD countries. For example, according to the 2000 *European Working Conditions Survey*, 35% of workers under permanent contracts in EU-15 countries had received training paid for or provided by their employer over the past 12 months, while 31% of workers with fixed-term contracts had received such training (Eurofound, 2005).

E. Career dynamics

Job tenure

44. Tenure and job retention rates in Korea are well below OECD averages. Even for regular workers average tenure is about one year below that in the United States, and four to six years below the levels in the European Union and Japan (Martin *et al.*, 2005). One of the reasons is that in Korea tenure peaks at a lower age than in other OECD countries. For example, while Korean average job tenures are similar to

17. The *churning flow rate* is defined by the authors as the difference between the *worker flow rate* (the sum of the hiring rate and the separation rate) and the *job flow rate* (the sum of the job creation and job destruction ratios). It represents an indicator that "shows worker turnover which occurs in excess of the scope normally caused by changes in company size" (Chung and Lee, 2004).

18. The under-representation of non-regular and low-skilled workers in further education and training in Korea was confirmed in a recent review of adult learning practices undertaken by OECD (2005b). Overall participation rates in adult learning in Korea are also below the OECD average – the participation rate of about 9% found by the KLIPS survey compares with 34% in the 2000 European Labour Force Survey and 35% in the 1999 European Continuing Vocational Training Survey (Eurostat, 2002).

levels in the United States for men up to age 49, and for women up to age 34, they are consistently lower at higher ages (OECD, 2000 and 2004b).

45. Against this background, how does the duration of jobs compare between permanent and temporary employment? Table 2.12 shows that, both in Korea, in the European Union and across the OECD area, the majority of temporary jobs last only for a relatively short period. In Korea, 62% of temporary workers have been in their current jobs for less than one year, and only 18% more than three years. By contrast, permanent workers enjoy much longer job tenure – 30% have worked in their current jobs for less than one year and over 46% for more than three years (data based on the EAPS Supplement). When comparing job durations in Korea with those of other OECD countries, job tenure of temporary workers in Korea is only slightly shorter, while job tenure of permanent workers in Korea is significantly shorter than the OECD – and particularly the EU-15 average. Table 2.13, considering workers with job durations of over three years, confirms the slightly below-average position of Korea in terms of job tenure for temporary workers.

Table 2.12. **Distribution of job tenure for temporary and permanent workers**

		Percentages					
		Total	Less than 1 year	1-2 years	2-3 years	3-5 years	More than 5 years
Korea (2005)	Temporary workers	100.0	61.9	12.3	7.8	4.6	13.4
	Permanent workers	100.0	29.9	14.2	9.6	6.3	40.0
EU-15 average (2005)	Temporary workers	100.0	54.3	21.9		23.8	
	Permanent workers	100.0	9.6	11.2		79.2	
OECD average (2000)	Temporary workers	100.0	57.6	16.9	4.3	9.9	11.6
	Permanent workers	100.0	13.2	9.4	4.0	12.9	59.8

Source: EAPS Supplement, August 2005, for Korea; European Union Labour Force Survey for the EU average; and OECD (2002), *Employment Outlook*, Chapter 3, Paris.

Table 2.13. **Proportion of temporary workers with job tenure three years and over in selected OECD countries, 2005**

Percentages							
Switzerland	39.5	Poland	25.5	Netherlands	21.7	Luxembourg	13.9
Italy	31.3	Germany	24.5	France	19.6	Finland	13.1
Austria	29.8	Hungary	23.9	Norway	18.0	Ireland	11.8
Greece	29.3	EU-15 average^a	23.8	Iceland	17.7	Slovak Republic	6.5
United Kingdom	27.8	Portugal	23.2	Korea	17.0		
Czech Republic	27.1	Spain	23.2	Denmark	16.7		
Belgium	25.6	OECD average^a	21.9	Sweden	16.7		

a) Unweighted average of countries shown.

Source: EAPS Supplement, August 2005, for Korea; and European Labour Force Survey for other countries.

46. The large differential in average job duration between permanent (regular) and temporary (non-regular) employees was confirmed in a further study using the *KLIPS database* and focusing on employment duration at the moment of separation from a current job. This study found that the average job tenure of *separating non-regular workers* was 21.6 months, in comparison with 41.9 months for *regular workers* (Lee and Nah, 2003).¹⁹

19. The definition of non-regular workers used by the authors corresponds to definition D from the Annex (own definition by KLIPS). This definition seems to produce higher average tenures of non-regular workers than that of the EAPS Supplement.

47. In addition to labour demand and supply factors, countries' legislative provisions on maximum contract duration and number of renewals can strongly affect average job tenure of temporary employees. Up to 2007, Korean labour law contained no restrictions on renewals of fixed-term contracts.²⁰ By contrast, in a European *high-EPL* country such as France, only one prolongation of a fixed-term contract is possible, and the potential maximum duration is 18 months. While corresponding data from other OECD countries are not available, in Korea 55.4% of workers with fixed-term contracts (who represent the majority of the workforce defined as temporary) said in 2005 that they had experienced contract renewals.²¹ At first sight, this seems at odds with the high proportion of temporary workers with very short tenure; however, this high proportion may be due to their concentration in certain service industries such as *wholesale and retail trade, restaurants and hotels* and in small establishments.

Are temporary jobs stepping stones or dead ends?

48. A major factor in assessing temporary employment is whether temporary jobs are *stepping stones* towards more stable employment or *dead ends* that trap workers in continuing precariousness. To answer this question, it is necessary to look at the mobility of temporary workers into and out of temporary jobs. Some research results from Korea concerning the mobility of non-regular workers have recently become available. Although these show some variation depending on data sources and definition, overall the research suggests that a considerable proportion of non-regular workers may be trapped in this type of job.

49. Chun and Lee (2004) calculate the labour force status of wage earners over a period of four years using data collected by the KLIPS from 1999 to 2002. The results show that more than 90% of regular workers in year t continue to hold regular jobs four years later, and that as many as 44% of non-regular workers move into regular jobs within a year – a share that increases to almost two-thirds in year $t+4$. However, over one-third of non-regular workers remain in this employment status over the longer term (see Table 2.14).²²

Table 2.14. **Transition probabilities of temporary (non-regular) workers^a**

		Percentages				
		Transitions by economic activity status				
		Permanent (regular) employment	Temporary (non-regular) employment	Not employed	Self-employed	Education/ Training
Korea (1)	$t+1$	44.3	55.0	0.7	..	..
	$t+3$	59.5	40.2	0.3	..	..
	$t+4$	64.8	35.0	0.1	..	..
Korea (2)	$t+1$	15.0	58.8	16.0	5.9	4.3
	$t+1$	28.5	44.3	19.8	3.1	4.4
EU-15	$t+2$	41.4	32.4	19.5	3.3	3.5
	$t+4$	51.0	22.3	19.7	4.7	2.3
	$t+6$	55.0	16.4	20.7	6.4	1.5

.. Data not available.

a) Transition probabilities for Korea (1) are calculated using data collected by the Korea Labour and Income Panel Survey (KLIPS) from 1999 to 2002; those for Korea (2) are calculated using data collected by the Supplement to the EAPS, August 2003 and August 2004; and those for EU-15 are based on data from the European Community Household Panel from 1995 to 2001.

Source: Chun and Lee (2004) for Korea (1), Ministry of Labor for Korea (2); and European Commission (2004), for EU-15.

20. From July 2007, the maximum duration of fixed-term employment with one employer will be two years (see Section 4).

21. NSO Press Release, 19 October 2005, presenting the results of the August 2005 EAPS Supplement.

22. See definition D in the Annex.

50. However, an analysis of labour force status using panel data collected by the EAPS Supplement tends to show much more limited mobility of non-regular workers. According to this survey and the definition it uses (which is closer to the definition of temporary employment used by the OECD), between August 2003 and August 2004, only 15% of non-regular workers moved into regular employment while a similar proportion moved into non-employment and 3 out of 5 remained in non-regular employment (Table 2.14).

51. Other research calculating mobility on the basis of the regular EAPS shows even more limited transition rates.²³ Based on a statistical model for the period of 1993 to 1999, Nam and Kim (2000) analyse transition probabilities using the EAPS distinction between regular and non-regular employment. Their results suggest that the probability of non-regular workers to remain in that status in year $t+1$ is approximately 90% while the probability to move either into regular employment or into self-employment is below 2%, with the remainder transiting to unemployment or inactivity. Based on these results, the authors conclude that non-regular jobs rarely represent a bridge to regular employment.

52. One explanation for the different results emerging from research using either the EAPS or its supplement is that the EAPS definition of non-regular employment is broader. For example, the EAPS would tend to classify a temporary worker who moves into permanent employment at a small business still as non-regular, if the small business does not pay bonuses and/or the retirement allowance.

53. Since the evidence on temporary workers' mobility in Korea is inconclusive, it is difficult to judge how transition rates in Korea compare with those in other OECD countries. Table 2.14 shows that in the European Union (EU-15), over one-fourth of temporary workers in year t move into permanent jobs one year later and that the proportion increases to a bit over half in year $t+4$. Further, the proportion of temporary workers maintaining their employment status decreases from 44% after one year to 22% after four years, while the probability of moving into unemployment or inactivity is around 20%. Note, however, that there is significant international variation in transition probabilities (not shown in the table). For example, based on the *European Community Household Panel* and other national panel data, while more than half of temporary employees in 2000 were in permanent jobs one year later in the Netherlands, less than a quarter of temporary employees managed the same in France and Greece (OECD, 2006, Chapter 5). With above-average mobility shown by one data source, and the opposite pattern by others, it is not possible to situate Korea *vis-à-vis* these European countries.

54. One study on mobility by worker characteristics in Korea can be found in Yoo (2004) who, using standard EAPS data, calculates transition rates of non-regular male workers by education and age. According to Yoo, the probability of a *temporary employee* in year t to move into *regular-employee* status is 15% in year $t+1$, 21% in year $t+2$ year and 25% in year $t+3$ for workers aged over 40. In the case of younger workers aged under 40, the transition probabilities are quite similar for the low-skilled (below high school), but about twice as high for those with tertiary education.²⁴ Based on these findings, Yoo concludes that non-regular jobs can, to some degree, be a stepping-stone into regular jobs for youths and young adults with tertiary education, while older workers or younger workers with less education are likely to be trapped in non-regular jobs. However, it needs to be kept in mind that this study suffers, again, from the limits of the EAPS definition of employment status.

23. Based on definition A in the Annex, which may include many workers at small establishments.

24. Similarly, for 12 European countries OECD (2002) estimated that the probability of moving from a temporary to a permanent job was highest for medium to highly educated persons between the ages of 25 and 35 and employed by a medium- or large-sized firm in the private sector.

2.3. Explanatory factors for the growth of temporary employment

55. Theories on the reasons for the growth of temporary employment usually focus either on the supply or the demand sides of the labour market. Theories focusing on the former tend to emphasize demographic changes in the workforce, *e.g.* the increase in the number of older workers or the increasing labour market participation of married women who may prefer non-standard work arrangements. On the other hand, theories emphasising demand-side factors take note of companies' changing human resource management strategies: according to this view, the temporary workforce has grown because firms aim to increase flexibility and reduce labour costs in circumstances of fierce competition and uncertainty of product demand.

56. Most of the recent research in Korea focuses on demand-side factors. Changes in hiring and human resource management practices by Korean firms, which aim to increase the flexibility of their workforce so as to circumvent relatively strict employment protection for permanent workers and to profit from labour cost differentials between various worker categories, are singled out as factors explaining the growth of the temporary or non-regular workforce (Ahn, 2004; Hwang, 2003; Chun and Lee, 2004; and IMF, 2004). In particular, large companies that underwent restructuring (including the 30 largest *chaebols*) reduced their workforce by 20% and changed the composition of their remaining staff (Kim and Cheon, 2004). Some research also argues that militant activities of labour unions have played an important role in the growth of non-regular work (see Park *et al.*, 2006; IMF, 2004; OECD, 2005*a*; and discussion further below).

57. The KLI's 2002 Workplace Panel Survey, which collected data on changes in human resource management practices, also shows that Korean firms increasingly favour external hiring over internal promotion and hire more and more under fixed-term contracts. This survey collected data on the reasons why firms hire non-regular workers; the main factors cited turned out to be *more flexibility of employment* (30.3%) and *reduction of labour costs* (32.1%) (Ahn, 2004). Broken down by industry, representatives of manufacturing gave primacy to workforce flexibility, while firms from non-manufacturing industries stressed the role of labour costs. Small and medium enterprises (SMEs) focused on the need for reducing labour costs, while large enterprises cited a flexible workforce as the most important factor (Table 2.15).

Table 2.15. **Reasons for hiring non-regular workers, 2002^a**

	Percentages				
	Labour costs	Flexibility	Peripheral tasks	Short-term tasks	Others
All industries	32.1	30.3	18.5	13.9	5.2
Manufacturing	28.7	34.5	17.9	14.7	4.1
Non-manufacturing	35.4	26.1	19.1	13.2	6.2
Firms with					
Less than 30 workers	35.5	28.9	15.8	13.2	6.6
30-99 workers	28.5	27.6	18.7	18.2	7.0
100-299 workers	37.7	26.2	15.5	14.3	6.3
300-499 workers	34.3	29.4	19.6	12.7	3.9
500 workers and more	26.1	39.9	22.9	9.6	1.6

a) Analysis of replies from 832 firms employing non-regular workers, collected by the Workplace Panel Survey.
Source: Cited from Ahn *et al.* (2003).

3. INSTITUTIONAL BACKGROUND TO LABOUR MARKET POLICY IN KOREA

58. This section discusses some institutional features behind labour market policy in Korea. First, two major factors which are often considered to contribute to labour market duality are examined: *i*) the relative strictness of employment protection legislation; and *ii*) wage practices and labour-management relations. Next, the section discusses the social safety-net and the public employment service as two key labour market and social policy institutions that, when functioning efficiently, can help reduce the significance and consequences of labour market duality. Finally, the issue of undeclared work is presented as a key characteristic of the current labour market in Korea and a contributor to labour market precarity.

3.1. Employment Protection Legislation (EPL)

59. Employment Protection Legislation (EPL) is a set of regulations governing the hiring and firing process. Although EPL aims to secure job stability, thereby enhancing workers' welfare, there is also the concern that it causes undue labour market rigidity and damages labour market performance. Economists emphasise that strict EPL makes firing workers expensive, and high firing costs reduce firms' incentive to hire. Since the mid-1980s, a number of OECD countries, particularly those with strict EPL, have eased their regulations with the purpose of lowering unemployment by enhancing labour market flexibility. However, deregulation has been concentrated on EPL for temporary forms of employment while existing provisions for regular employment have been largely left unchanged.²⁵ The most common reform has been to facilitate the use of fixed-term contracts and to relax restrictions on temporary agency work. One significant example of EPL reform is Spain, and the Spanish experience suggests that deregulation of temporary employment, while maintaining strict EPL for regular employment, can lead to a strongly segmented or dual labour market. At the same time, it probably contributed to the significant employment growth that Spain has enjoyed since the late 1980s (see Box 3.1).

60. OECD (1999; 2004*c*, Chapter 2) assessed the strictness of EPL for regular and temporary employment in OECD countries and estimated its relationship with labour market outcomes.²⁶ Importantly, no statistically significant relationship between EPL strictness and the unemployment rate was found. Findings also include that EPL strictness for regular employment has a positive relationship with the incidence of temporary employment and a negative relationship with the transition rate from temporary to permanent contracts (Figure 3.1). This would suggest that stricter EPL for regular employment (in particular heavy procedural inconveniences linked to lay-offs) tends to increase the incidence of temporary employment and to limit the extent of conversion from a temporary to a permanent contract. This finding is consistent with theoretical predictions.

25. Only four OECD countries are considered as having undertaken comprehensive reforms governing both permanent and temporary employment: Portugal and Spain (during the 1980s and 1990s) and the Slovak Republic and New Zealand (in 2000 and after) (OECD, 2004*c*, Chapter 2).

26. The OECD's index of EPL strictness for regular employment covers eight indicators relating to the procedures involved in individual dismissal, notice and severance pay provisions, and additional provisions governing collective dismissal. The index for temporary employment covers restrictions on fixed-term contracts and temporary agency work.

Box 3.1. EPL reform in Spain

The Spanish labour market was long an extreme case among OECD countries. Spain suffered from one of the highest unemployment rates in the OECD area, while being among the countries with the strictest EPL and the highest effective levels of severance pay for permanent workers. Such a high degree of employment protection against dismissal can be traced back to the so-called Workers' Statute (*Ley del Estatuto e los Trabajadores*) from 1980. Under this act, collective dismissals were allowed for technological and economic reasons, but were in fact rarely used by firms up to the 1990s, because of the need for prior administrative approval which involved long time delays.

The law also made severance pay dependent on job tenure and, in case of appeal, on a judge's decision on fairness of dismissal. The judge may declare dismissals *fair*, *unfair* or *null*. If the dismissal is declared *fair*, the worker will receive severance pay of as much as 20 days' wages per year of tenure with a maximum of 12 months' wages. In case the dismissal is declared *unfair*, the worker will receive up to 45 days per year of service, with a maximum of 42 months' wages. If the dismissal is *null*, the worker can be reinstated and all wages during the lay-off period will be fully paid. In practice, employers have tended to pay the higher severance amount in order to avoid a legal appeal or to more easily obtain administrative approval for collective dismissals.

In an atmosphere of trade union militancy and persistently high strike rates in the late 1970s to early 1980s (after the country emerged from the Franco dictatorship), real wages increased sharply, employment stagnated, and unemployment rose from relatively low levels to over 20%. Unemployment was concentrated on youths who were unable to find a place in the labour market – at the time, the youth unemployment rate reached up to 36%. After much discussion about excessive employment protection, as well as recommendations from international organisations that firing costs should be reduced, the Spanish government in 1984 significantly eased restrictions on fixed-term contracts, extending their maximum duration and minimizing restrictions on redundancies. By contrast, despite a reform of severance pay in 1997, EPL for permanent workers continued to be among the strictest in the OECD area.

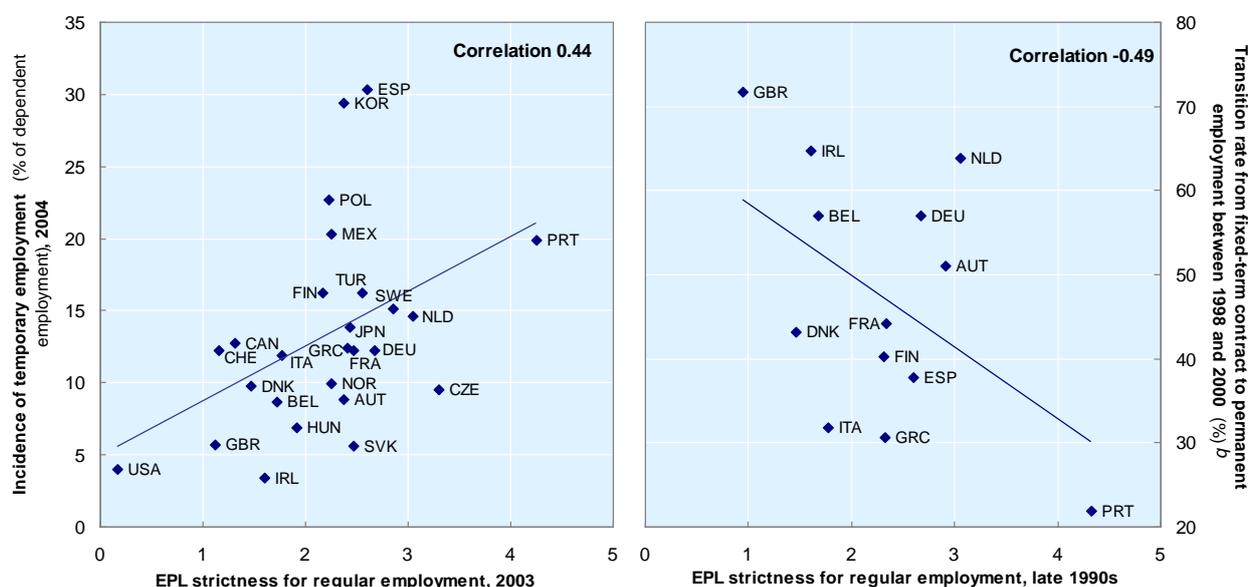
Just after relaxation of EPL for temporary employment, the proportion of temporary workers began to increase rapidly from about 15% in the mid-1980s to 35% in the mid-1990s. During this period, more than 95% of newly hired workers were temporary workers and the conversion rate from temporary to permanent contract was extremely low. While the unemployment rate initially remained high, since the 1990s recession Spain has enjoyed a long economic boom, accompanied by a fall of unemployment to below 9% in 2006. Also, by 2006 the employment rate reached 66%, 19 percentage points higher than in the mid-1980s – the greatest improvement achieved by any OECD country over this 20-year period. The relaxation of EPL for temporary employment is certainly one important factor behind these labour market developments; to a certain extent it has transformed the previous Spanish unemployment problem into one of labour market duality.

Since the mid-1990s, the Spanish government has undertaken a series of labour market reforms to tackle the surge of temporary employment. These reforms tried to achieve a more *balanced* situation by restricting the use of temporary contracts, on the one hand, and by reducing firing costs under permanent contracts, on the other. In particular, a new type of permanent contract introduced in 1997 reduced the maximum amount of severance pay in case of unfair dismissal to 33 days per year of service, with a maximum of 24 months pay (but only for certain groups of new hires, not for existing personnel). Further, the categories under which fixed-term contracts can be concluded were tightened, severance pay at the end of a temporary contract was introduced and all existing financial incentives for temporary employment were abolished (except for the handicapped).

Indeed, hiring under permanent contracts has increased and the incidence of temporary employment has declined by several percentage points since 1995, with a stronger decline in the private sector partly offset by an increase of temporary contracts in public service (due mainly to fiscal restrictions and an increase in ALMP posts).

Source: Dolado *et al.*, 2002; Kugler *et al.*, 2002; IMF, 2004; OECD, 2001*b*, and 2005*c*.

61. OECD (2004*c*) suggests that the relative difference in the strictness of EPL between regular and temporary employment constitutes an incentive for employers to hire on temporary contracts, and that it may have a different impact across particular groups of workers. For youth and the low-skilled, the larger this difference, the higher is the incidence of temporary work. By contrast, no relationship was found for prime-age men, women and older workers.

Figure 3.1. **Strictness of EPL and the incidence of temporary work^a**

a) Incidence of temporary employment refers to 2005 for Korea and for the United States.

b) Share of workers aged 25 to 64 years with a fixed-term contract in 1998 who have a permanent contract in 2000.

Source: OECD (2004c), *Employment Outlook*, Paris, Chapter 2 (revised EPL figure for the Slovak Republic); and OECD Temporary Employment database.

62. In Korea, a major EPL reform took place in 1998. First, EPL for regular employment was relaxed by introducing the concept of redundancy dismissal for “urgent managerial needs” and, second, EPL for non-regular employment was eased by allowing temporary agency work. OECD (2004c, Chapter 2) has assessed Korean EPL for permanent and temporary work in comparison with other OECD countries. As to permanent employment, it ranks Korea somewhat above average among OECD countries in terms of strictness, at about the same level as Austria, Greece and Japan (but below France, Sweden and Germany). Korea’s EPL classification reflects a number of protective provisions including:

- Relatively strong procedural requirements and long consultation periods with employee representatives;
- The need for employers to make verifiable efforts to avoid dismissal and apply certain standards in selecting employees to be laid off;
- Generous severance pay regardless of the circumstances of termination.²⁷

63. Korea was also ranked above average in terms of EPL strictness for temporary work. However, the different types of temporary employment (fixed-term contracts and temporary agency work) are regulated in quite an unbalanced way. In the case of fixed-term contracts, the Labour Standards Act contains no restrictions for firms with less than five employees. In larger firms, the law allows (up to 2007, see Section 4.1 for recent legislative changes) contracts of up to one-year duration, but there is no restriction of contract renewal and no specification of a need for objective reasons (which is necessary in many European countries). Although, as elsewhere in the OECD, several successive renewals run the risk

27. The OECD ranked Korea low on severance pay since the retirement allowance is not, strictly speaking, a *firing cost* as it needs to be paid to all terminated regular employees. However, for the purpose of the present analysis, it is an important EPL feature that sets regular workers apart from most temporary ones.

of a court declaring the contract null and void, the Korean courts have not been too rigid on this issue and employers have in the past faced no major difficulty in renewing fixed-term contracts and employing temporary workers *de facto* for long time periods (OECD, 2000). In contrast to this relatively soft regulation on fixed-term contracts, legislation on temporary agency work is quite restrictive in that temporary agencies are allowed (up to 2007) to operate in only 26 specified occupational areas – quite different from most other OECD countries, where temporary agency employment is now allowed as a general principle, with only a few specified exceptions.

64. There have been conflicting arguments in Korea concerning the nature of the 1998 EPL reform. Some analysts and trade unions have argued that the reform, whose purpose was to enhance labour market flexibility and ease economic restructuring, has caused rapid growth of temporary or non-regular employment. By contrast, employer circles tend to argue that the reform was not sufficient to provide firms with enough incentives to hire under regular contracts, and therefore request continued easing of EPL for permanent workers. Social and economic research in Korea also takes different views as to the role that strict EPL has played in the growth of temporary or non-regular employment.

65. There is little direct evidence to support the argument that the 1998 reform has caused or aggravated labour market duality. While the reform permitted temporary agency work, it left regulations on fixed-term contracts unchanged. The available data, however, indicate that temporary agency work still represents only a small share of the labour force, while fixed-term contracts have been responsible for most of the growth in temporary employment (see Table 2.4).

66. Some Korean literature, as well as reports by the IMF (2004) and OECD (2005a), rather provide evidence for the argument that the 1998 reform failed to provide firms with enough incentives to hire on regular contracts. Indeed, the mandatory requirements for redundancy dismissal, such as “making every effort to avoid dismissal”, and holding “sincere consultations” with trade union representatives, are considered quite restrictive by Korean firms. To circumvent these requirements (in particular to avoid objections by trade unions), Korean firms still tend to rely on *honorary retirement*, although this is a more expensive measure. IMF (2004) even maintains that the 1998 reform has made redundancy dismissal more difficult since the law prescribes stricter procedural requirements than previously set by the courts. However, this argument might be misleading. Before these reforms were legislated, Korean firms had argued that court rulings permitting redundancy dismissal could not provide firms with sufficient reliability since they applied to individual cases differently and thus could not be a substitute for legislation which applies uniformly to all cases. Also, *de facto* Korean courts have not always strictly enforced the procedural requirements enacted in 1998.

67. As noted above, OECD (2004c, Chapter 2) found that the relative difference in EPL strictness between regular and temporary employment can be an important element in explaining the growth of the temporary labour force. The same case can be made for Korea, where EPL is composed of relatively soft regulation on fixed-term contracts and strict protection of permanent employment (as well as tight control of temporary agency work). Therefore, it seems plausible to assume that the easy use of fixed-term contracts may have provided incentives to hire temporary workers for firms which, particularly when emerging from the financial crisis, were interested in reducing labour costs and/or increasing the flexibility of their labour force. At the time, one of the main objectives pursued by Korean firms was the reduction of excessive corporate debt and to pursue this objective, they focused more than ever on increasing the flexibility of their human resources and reducing their labour cost by *i*) hiring temporary workers, and *ii*) subcontracting or outsourcing work to other companies and individual contract workers.

3.2. Wage determination practices and labour-management relations

68. In the view of many analysts, trade union power plays an important part in the segmentation of internal and external labour markets. The insider-outsider theory, for example, notes that unionised employees, as insiders, are given labour market power *via* the high labour turnover costs associated with firing of incumbent workers and hiring and training new employees. In this view, trade unions represent the interests of their members rather than non-members, and seek to extract rents from employers *via* a union wage premium (Lindbeck and Snower, 1994 and 2002). Using the same analytical approach, Hwang (2003) emphasises that in Korea trade union activities have contributed to the emergence of rigid internal labour markets, and as a result, firms have pursued a strategy of employment externalisation with a view to increasing flexibility of staff use.

69. Indeed, the 1987 democratisation movement had seen the emergence of a strong independent trade union movement in key sectors of the economy. Within a few years, the number of unionised firms tripled and enterprise unions were able to achieve substantial wage increases through militant shop-floor activities. This led to the emergence of a culture of confrontation in industrial relations which is still prevailing today, although union membership itself is in decline and the movement is highly fragmented and characterised by inter-union rivalry (OECD, 2000; and Lansbury and Wailes, 2005).

70. A number of Korean researchers agree that confrontational labour relations have at least a partial responsibility for the increase in labour market duality (Chun and Lee, 2004; and OECD, 2005a). Employers are said to react to militancy and confrontational attitudes by using more non-regular workers as a *union-avoidance* strategy. This type of research is by no means restricted to Korea. As temporary employment has increased in a number of countries, research has analysed the effects of trade union activities and unionisation rates on externalisation practices and job precarity in international comparison. However, these studies have produced ambiguous and even contradictory results: while some demonstrate a positive relationship between trade union strength and the incidence of temporary or non-standard types of employment, others have yielded negative correlations between the two factors (Uzzi and Barsness, 1998).

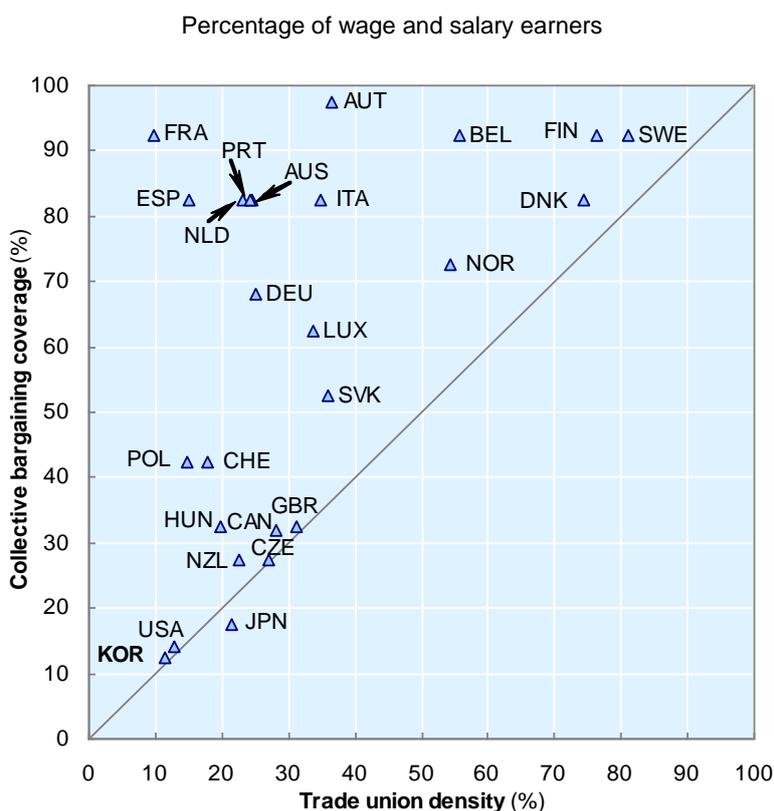
71. Korean research has produced similarly conflicting results. For example, Kim (2003) concludes (based on analysis of data from the KLIPS survey) that a firm's probability of using non-regular workers decreases with trade union strength. By contrast, both Park *et al.* (2006) and Ahn *et al.* (2003) report (based on analysis of WPS data) a positive relationship between the use of non-regular workers on the one hand, and the existence of a trade union or the unionisation rate, on the other.

72. These contradictory results may reflect the ambiguous attitudes of labour unions towards the use of temporary or non-regular workers (Lee and Kim, 2003; and Park *et al.*, 2006). In Korea, most organisation of labour unions and collective bargaining occurs at enterprise level. Enterprise unions, by improving working conditions for their members – often exclusively regular workers – give firms an incentive to employ non-regular workers. On the other hand, to some extent labour unions also seek to limit or prevent increased use of non-regular workers and to improve their working conditions, although this attitude seems to be more predominant at the level of the national labour federations (FKTU and KCTU) rather than among enterprise unions themselves.

73. Park *et al.* (2006) (based on an analysis of WPS data) found that local unions are more oriented to pursue their own interests and that any demands or activities of unions to protect non-regular workers at their enterprise remain limited. For example, most enterprise unions surveyed refuse to organise non-regular workers as members. Collective agreements signed by trade unions and employers often do not extend to non-regular workers (although the situation varies considerably by industry and individual firm). As a result, in some branches non-regular workers are now increasingly trying to establish their own separate trade unions.

74. According to information provided by the Ministry of Labor, only 5% of non-regular workers, but 17% of regular workers, are trade union members. All worker categories combined, trade union density, at little more than 10%, is very low in Korea. This is also true for the coverage by collective bargaining (Figure 3.2). As of 2000, Korea ranked second-to-last in trade union density (above France), and last in bargaining coverage among all OECD countries for which data are available (OECD, 2004c, Chapter 3).²⁸ However, trade unions remain firmly entrenched in key sectors of the economy, particularly in large enterprises.

Figure 3.2. **Union density and coverage in OECD countries, 2000**



Source: OECD (2004c), *Employment Outlook*, Paris, Chapter 3, Chart 3.4, Table 3.3, and Annex 3.A1.

75. In conclusion, trade unions and wage bargaining structures have contributed to the (growing) extent of wage differentials in Korea, both by company size and by regular/non-regular worker status. Section 2.2 above has shown that temporary workers are not only paid less than permanent workers, but also have limited access to mandatory and non-mandatory employee welfare benefits. Such labour cost differentials may encourage firms to hire on temporary employment contracts, particularly in those sectors where employee loyalty to the firm and human capital formation are less emphasised.

76. For background, Table 3.1 presents evidence on Korean firms' labour costs, broken down by establishment size. On average, direct labour costs, *i.e.* wages and salaries, represent almost 80% of total labour costs, while severance pay (mainly the retirement allowance), mandatory social insurance and non-mandatory fringe benefits (housing subsidies, educational costs for children, childcare, etc.) each

28. France ranks lowest on trade union density (10%), but among the highest on collective bargaining coverage (over 90%), together with Austria, Belgium, Finland and Sweden. This is the result of legislation promoting collective bargaining, and of extension mechanisms (OECD, 2004c, Chapter 3).

represent between 5% and 7% of total labour costs. The share of indirect labour costs rises with establishment size, mainly due to the increasing share of severance pay. If firms with less than 10 employees were included in the data, the comparative share of severance pay would be very low, since it is mainly in these firms that temporary and non-regular workers are concentrated (see Table 2.8) and since firms with less than five employees do not need to pay the retirement allowance. More generally, it needs to be kept in mind that the share of the non-wage component in total labour costs in Korea is still considerably lower than in many other OECD countries, in particular due to lower social insurance contributions, so that direct pay levels will tend to play a more important role in hiring than mandatory non-wage labour costs.

Table 3.1. **Composition of monthly labour costs by establishment size in Korea, 2005**

	Total	10-29 workers	30-99 workers	100-299 workers	300-499 workers	500-999 workers	1 000 workers and more
Monthly labour costs, total (in thousand KRW)	3 221	2 388	2 537	2 623	3 325	3 627	4 611
	(100.0)	(100.0)	(100.0)	(100.0)	(100.0)	(100.0)	(100.0)
Direct labour costs	(79.8)	(81.1)	(80.8)	(79.9)	(79.5)	(79.0)	(79.0)
Indirect labour costs	(20.2)	(18.9)	(19.2)	(20.1)	(20.5)	(21.0)	(21.0)
Severance pay	(6.9)	(5.8)	(6.4)	(7.9)	(8.2)	(9.0)	(6.5)
Mandatory benefits	(6.5)	(6.9)	(6.5)	(6.5)	(6.4)	(6.5)	(6.3)
Non-mandatory benefits	(5.5)	(5.7)	(5.6)	(5.0)	(4.7)	(4.4)	(6.0)
Education and training costs	(0.8)	(0.2)	(0.3)	(0.4)	(0.7)	(0.8)	(1.5)
Other indirect costs	(0.5)	(0.4)	(0.5)	(0.3)	(0.6)	(0.4)	(0.6)

Source: Survey on Labour Cost, 2005, Ministry of Labor.

77. Historically, Korea has chosen to base its collective bargaining system on the enterprise. This particular labour market feature explains in part the country's large wage differentials.²⁹ Although there is a current trend of transforming enterprise unions into industry-level organisations,³⁰ industry-level bargaining has remained rare, due to Korean employers' reluctance to shift to industry-wide negotiations, to the existing large differences in wage level among firms in the same industry, and to the historical autonomy of strong enterprise unions. Presently, industry bargaining occurs mainly in the financial, textile, transportation and to some extent the metal industries.³¹

3.3. The state of the social safety net

78. An important issue in analysing labour market duality is the extent to which it is affected by a country's social safety net. Most OECD countries offer both unemployment and social assistance benefits.

29. The wage differential between the 90th and the 10th earnings percentile ($D9/D1$) in Korea in 2005 was the third largest after Hungary and the United States according to OECD estimates (see www.oecd.org/els/employment/stats).

30. According to administrative data published by the Ministry of Labor, a little less than one-third of all unionised workers are now members of industry-level trade unions (43% of KCTU members and 16% of FK TU members). However, this does not necessarily imply that these workers actually bargain at industry level.

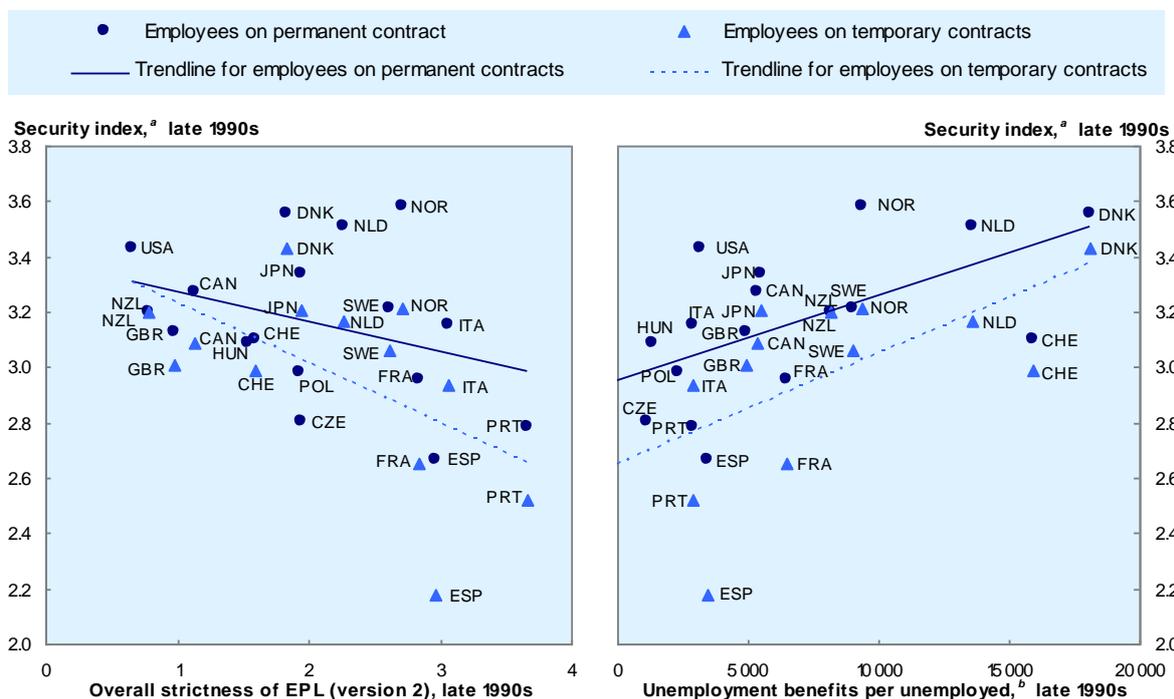
31. Much research has tackled the relationship between bargaining structure and employment performance. Decentralised bargaining, it is argued, can produce good employment performance through higher skill premia and greater responsiveness of wages to local conditions, but also tends to contribute to higher wage inequality. Centralised or co-ordinated bargaining systems may also support high employment, but coupled with lower overall wage inequality because of the responsiveness of aggregate wage demands to macroeconomic conditions. OECD (2004c, Chapter 3) found that wage inequality is lowest in countries where union membership and bargaining coverage are high, and where bargaining is centralised and/or co-ordinated.

Unemployment benefit is based on an insurance principle – the unemployed need to have contributed to an insurance fund for a specified time period in order to be eligible for benefits. For those unemployed who have exhausted unemployment insurance (UI) benefits or who are not entitled to them, social assistance (SA) and in some countries also unemployment assistance (UA) are available. SA is meant to ensure a last-resort, minimum standard of living. The main eligibility criterion relates to available resources of the household.

79. In Korea, the social safety net providing income security for the unemployed is sometimes conceived as consisting of three layers – the Employment Insurance System (EIS), the National Basic Livelihood Security System (NBLSS), and the public works programme (Kim and Cheon, 2004). The latter element had been very much expanded at the time of the financial crisis, but was significantly reduced again as the number of unemployed fell from the high 1998/99 levels, and as the EIS and the NBLSS were progressively strengthened. Therefore, income security is mainly guaranteed by the EIS representing social insurance and the NBLSS representing social assistance. Despite some strengthening of both benefit systems in recent years, in international comparison the social safety net in Korea is still underdeveloped, which explains in part the strong resistance of workers to dismissal and which contributes to concern about the precarious labour market status of temporary workers.

80. Indeed, employment security and income security after job loss have a complementary relationship, and a well-knit benefit system can enhance workers’ perception of employment security. This is confirmed by Figure 3.3 which shows that generous unemployment benefits tend to have a positive relationship with workers’ perceptions of employment security. This relationship also holds for temporary employees who, however, in every country surveyed feel less secure than permanent workers.

Figure 3.3. **Unemployment benefits and workers’ perception of employment security, late 1990s**



Note: The Pearson correlation coefficient for EPL is -0.35 for permanent contracts and -0.57 (significant at the 5% level) for temporary contracts. Regarding unemployment benefits per unemployed, it is 0.58 for permanent contracts and 0.59 for temporary contracts (both significant at the 5% level).

- a) Average answer, by country, to the following question from ISSP "Do you worry about the possibilities of losing your job?" – Scale from 1 (I worry a great deal) to 4 (I don't worry at all).
- b) Expenditure on unemployment compensation divided by LFS unemployment.

Source: Data on security index taken from the International Social Survey Programme 1997 (ISSP); OECD database on Labour Market Programmes; OECD Labour Force Statistics database. The particular ISSP survey did not cover Korea.

A. *The Employment Insurance System (EIS)*

81. The Korean Employment Insurance System – composed of unemployment benefits, employment subsidy programmes and vocational training – was only introduced a decade ago, in 1995. The EIS initially covered only workers in establishments with more than 30 workers, but in 1998 eligibility was expanded to all workplaces to address the problem of mass unemployment due to the financial crisis. Eligibility has also been extended in several steps to all non-regular workers. Workers with fixed-term contracts for less than three months were included in 1998, and daily workers³² were included in 2004. Further, eligibility has been extended to part-time workers in two stages.³³ The EIS now in principle covers all wage and salary earners in all establishments except for *a*) part-time workers working less than 60 hours a month (or 15 hours a week), *b*) government officials and employees subject to the Private School Teachers' Pension Act, and *c*) workers over age 65.

82. Despite this rapid expansion, the proportion of wage and salary earners actually insured by the EIS remains rather limited. As Table 3.2 shows, the percentage eligible for the EIS has increased from 33% in 1995 to 81% in 2005. However, as eligibility was extended to small establishments and daily workers, enforcement became more difficult. The rate of contribution compliance among eligible workers remained at about three-quarters for some years, and fell back in 2004 when eligibility was extended to daily workers. According to administrative data (see Table 2.11), the compliance rate (not counting daily workers) in 2004 was around 80% in workplaces with five and more workers, and 64% in workplaces with less than five workers. For daily workers, the average compliance rate in 2004 was less than a quarter, although it continues to rise. Reflecting these factors, according to the administrative data in Table 3.2 the proportion of all wage and salary earners who are insured remained around half from 1999 to 2003 and rose to reach 57% by 2005.

Table 3.2. **Coverage of Employment Insurance**

Number of workers in thousands, and in percent

	1995	1999	2000	2001	2002	2003	2004	2005
Wage and salary earners	12 824	12 603	13 142	13 265	13 932	14 672	14 584	15 185
Eligible for EIS	4 280	8 342	8 700	9 269	9 269	9 651	12 389	12 011
Actually insured	4 204	6 876	6 747	6 884	7 102	7 180	7 905	8 663
Eligible (<i>% of wage and salary earners</i>)	33.4	66.2	66.2	69.9	66.5	66.0	84.9	79.1
Insured (<i>% of eligible workers</i>)	98.2	70.4	77.6	74.3	76.6	74.4	63.8	72.1
Insured (<i>% of wage and salary earners</i>)	32.8	46.6	51.3	51.9	51.0	49.1	54.2	57.0
Proportion of unemployed receiving benefits	..	13.5		16.0	17.7	19.1	23.6	27.3

Source: Ministry of Labor, administrative data from EI database; and EAPS. See also OECD, 2007c, p. 142.

83. Table 3.2 also shows that the proportion of unemployed who receive unemployment benefits from the EIS has increased steadily from 1 in 8 in 1999 and 2000 to over 1 in 4 by 2005. This percentage nevertheless remains lower than in most OECD countries.³⁴ Apart from the relatively low proportion of

32. Daily workers are defined as those hired for less than one month.

33. Eligibility was extended to part-time employees working over 80 hours a month (or 18 hours a week) in 1998, and to those who work over 60 hours a month (or 16 hours a week) in 2004.

34. The figure for the percentage of unemployed who receive benefits in Korea is taken from administrative sources. Vroman and Brusentsev (2005) report the ratio of unemployment benefit recipients to unemployed persons in labour force surveys in the 1990s. These ratios ranged from 0.34 in the United States and 0.38 in Japan, to over 1.0

wage and salary workers who are insured, other reasons for the low percentage of unemployed who receive benefits include the high share of self-employed in the labour force, the strict treatment of voluntary quits, and the low maximum duration of unemployment benefits (see also Hwang, 2004a).³⁵

84. The maximum potential duration of benefits in Korea, depending on the age and contribution period of the unemployed individual, is between 90 and 240 days. The average actual duration of benefits paid to claimants was 114 days in 2004 (Table 3.3). This average duration has stabilised between 112 and 114 days since 2001, but is expected to increase from 2005 when the insured period of many workers first exceeds 10 years. As shown in Table 3.4, for a 40-year-old worker with a 22-year employment record the maximum duration of unemployment insurance benefits in Korea is seven months. The comparable maximum duration is shorter in the Czech Republic, Italy, the United Kingdom and the United States, but much higher in most European countries.³⁶

Table 3.3. **Maximum and actual duration of unemployment benefits**

Age	Days					Actual duration (2004)
	Maximum duration					
	Insured period (years)					
	6-12 months	1-2 years	3-4 years	5-9 years	10 years and over	
Less than 30	90	90	120	150	180	85.8
30-49	90	120	150	180	210	111.1
50 and over	90	150	180	210	240	150.5

a) In 2004, among 157 000 total recipients, 36 000 (23%) were aged less than 30, 85 000 (54%) were aged 30 to 49, and 36 000 (23%) were aged 50 and over. The average actual duration of unemployment benefits was 114.3 days.

Source: Ministry of Labor, administrative data from EI database.

85. Average replacement rates in Korea are in most cases below the OECD average. The minimum contribution requirement, to the effect that the claimant be insured in the EIS for no less than 180 days over the 18 months preceding the date of unemployment, is similar to that in Japan and most Western European countries where a contribution record of 6 months or more over a period of 1 to 3 years is usually needed. The minimum contribution period is a bit lower in Canada (630 hours) and the United States (20 weeks) (Grubb, 2005; and OECD, 2005d). Further, the Korean EIS is relatively strict in cases of voluntary quit: an unemployed person who left a job voluntarily is not entitled to any benefit. In many other OECD countries, benefits can be paid after a sanction or benefit suspension period of 2 to 4 months (OECD, 2000).

86. Labour market behavioural conditions for benefits in Korea are similar to those in other OECD countries, since claimants must be available for work and actively looking for a job. Benefit claimants must visit the PES between once a week and once every four weeks and give proof of at least one job-search action during the previous period. However, the incidence of benefit sanctions for insufficient job-search activity or refusal of a job or a training offer is very low. Enforcement is probably lax, related to low staff/client ratios, the comparatively short potential benefit period, and the low incidence of long-term unemployment which reduces the need for more intensive, personalised follow-up. Also, the early re-employment allowance in the EIS provides an incentive to find a job quickly. If unemployment benefit recipients find a job which is expected to last for at least six months, they are paid half of the

in Austria, Ireland and the Netherlands. Some typical shares in Eastern European countries, where unemployment insurance (like in Korea) was introduced more recently, were 0.13 in the Ukraine and 0.39 in Bulgaria.

35. On the other hand, the low rate of exit from benefit prior to exhaustion would have the effect of increasing benefit coverage in Korea.

36. In Australia and New Zealand, there is no UI benefit, but only assistance benefit.

unused unemployment benefit (or all of the unused benefit when taking a job in certain specified occupations). More than one in six recipients of unemployment benefits were paid the re-employment allowance in 2004.

Table 3.4. **Unemployment insurance (UI) benefit duration and replacement rate, 2002, 2004**

Case of a 40-year-old worker with a 22-year contribution record

	Maximum benefit duration, 2002 (Months, equivalent initial rate ^a)	Ages at which UI duration increases, 2002	Unemployment benefit replacement rate, 2004 ^b
Japan	8	30, 45, 60	60
Korea^c	7	30, 50	51
Asia	8		
Australia	..	..	31
New Zealand	..	..	37
Canada	9	No	62
United States	6	No	62
Anglo-Saxon, non-Europe	8		
Ireland	15	18	30
United Kingdom	6	No	45
Anglo-Saxon Europe	11		
Denmark	48	Duration decreases after age 60	61
Finland	23	55	60
Norway	36	61	66
Sweden	28	No	77
Nordic Europe	34		
Austria	9	40, 50	55
Belgium	No limit	No	63
France	30	50, 55	73
Germany	12	45, 47, 52, 57	77
Netherlands	24	Increase after long contribution record	71
Switzerland	24	No	70
Central and Western Europe	19		
Greece	12	Minor changes by age in some cases	48
Italy	6	50	54
Portugal	24	30, 40, 45, 50, 55, 60	78
Spain	21	No for UI, 52 for UA	69
Southern Europe	16		
Czech Republic	5	No	50
Hungary	9	No	43
Poland	12	Minor changes by contribution record	52
Slovak Republic	8	Contribution record over 15 years	64
Eastern Europe	9		

.. Data not applicable.

a) Applies to the Czech Republic, Spain and the Slovak Republic, where the benefit level declines during the UI period.

b) Data are adjusted for taxation. They relate to the average of net replacement rates faced by single persons without children with pre-unemployment earnings of 100% of the average production wage. They relate to the initial phase of unemployment, but following any waiting period. No social assistance "top-ups" are assumed to be available.

c) See Table 3.3 for increases in UI duration by length of contribution period.

Source: OECD (2004d), *Benefits and Wages: OECD Indicators*; *Benefits and Wages* country chapters (www.oecd.org/els/social/workincentives); and OECD (2007d), *Benefits and Wages: OECD Indicators*, forthcoming.

87. Table 3.5 suggests that around 70% all exits from EIS benefits occur through benefit exhaustion. Korean research (see for example, Hwang, 2004b and 2005) concludes from this that the effectiveness of PES job placement is low. However, the high figure may also reflect non-declaration of jobs by EIS beneficiaries (this is discussed further below). In this case, measures to minimise undeclared work are also needed, since PES placement will usually only propose declared jobs.

Table 3.5. **Proportion of EIS beneficiaries who found a job before exhausting benefit entitlement and who exhaust benefit entitlement before finding a job**

	Total beneficiaries during the year ^a	Exited benefit before exhaustion				Exhausted benefit ^b
		Total	Within 30 days	30-90 days	90 days or longer	
2002	<i>366 770</i> 100.0	17.9	4.1	7.9	5.8	47.0 (72.4)
2003	<i>423 729</i> 100.0	17.1	4.3	7.8	5.1	45.8 (72.8)
2004	<i>577 672</i> 100.0	19.6	5.5	8.6	5.6	47.6 (70.8)
2005	<i>680 758</i> 100.0	21.7	6.0	9.9	5.8	49.1 (69.4)

a) Including those in a spell that started the previous year and those whose spell did not end during the year.

b) Figures in brackets and italics represent the share of benefit exhaustees among all exits.

Source: Ministry of Labor.

B. The National Basic Livelihood Security System (NBLSS)

88. The NBLSS is the main social assistance scheme in Korea. It provides the poor with livelihood assistance along with medical care, educational and housing assistance as the last-resort social safety net for all citizens. Several features of the NBLSS differ from the Livelihood Protection Programme which it replaced in 2000. In the old scheme, prime-aged persons between 18 and 60 were considered able to work and therefore disqualified from applying for benefits (unless pregnant or handicapped). In the NBLSS, this eligibility condition was removed, and those whose estimated income (based on income and assets) falls below the minimum cost of living qualify for benefits. The minimum cost of living is recalculated every year by the Ministry of Health and Welfare, and livelihood assistance and housing assistance are paid in cash to compensate for the difference between estimated income and the minimum cost of living. Beneficiaries who are able to work are now categorised as *conditional beneficiaries* and, in order to receive benefits, are required to participate in so-called self-support programmes which are designed to help them get out of poverty and prevent unnecessary dependency on social assistance. These are usually run by municipalities; however, they can also be contracted out to public or private agencies (Lee, 2004; and Kim, 2005).³⁷

89. Under the NBLSS, all those aged 18 to 64 who are not prevented from participating in self-support programmes because of disability, pregnancy or study are categorised as conditional beneficiaries. Social workers assess their ability and willingness to work and establish self-support assistance plans for them. Ability and willingness to work are assessed by means of a scoring system, based on age, health, education, work history and other considerations such as family background, etc. Following this assessment, self-support programmes are recommended. Beneficiaries with a low score are required to do volunteer work in the local community, while high-score clients are categorised as *beneficiaries to be employed*.

37. Starting from 2004, the Korean government allows people whose income slightly exceeds the minimum living costs to participate in the self-support programmes on a voluntary basis.

90. People classified in the latter category, who have been assessed as having the ability and willingness to get a job in the private labour market, are sent over to the PES, and PES job counsellors are supposed to establish individual action plans with them through in-depth interviews. Employment services include vocational training and self-support employment promotion programmes. In order to facilitate co-operation between municipalities and the PES and streamline the registration and follow-up of beneficiaries, a *Council of Self-Support Institutions* was established, and the two separate computer networks – the municipal welfare administration system and the employment service's *Work-Net* – have been linked.

91. With the introduction of the NBLSS in 2002, the annual average stock of livelihood assistance (cash benefit) recipients increased from 370 000 in 1997 to 1.55 million, while the benefit levels also increased considerably. However, NBLSS recipients still represent only 3% of the total population (OECD, 2004a). Only 6% of its caseload is registered as unemployed.³⁸ This implies that there are about 100 000 unemployed recipients of the NBLSS and therefore that about 16% of the unemployed are covered by NBLSS in addition to the 27% who are covered by EIS. Thus, a majority of the unemployed receive neither EIS nor NBLSS payments. They may live on other family income, assets, student grants or other income sources, including undeclared earnings although the extent of this is not known.

3.4. The PES and Labour Market Programmes

92. In response to the steep rise in unemployment following the 1998 financial crisis, the Ministry of Labor established a new nationwide employment service network called Employment Security Centers (ESCs), replacing the ineffective previous public service, which had long played only a modest role in the job placement market. Over the space of just a few years, the number of employment offices expanded substantially. The set-up of PES functions as a *one-stop service* follows policy recommendations by the OECD in its original Jobs Study (1994) which recommended the integration of the three core PES functions – *i*) job brokerage; *ii*) unemployment benefit administration; and *iii*) referral to active labour market programmes – in order to enhance the effectiveness of labour market policies. Currently, the ESCs take charge of all three core functions, along with the granting of foreign worker permits. Meanwhile, EIS premiums, together with Industrial Accident Compensation Insurance premiums, are collected by the Labour Welfare Corporation.

93. Since the last comprehensive review by the OECD of the Korean employment service (OECD, 2000), a number of changes have been made to the PES system, although the most significant reform package was not launched until 2005. These changes include the integration of the so-called Manpower Banks (offices created during the financial crisis, co-managed with provincial governments) into the ESC chain. In addition, special employment offices operated by the Ministry of Labor for daily workers in the construction trades have been phased out.

94. Meanwhile, municipalities and local governments continue to provide employment services through their Job Information Centres. The Ministry of Labor decided to strengthen co-operation with these local government agencies and to expand financial assistance to them, rather than merging the two office chains (as had, for example, been suggested by the 2000 OECD review). The Ministry argued that municipalities had a relative advantage *via* their proximity to local residents and that they can receive support from ESCs to make up for their insufficient expertise in placement issues. The Ministry of Labor and municipalities share the internet-based employment information system (*Work-Net*), so that the staff working at ESCs and Job Information Centers can access the same information on vacancies and jobseekers.

38. According to the profile of NBLSS recipients published by the Ministry of Health and Welfare, in 2004 about 77% of recipients aged 15 and over were inactive, 17% were employed, and 6% were unemployed.

95. Table 3.6 throws some light on the significant improvement of PES performance in recent years. For example, the PES radically improved its market share by increasing the proportion of registered vacancies and placements among total annual hirings in the economy. It also seems to succeed in filling vacancies received from employers at a better rate than previously. However, in comparison with many other OECD countries, there remains room for further improvement. For example, in the best-performing OECD countries the PES has a considerably higher market share among total vacancies and total hirings in the economy (OECD, 2001*b*, Table 3.7). One factor is that vacancies registered at the PES in Korea tend to be for jobs in manufacturing and in business services. According to administrative data, almost half of total vacancies registered in 2005 were jobs in manufacturing and an additional 13% were jobs in the business service industry, while the share of the labour force in these industries combined was only around 25%. In other service industries, which represent a majority of employees, the market share of the PES is limited.³⁹ In addition, more than three quarters of all vacancies registered with PES offices are for regular workers. More than four out of five temporary workers are employed in service industries, and less than one out of six in manufacturing (see Table 2.8). Thus, the lack of PES presence in the service industry also implies a limited role of the public service in helping non-regular workers find jobs.

Table 3.6. **PES market share in Korea, 1995, 1998 and 2005**

	1995	1998	2005
Administrative data (000s)			
<i>Annual vacancy registrations</i>	130	335	866
<i>Annual placements</i>	12	138	415
Labour market data			
<i>Dependent employment (000s)</i>	12 740	12 190	15 185
<i>Monthly hiring rate^a (approximate)</i>	2.7	1.7	2.4
Derived indicators (%)			
<i>Placement/registered job vacancies</i>	9	41	48
<i>Registered job vacancies/ dependent employment</i>	1	4	6
<i>Placements/dependent employment</i>	0	1	3
<i>Registered job vacancies/ hirings</i>	3	13	20
<i>Placements/ hirings</i>	0	6	9

a) The monthly hiring rate in 2005 refers to the first half of the year and is based on hirings in firms with five employees and more, while rates for the 1990s are from a survey on firms with 10 employees and more.

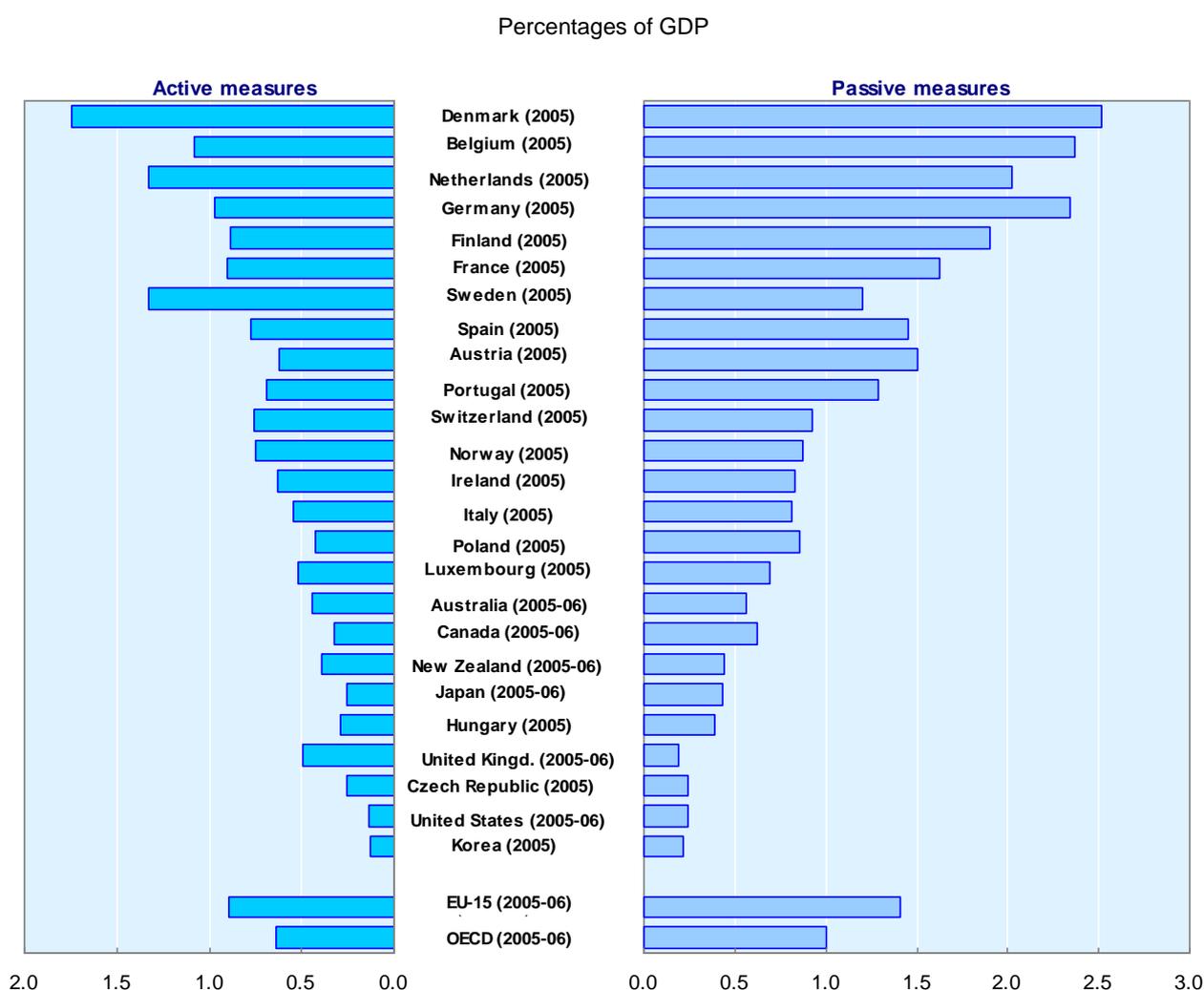
Source: Ministry of Labor; and OECD PES database.

96. Korean employment services remain understaffed compared to other OECD countries, and the low staff/client ratios are likely to decrease their effectiveness. In 2006, a total of 2 800 staff were working at 97 ESCs across the country, implying a ratio of PES staff to the total labour force of 1 to 8 000, and of staff to unemployed of 1 to 300. These ratios need to be much improved considering that those in high-income OECD countries are often below 1 to 1 000 and 1 to 100, respectively. Good staff/client ratios are important for *activating* the unemployed and following up on their job-search strategies. Considering that total PES staff in Korea includes staff working on benefits and in support positions, in all likelihood less than half of total staff are employment counsellors or placement officers in direct contact with unemployed clients, so that by this definition staff to unemployed ratios are closer to 1 to 700-800. This is in contrast to the situation in the Netherlands, for example, where this ratio is close to 1 to 65. Similarly, in Germany recent legislation has set targets of 1 to 75 for youths and 1 to 150 for adults (Tergeist and Grubb, 2006).

39. For example, the share of vacancies received in wholesale and retail trade, restaurants and hotels was around 12%, while this industry's share in total employment is over one-quarter, and its share in hirings is likely to be higher (due to high turnover).

97. Meanwhile, public expenditure on labour market policies in Korea as a percentage of GDP is the lowest among the 25 countries shown in Figure 3.4. This reflects not only the low Korean unemployment rate, but also the fact that expenditure per unemployed person (both active and passive) is below the OECD average. As elsewhere, active labour market policies (ALMPs) in Korea consist of training programmes, wage subsidies, and job creation in the public sector (public works programmes). All these programmes – in particular public works which were criticised for insufficient targeting, and training for the unemployed which suffered from high drop-out rates – have been significantly cut back since 2000. Instead, a new programme, called the *social jobs programme*, has recently been introduced, which aims to create jobs in the non-profit sector. There have also been efforts to clarify the target groups of wage subsidy programmes. Overall, there is a need to continue efforts to enhance the effectiveness of ALMPs, to effectively coordinate ALMPs with the administration of unemployment benefits (a task that will become increasingly important as the share of benefit recipients increases), and to implement coherent *activation* strategies for the unemployed registered with employment offices.

Figure 3.4. Active and passive labour market measures in OECD countries,^a 2005-06



a) For Greece, Iceland, Mexico, the Slovak Republic and Turkey, only incomplete data were available.
Source: OECD database on Active Labour Market Programmes.

3.5. Undeclared employment

98. *Undeclared* or *informal* employment falls outside taxation, social insurance and other regulations. The EU's *European Employment Guidelines* call for undeclared employment to be converted into regular employment, since it damages tax revenues and social security contributions, and leads to a loss of legal jobs through unfair competition. The *OECD Employment Outlook* (OECD, 2004c, Chapter 5) emphasises, along with the two points specified by the EU, that in a number of middle-income OECD countries a majority of disadvantaged workers are in informal employment and as a result most labour market policy measures cannot reach them, and that informal employment is often a trap which offers few career prospects – in short, it contributes to labour market precarity.

A. *The incidence of undeclared work in Korea*

99. Although there is no simple and reliable way to measure the incidence of informal employment, several methods can be used to estimate it. According to results from survey-based and national accounts-based estimates, the incidence of informal employment in many high-income OECD countries is 5% or less, while in other OECD countries including Korea, Mexico, Southern European countries, and some transition countries in Eastern Europe, it appears to be several times higher. As regards wage and salary workers, OECD (2004c, Chapter 5) compared the theoretical liability for social security contributions based on wages and salaries in the National Accounts and detailed contribution schedules (as reported in OECD, *Taxing Wages*), with actual receipts of contributions (reported in *OECD Revenue Statistics*). This suggested the overall shortfall in receipts in Korea, Hungary and Mexico in 2000 was more than 30%, as compared to a situation where contributions are paid on all wages and salaries.⁴⁰

100. Although in Korea only about 50% of all wage and salary workers were covered by the EIS in 2000 (see Table 3.2 above), higher percentages of workers are covered by the larger Public Health and National Pension systems, and non-covered workers are likely to have relatively low earnings. From this point of view, the estimated 30% shortfall in contributions seems to be an overestimate.

101. However, shortfalls in contributions received can also arise from under-declaration of earnings by employees who make some contributions. In Europe reporting of earnings at or near the minimum wage when true earnings are higher seems to be common in some countries. Given the low minimum wage (29% of the average wage in manufacturing in 2005), the percentage of workers paid the minimum wage in Korea (8.8%; see Table 4.1 below) seems surprisingly high. Under-declaration of earnings may be a factor in this high reported incidence of minimum-wage employment.⁴¹

102. In 2003, 10.6 million workers, 74% of total wage and salary earners, submitted income tax returns. This is far more than the number of workers insured by the EIS. The amount of wages reported in tax returns

40. Stanovnik and Fultz (2004), in analysing the collection of pension contributions in Central and Eastern Europe, apply the similar concept of the *covered wage bill*, which is the hypothetical amount of wages that would generate the contributions actually collected. Their study estimates that the covered wage bill as a percentage of GDP ranges from 16% in Romania to 41% in Croatia, with intermediate values for Hungary, Poland, and Slovenia; in more developed economies the ratio normally exceeds 50%.

41. For comparison, World Bank (2004) considers that Korea in recent years has achieved a low poverty rate. In the Netherlands and Portugal with minimum wages of around 60% of the average manufacturing wage, only about 4% of employment in the late 1990s was at the minimum wage (OECD, 1998). Eurostat (2007) reports that the percentage of employees receiving the minimum wage exceeds 5% only in France and Luxembourg (which have a high ratio of the minimum to the average wage) and Eastern European countries.

was about 85% of wages and salaries in the national accounts.⁴² The 3.8 million workers who did not report their wages to the tax authority are estimated to include about 2.1 million daily workers, who are exempted from the obligation to submit a tax return, and 1.7 million other low-paid workers. Although all workers except daily workers are legally required to submit an income tax return, some low-paid workers, whose income tax is calculated to be negative (based on the *Simplified Tax Table* used for monthly withholding of income tax by employers), are not submitting tax returns in practice.

B. Undeclared work and the PES

103. Given that a high proportion (still over 40% in 2005; see Table 3.2 above) of wage and salary workers do not pay EIS contributions and a lower but still high proportion do not submit an income tax return, unemployed workers – especially those who have been working in a sector that has many non-regular jobs – will have many opportunities to work an undeclared wage and salary job. Also, since nearly 30% of non-agricultural workers in Korea are self-employed and family workers, low-paid employees will often also have opportunities for working in a family business or a friend's business.

104. According to PES statistics (Table 3.5 above), in 2005 about 69% of exits from benefit occurred through benefit exhaustion. Assuming an average initial entitlement of about 4 months, this implies that as few as 9% on average leave benefit each month $[(0.91)^4 = 0.69]$. At the same time, according to labour force survey statistics, in years after 2000 about 10 to 13% of all unemployed have been unemployed for 6 to 12 months and only 1 to 2% have been unemployed for more than 12 months. This implies that as many as 33% of the unemployed on average leave labour force survey unemployment each month – which is several times higher than the rate of exit from insured unemployment.⁴³ This suggests that those who exhaust their unemployment benefit may often not be truly unemployed: it seems unlikely that benefit disincentives alone can account for the low rate of exit from unemployment benefit.

105. As noted above, PES job vacancies relate mainly to regular jobs. Employers who are offering undeclared work will usually not notify vacancies to the PES. A reduction in the incidence of undeclared work seems to be a precondition for the PES to become more effectively involved in job-matching in the low-wage and non-regular labour market.

42. This estimate appears in a 2005 joint report by the Ministry of Health and Welfare, Ministry of Labor, National Tax Office, and the Presidential Committee on Social Inclusion, *Unified Application and Premium Collection for Social Insurances* (in Korean).

43. Hur (2001) cites an average monthly outflow rate from unemployment of 21% in 1998, at the depth of the economic crisis.

4. POLICIES TO ADDRESS LABOUR MARKET DUALITY

106. Labour market duality has become one of the key issues in the Korean political debate. Most of this debate seems to be dominated by a concern with social equality, job insecurity and discrimination, coupled with the more recently emerging issue of *polarisation* in income distribution. However, labour market duality should be addressed not only for reasons of social equality, but also of economic efficiency, in particular due to the high level of labour and job turnover that it produces, and to its potentially negative impact on human capital accumulation and, therefore, productivity.

107. In recent years, the Korean government has introduced a number of measures and policy proposals to address labour market duality, ranging from anti-discrimination legislation to revisions of EPL, and to the expansion of the social safety net described in the previous section. However, these measures have been rather fragmented, resulting in few synergy effects. In addition, some reform measures have met with strong objections from trade unions and/or business groups, due to which certain legislative initiatives – such as the recent legislation to reverse the trend towards temporary employment – were blocked for a considerable time in the National Assembly. Further improvements of the employment prospects and working conditions of non-regular workers are needed, and the government's comprehensive plan adopted in the fall of 2006, which includes a series of measures to tackle labour market duality, indicates that it intends to move further ahead on this issue.

4.1. Rebalancing EPL for regular and non-regular employment

A. Revising EPL for non-regular workers

108. The Korean Tripartite Commission (a tripartite institution for social dialogue, recently renamed the Economic and Social Development Commission) in 2001 began to discuss potential revisions to EPL for non-regular employment, but no agreement could be reached because of widely diverging positions among the parties involved (mainly labour unions, business and national government). In late 2004, the Korean government – despite the lack of an agreement in the Commission – submitted a series of draft bills on employment conditions of non-regular workers to the National Assembly. Through these bills, the government intended to stop discrimination against non-regular workers and prevent their overuse by firms, in particular by tightening regulations on fixed-term contracts. On the other hand, they aimed to ensure a degree of labour market flexibility by easing restrictions on temporary agency employment (see Box 4.1).

109. The draft bills met with strong objections from both trade unions and business organisations. Trade unions argued that the measures did not go far enough toward their goal of restricting the use of temporary employment. In particular, they wanted the principle of “equal pay for work of equal value” enshrined in the law, and wanted fixed-term contracts to be allowed only for a *reasonable cause*. In addition, they objected to any extension allowing temporary agency work beyond the 26 occupations specified in the current legislation. By contrast, employers argued that the proposed restrictions to the maximum period for fixed-term contracts would aggravate labour market rigidities and thus, in the final analysis, hamper employment creation. In addition, they pointed out that the proposed complaint mechanism (direct appeal to the Labor Relations Commission) would result in costly and time-consuming litigation.

Box 4.1. The 2006 non-regular workers legislation

The Korean government, in November 2004, submitted two draft bills on non-regular employment to the National Assembly: *i)* the Act on the Protection of Fixed-term and Part-time Employees; and *ii)* the Act on the Protection of Dispatched Employees. After considerable debate, these bills were finally passed in December 2006. Their main contents are as follows:

- Employers are obliged to establish a written contract when hiring fixed-term and part-time workers (written contracts for temporary agency workers are already mandatory under the existing Act on the Protection of Dispatched Employees).
- The maximum period to hire workers on fixed-term contracts *without a reasonable cause* is limited to two years (three years in the original government draft), except that there is no maximum period for older workers aged 55 and over and certain categories of professionals. If the person is still on the job at the end of the two-year period, the fixed-term contract will be regarded as a permanent contract.
- Overtime work by part-time workers is limited to 12 hours a week.
- Temporary agency workers will need to be hired by the user company if they have continuously worked with this company for over two years. Allowable jobs for temporary agency work will be set in a more flexible manner by Presidential Decree.
- Discriminatory treatment of non-regular workers – workers on a fixed-term contract, part-time workers and temporary agency workers – is prohibited. Workers can submit complaints against discriminatory treatment relating to wages and working conditions to the Korean Labor Relations Commission, where employers are responsible for proving that their treatment is not discriminatory.
- The Acts are in principle effective as from July 2007. Provisions on discrimination will be introduced gradually by enterprise size from 2007 to 2009.

110. The National Assembly indeed made efforts to respond to the criticisms, mainly in the direction of trade union arguments. The bills, as modified by the Assembly's Environment and Labor Committee, further restricted the government's original provisions on the use of fixed-term contracts by limiting the maximum period from three years to two years.⁴⁴ Also, the original government plans to extend the possible use of temporary workers, from 26 occupations at the time to all occupations other than those expressly forbidden, were blocked although in the end the Assembly decided to allow the list of allowable jobs to be expanded by Presidential Decree. As a result of the legislative package passed in late 2006, employers are unhappy with what they consider further reductions in their flexibility of staff use, while some trade unions remain dissatisfied with the lack of precision on the equal pay issue and call for the further reduction of contract length to a one-year maximum. To overcome this general lack of consensus, a tripartite Committee has been set up to design and implement measures to complement the non-regular workers bills.

B. Revising EPL for regular workers

111. Modifications to employment protection provisions for regular employment were proposed separately in the *Roadmap for Industrial Relations Reform* in the fall of 2003, and also were passed by the Assembly in late 2006. The new provisions provide employers with some more flexibility in dismissals:

44. A 24-month maximum for cumulated contract duration is also the case in, *inter alia*, Germany, Greece and Spain, while the Netherlands, Portugal and the United Kingdom have maximum periods of between three and six years and some countries do not regulate maximum cumulated duration at all (always with the caveat that in case of successive renewals of the same type of job, a court may find the contract *null and void*) (OECD, 2004c, Chapter 3).

- The requirement of a 60-day notice period to employee representatives in case of dismissal (in addition to the 30-day advance notice to the worker himself) is shortened to 50 days – the original proposal had been to differentiate (*i.e.* mainly shorten) the notice periods depending on the size of the dismissal;
- Penal provisions (imprisonment up to five years) for unfair dismissal are replaced by financial penalties;
- Employers can agree with workers unfairly dismissed on monetary compensation instead of re-instatement.

112. These measures are intended to reduce the cost involved in firing regular/permanent workers. However, they do not tackle the generous severance pay (retirement allowance) provisions or the requirements to “make every effort” to avoid dismissal and to turn to previously dismissed workers first in case of new recruitment. Also, they will not tend to affect the “honorary retirement” practices which go beyond legal requirements. This said, the proposed shortening of notice periods is a welcome step, as is the focus in the Act on speedy remedies, since the existing remedy procedure against unfair dismissal often involves an excessively long period of time before the final court decision is reached. As pointed out in OECD (2006, Chapter 3), at any given level of EPL strictness, it is important to enhance efficiency by reforming the implementation of these regulations so that they are quick and predictable. Experience in the Netherlands shows how shorter procedures with more predictable outcomes may be preferable to employers compared to more uncertain procedures, even if higher amounts of severance pay may be involved (Box 4.2).

Box 4.2. EPL in the Netherlands and Austria

The *Netherlands* provides an interesting illustration of the importance of predictable timing and outcomes of EPL proceedings for employers. Dutch dismissal law is governed by a “dual system”. On the one hand, an employer can dismiss a worker without severance payment, provided that the employer has received prior permission to do so from the designated public authority, the Centre for Work and Income (CWI). However, this procedure is slow and its outcome is uncertain in two respects: *i)* the CWI may deny the request; and *ii)* workers dismissed under this procedure may seek compensation for wrongful dismissal or reinstatement in the courts.

Since the 1970s, an employer can opt instead to petition a sub-district court to dissolve the employment contract under the provisions of the Civil code. The court checks the request’s validity and, if the contract is dissolved, the court usually imposes severance compensation to be paid by the employer. In practice, the court method is much quicker and the severance awards are substantial, but quite predictable. Whereas in the late 1980s less than 10% of the requests for dissolution of contract were submitted to the courts, this proportion had grown to about half in 2002. This example shows that employers prefer quick procedures with predictable outcomes to more uncertain, although less expensive, procedures.

Another OECD country that recently undertook major EPL reform is *Austria*, which transformed its severance pay system into one of an individual savings account in 2003, thus converting unpredictable firing costs for employers into a predictable cost of regular employment. Under the old system, severance was paid to employees in the event of termination of the employment contract by the employer as long as the employee had worked for the employer for at least three years. The payment increased in graduated steps with the length of service, ranging between two months and (after 25 years) one year’s pay.

Since 2003, employers contribute about 1.5% of the payroll to each worker’s individual savings account (managed by a fund that invests the balance in private capital markets), from the first day of employment until contract termination. The accumulated balance in the account is carried over to the next job. Only employees with at least three years of job tenure have the option of receiving a lump-sum severance payment from the account in the event of dismissal. Alternatively, the balance in the account can be cumulated by the employee over an entire working life, functioning as a form of retirement saving. From the employers’ standpoint, the new system suppresses the specific monetary costs of a dismissal and the uncertainty related to this payment at the time of hiring. However, the contributions to the individual accounts increase their regular (non-wage) labour costs. From the employee’s standpoint, the new system reduces the cost of job mobility, since entitlement to severance pay is not lost when quitting to take a new job.

113. Taken together, the legislative package (the non-regular workers bills and the industrial relations roadmap) seems to increase somewhat the overall level of employment protection regulation in Korea – particularly since the original government approach of balancing out tightening of fixed-term contracts with far-reaching liberalisation of temporary agency work had to be abandoned. Some critics fear that the bills may reduce total employment. However, at this stage it is impossible to predict the impact on employment levels with any certainty. In any event, Korea should take care not to further increase the overall strictness of employment protection. After all, most research on EPL comes to the conclusion that stricter EPL tends to decrease the employment opportunities of both youth and women, even if the effects on overall employment levels are considered ambiguous (OECD, 2004c, Chapter 2). The challenge of diminishing labour market segmentation by both making the hiring of permanent workers more attractive and tightening the use of temporary employees remains on the Korean policy agenda.

C. *Reforming severance pay*

114. Severance pay is an important component of firing costs and therefore a major element of EPL strictness. In Korea, firms are obliged by law (the Labor Standards Act) to pay a *retirement allowance* of at least one month's wages per year of service to all workers with over one year's tenure, regardless of the reasons for termination (*i.e.* also to voluntary quits). The worker's final wage, including bonuses, is used to calculate the allowance, which was made mandatory in 1961 for companies with over 30 employees, and in 1989 for those with over five employees. Many rounds of collective bargaining have even increased the amount to over one month's salary per year for employees with long service.

115. Thus, by itself the allowance does not increase dismissal costs over other termination costs.⁴⁵ Nevertheless, although it may be argued that the existing regulation is an incentive to longer-term employment and can foster employee loyalty and trust, in fact it has encouraged firms to employ temporary workers with short tenure and discouraged them from keeping workers more permanently. This is for two reasons. First, firms are exempted from the obligation to pay the retirement allowance to workers who leave after less than a year. Second, employers are increasingly trying to avoid the seniority-based wage scheme, where the basic wage tends to increase steeply with tenure.

116. Reforms of the severance pay system have been debated for a long time in Korea, particularly since the introduction of a national pension scheme in 1988 and of the EIS in 1995. However, after social dialogue on this issue within the Tripartite Commission was not successful, in 2004 the government introduced a Corporate Pension scheme, effective as from December 2005. The key elements are as follows:

- The existing retirement allowance scheme can be converted to a corporate pension scheme, based on agreement between labour and management. Both a defined-benefits scheme and a defined-contribution scheme are possible, again to be decided by labour/management agreement;
- Under the defined-benefits scheme, the benefits payable should be equal to the current amount of severance pay, while under the defined-contribution scheme the employer's annual contributions should be equal to 1/12th of the employee's total annual wages;
- Employees moving between jobs can accumulate their lump-sum severance payments in an *individual retirement account*.

117. Since the set-up of a corporate pension scheme and establishment of an "individual retirement account" is not mandatory, the government has introduced tax incentives to encourage the conversion. For

45. Employees or trade unions may in practice still negotiate higher payments for a dismissal than for a voluntary separation, but the extent of such a differential is unknown.

employers, all contributions to the corporate pension scheme are treated as business expenses. For employees, any income tax is deferred to the time of withdrawal from the pension scheme or retirement account, and the tax-exempt portion of the pension is quite substantial while that for the traditional lump-sum retirement allowance has been considerably reduced.

118. From the employer's point of view, the corporate pension scheme transforms more or less unpredictable firing costs into a predictable cost of employment, particularly in the case of the defined-contribution scheme. This can mitigate the employer's financial cost at separation and reduce the related disincentive for hiring permanent workers. However, the new scheme has so far had limited impact, since the conversion from severance pay to a corporate pension scheme is not mandatory, and the number of enterprises joining the scheme has remained relatively low. Workers with tenure of less than one year and workers in enterprises with fewer than five employees are still not entitled to join the corporate pension scheme – the same cut-offs as for the retirement allowance – so that employers may still feel encouraged to hire workers on short-term contracts.⁴⁶ Thus, the Korean reform of severance pay is much more timid and has had much less of an impact so far than the Austrian reform, which also replaced lump-sum severance payments with individual accounts (see Box 4.2).

119. The Korean government is aware of the need for EPL reform to address labour market duality. However, for an efficient reform a more comprehensive approach would seem to be needed. If, as argued above, the difference in relative EPL strictness between permanent and temporary forms of employment is important, then Korea would have to further relax EPL for permanent employment, after having tightened the laws governing the use of fixed-term contracts, so that overall EPL does not become stricter. However, the recent revisions in temporary contract regulations in Korea have not been effectively linked with EPL for regular workers, and the corporate pension scheme has not fully responded to the need for comprehensive EPL reform and for a reduction in labour market segmentation. Making the corporate pension scheme mandatory for all enterprises would be a big step in the direction of a “comprehensive approach” to labour market duality.

4.2. Narrowing wage differentials while maintaining wage flexibility

120. Policies in OECD countries aiming to reduce wage differentials between temporary and permanent workers who perform equivalent work can include legislation on equal treatment and/or equal pay between different labour market groups; minimum wage legislation; and clauses in collective agreements which ensure the automatic application of their terms and conditions of employment to temporary workers. These factors vary widely across OECD countries.

A. *Anti-discrimination legislation*

121. The Korean bills on non-regular employment passed in 2006 include provisions against discriminatory treatment relating to wages and working conditions between non-regular and regular workers, who work in the same or similar jobs in the same enterprise (see Box 4.1).⁴⁷ This principle is roughly equivalent to the approach taken by the European Directive 99/70/EC of May 1999 (which corresponds to a text previously agreed by the social partners at European level). The Directive also intends to curb the excessive use of fixed-term contracts, to improve the quality of work of temporary employees and to outlaw discriminatory treatment (see Box 4.3).

46. The Act envisages an extension of the entitlement to join the corporate pension scheme to small enterprises between 2008 and 2010.

47. The National Labor Relations Commission is designated as the body responsible for determining the existence of such discrimination.

Box 4.3. The 1999 European Council Directive on Fixed-term Work (excerpts)

Clause 1: The purpose of this framework agreement is to:

- a) Improve the quality of fixed-term work by ensuring the principle of non-discrimination;
- b) Establish a framework to prevent abuse arising from the use of successive fixed-term employment contracts or relationships. [...]

Clause 4: In respect of employment conditions, fixed-term workers shall not be treated in a less favorable manner than comparable permanent workers solely because they have a fixed-term contract or relation, unless different treatment is justified on objective grounds. Where appropriate, the principle of *pro rata temporis* shall apply.

Clause 5: To prevent abuse arising from the use of successive fixed-term employment contracts or relationships the Member States, after consultation with the social partners, must introduce one or more of the following measures (taking account of the needs of specific sectors and/or categories of workers):

- Objective reasons justifying the renewal of such contracts or relationships;
- The maximum total duration of successive fixed-term employment contracts or relationships;
- The number of renewals.

Clause 6: As far as possible, employers must facilitate access for fixed-term workers to appropriate training opportunities to enhance their skills, career development and occupational mobility.

Clause 7: Fixed-term workers must be taken into consideration in calculating the threshold above which workers' representative bodies may be constituted.

122. The two Korean trade union federations had requested that the principle of “equal pay for work of equal value”⁴⁸ be prescribed explicitly in the Act on the Protection of Fixed-term and Part-time Employees, but the draft bill at the National Assembly did not contain this particular language since the government argued that the principle as such was well represented in the text. Only a few OECD countries (*i.e.* Belgium, France and Spain) have enacted legislation that explicitly requires temporary workers to be paid the same wages as equivalent permanent workers (OECD, 2002). It is interesting to note that the European Directive on Fixed-term Work does not make explicit reference to this principle, although it can be argued that it is contained *de facto* in Article 4 of the Directive, as well as other European Union instruments.⁴⁹

123. Anti-discrimination legislation is expected to reduce *unreasonable* or unjustified differences in wages or benefits between permanent and temporary workers. Its application may be relatively straightforward in cases where non-regular workers are, for example, openly denied the fringe benefits that a company provides its regular workforce. However, the complex, seniority-based wage structure prevalent in Korean firms will make it difficult in practice, even in the presence of anti-discrimination legislation, to determine unjustifiable wage differentials between employee categories, since wages are composed of a basic salary depending largely on seniority, and a number of different allowances whose entitlement varies for different purposes. Employers may well argue that some specific allowances are paid as remuneration for long-term service, rather than for the job currently performed. Therefore, changes in wage determination systems are one precondition for reducing discriminatory practices in Korean firms.

48. At present, the principle of *equal pay for work of equal value* is prescribed in the Gender Equal Employment Act in Korea.

49. Among these are Article 141 (formerly Article 119) of the original EC treaty, and the 1975 Equal Pay Directive.

B. *Modernisation of the wage system*

124. The 1997 financial crisis led to a 10% cut in real wages, showing that there is a high measure of wage flexibility in Korea. In particular, bonuses vary closely with the economic cycle (OECD 2000; and Kim and Cheon, 2004). However, as regards *basic pay*, recent surveys by the KLI and the Korean Employers' Federation show that a system based on rigid, seniority-based wage steps remains dominant in Korean enterprises (KOILAF, 2005; and KLR, 2006). Skills components and performance-based pay are of comparatively little importance. Among the reasons given by surveyed firms for not introducing more performance-pay elements was that they lacked managerial resources or technical know-how relating to the assessment of individual worker productivity. Also, wage determination based solely or mainly on seniority-based wage steps is most prominent in unionised companies and in the public sector.

125. The Korean seniority-based wage system leads not only to a reluctance of employers to hold on to older workers, but also contributes to the wage differentials between temporary workers, who have low tenure, and permanent workers. The government is aware of the need for reforms, but it has limited leverage on wage systems chosen in the private sector. Tripartite efforts seem most promising in this area. In the 2004 *Social Pact for Job Creation*, trade unions, businesses and the government agreed to establish the Wage and Job Research Center within the Korea Labour Institute, which aims to modernise enterprise wage schemes. This Center, which is financially supported by the government, is currently developing various models of skills- and performance-based wage schemes and aims to diffuse these models through providing consulting services to firms, operating regional innovation networks and holding forums and seminars to promote best practice. The Korean government offers financial support to employers who use these consultation services.

C. *Minimum wages*

126. Minimum wages could potentially have a considerable impact on wage differentials. In Korea, the level of the minimum wage has remained moderate since its introduction in 1988: the ratio of the minimum to the average wage in manufacturing first declined from around 30% to about 22% in the late 1990s, but subsequently the minimum rate increased by over 10% annually on average to reach about 28% of the average manufacturing wage in 2005. However the ratio of minimum to average or median wages in Korea is still among the lowest in OECD countries (Table 4.1; and OECD, 2006, Table 3.10). For example, in the United Kingdom and Ireland, which introduced the national minimum wage in, respectively, 1999 and 2000, the level was set at around 40% of basic full-time average earnings. Parallel to the recent rise in minimum wages in Korea, the proportion of regular workers paid the minimum wage rose to 10% in 2005 and to almost 12% in 2006. This is quite a substantial proportion in view of the low wage level involved, which points to the large and growing wage differentials in the Korean labour market. An alternative hypothesis might be that earnings are often not fully declared (see the analysis of undeclared work in Sections 3.6 and 4.4).

127. Reforms undertaken by the Korean government in 2005 included expanding coverage of the statutory minimum wage to all wage and salary earners including workers on probation for less than three months, and applying the full minimum to young workers aged below 18 and employed for less than six months. To some extent, these reforms could contribute to reducing low pay among temporary employees.

128. The OECD's Jobs Strategy Reassessment emphasises that a moderate minimum wage is generally not a problem for employment and can play a positive role in a "make-work-pay" strategy, encouraging higher labour market participation. But the devil lies in the detail of deciding what is a "moderate" level and how it should vary over time. Therefore it is important for governments to monitor closely whether the minimum wage results in significant job losses, particularly in the absence of sub-minima for youth or other vulnerable groups (OECD, 2006, Chapter 3).

Table 4.1. **Minimum wages**

Year	Minimum wages		Minimum wage (% of average wage in manufacturing)	Number of workers paid the minimum wage ^a	Workers earning minimum wage (% of dependent employment) ^a
	Won per hour	Increase (%)			
2000	1 600	4.9	23.6	53 760	1.1
2001	1 865	16.6	25.8	141 102	1.8
2002	2 100	12.6	26.3	201 344	2.8
2003	2 275	8.3	26.2	849 000	6.4
2004	2 510	10.3	26.9	1 035 000	7.6
2005	2 840	13.1	28.1	1 245 000	8.8
2006	3 100	9.2	..	1 503 000	10.3
2007	3 480	12.3	..	1 784 000	11.9

.. Data not available.

a) Up to 2002, figures were based on workplaces with five regular workers or more.

Source: Ministry of Labor; and Minimum Wage Council website (www.minimumwage.go.kr/w_progress.jsp).

4.3. Enhancing employment prospects for temporary or non-regular workers

129. Section 2 has shown that temporary employment in Korea concerns mainly female workers, older workers and the less educated, and that a considerable number of these workers may be trapped in temporary or low-paid employment, unemployment and inactivity. This suggests the need for policy measures to improve employment prospects for these disadvantaged workers, thus reducing labour market segmentation. These measures should include, in particular, removing barriers in labour supply and demand that limit participation in the labour market, as well as training programmes that increase these workers' employability.

A. Measures to remove barriers against participation in the labour market

130. Many women withdraw from the labour market at the time of marriage or child-birth and encounter difficulties when returning to the labour market after child-raising. The labour force participation pattern of women over the life-span is more clearly M-shaped in Korea than in other OECD countries, and many of them find themselves in precarious or low-paid employment. The Korean government has set a goal of raising the employment rate of women from 52% in 2003 to 55.9% in 2008, since the current rate is one of the lowest among OECD countries. To reach this goal, the government has initiated a series of measures to promote family-friendly employment practices.

131. One such measure was to lengthen paid maternity leave from 60 to 90 days. In order to reduce the employer cost of maternity leave, the EIS has expanded its financial contribution. In the case of big enterprises, the initial 60 days are paid for by employers and the additional 30 days are paid for by the EIS; by contrast, the EIS pays the complete duration of the leave in the case of SMEs. However, as in the case of unemployment compensation, women need to have been insured for at least 180 days in order to qualify for this benefit scheme. While Korean women can take unpaid childcare leave for up to one year, the duration of paid maternity leave remains only half the average of other OECD countries where, in 1999, the average length of paid *maternity*, *parental* or *childcare* leave was 26 weeks (OECD, 2006, Chapter 4). As from 2008, Korea also plans to introduce paternity leave.

132. The Korean government also supports the establishment of public and private child-care facilities. Employers who set up and operate child-care facilities at the workplace are eligible to receive financial assistance from the Labour Ministry. However, child-care costs may be a barrier to starting

employment, particularly for the low-paid. The government is currently considering the introduction of child-care subsidies for low-paid workers in SMEs in order to facilitate the take-up of employment.

133. Next, concerning older workers there are in principle three key barriers to employment: financial disincentives, employer barriers, and reduced employability (OECD, 2006, Chapter 4). In the case of Korea, financial disincentives do not represent a significant barrier since there is no provision for early retirement in the public pension scheme (which, however, is in need of reform in preparation for an ageing population). Employer barriers and reduced employability represent more significant barriers.

134. Employer barriers include stereotypical views by employers about older workers which can lead to age discrimination; the reluctance of employers to employ older workers due to the seniority-based wage progression; and the pervasive use of mandatory retirement. In order to tackle the link between mandatory retirement practices and seniority-based wage progression, the Korean government initiated the *wage peak system* which allows for wages to decline upon reaching an agreed-upon age in exchange for guaranteed employment up to a specified age. Starting in 2006, the EIS offers a subsidy to older workers who agree to join the system.⁵⁰ Further, the government is calling on firms to increase the mandatory retirement age and is offering employers subsidies for retaining workers after retirement age and/or above the age of 50. The complete phasing out of mandatory-retirement practices ought to be considered, and age-discrimination legislation may be one tool to reach that goal.

135. Factors contributing to the weak employability of older workers in many OECD countries include the obsolescence of skills and a lack of suitable employment services. In Korea, the low educational attainment level of older people may be a leading cause of reduced employability. In 2000, about two-thirds of those aged 50-64 had not completed secondary education – a proportion significantly higher than in most other OECD countries (OECD, 2004b). This explains, at least in part, why many older persons work in temporary or non-regular jobs with low pay. The inclusion of older workers in training or lifelong learning schemes could contribute to improving their employment prospects.

B. Training programmes targeted at temporary or non-regular workers

136. A number of studies have found positive associations between training and worker productivity and between training and earnings (OECD, 2004c, Chapter 4; and Ok and Tergeist, 2003). When assessing the impact of training with previous employers on the probability of finding or keeping a permanent job for an employee who participated in some formal education or training, OECD (2004c, Chart 4.9) found that, on average, the probability of finding permanent work increases significantly for each year of work with previous employers during which the employee received some training. Similarly, research at European level found that job training is strongly correlated with opportunities for temporary workers to move into permanent jobs (Eurofound, 2005). Thus, there is evidence that adult training can improve job prospects for non-regular workers.

137. However, as noted in Section 2 above, temporary workers tend to have less access to work-based training programmes, both in Korea and other OECD countries. Eurofound (2005) cites examples of policies undertaken in some countries to facilitate access of temporary workers to appropriate training opportunities and to implement the non-discrimination principle in this respect (Box 4.4).

50. The government can provide up to 50% of the reduced wage, up to a limit of KRW 1.5 million each quarter.

Box 4.4. Legal and other regulations on training for workers with fixed-term contracts

In the *Netherlands*, the Law on Equal Treatment of Fixed-term and Permanent Contracts prohibits differences in the treatment of permanent and non-permanent workers without objective justification, and specifies that the exclusion of temporary employees from long-term training plans can only be justified in special circumstances – e.g. if training will be implemented after the contract ends; or if training would result in unjustified high costs for employers. In addition, a national Collective Agreement on Temporary Agency Work sets up a personal training budget for temporary agency workers from their 27th week of employment.

In *Germany*, the law on part-time work and fixed-term labour contracts provides for equal treatment of workers with fixed-term contracts when selecting participants for company training measures. Further, it requires employers to ensure that workers on fixed-term contracts participate in appropriate education and further training measures to promote their up-skilling and mobility, unless these measures are in conflict with urgent company-related reasons or interests.

In *France* where employers need to spend a certain percentage of their payroll on training or otherwise pay a training levy, a 2005 act (based on a previous inter-sectoral agreement by the social partners) establishes the principle of an individual right to training, in the form of a 20-hour training credit per year, which can be accumulated over six years. This right is granted to permanent workers who have worked for more than one year in the company and to fixed-term contract workers who have worked for more than four months.

In *Portugal*, Law No. 99/2003 prescribes that an employer should provide continuing vocational training to workers on fixed-term contracts whenever the contract duration exceeds six months. The law also prescribes a minimum number of training hours depending on the contract duration – ranging from 1% of normal working hours for workers whose contract duration is less than a year to 3% of normal working hours for workers whose contract duration is over three years. Under the Portuguese Labour Code, the minimum number of training hours for permanent workers is set at 35 hours a year.

Source: Eurofound (2005).

138. The under-representation of non-regular workers in training in Korea is discussed in Section 2.2.D above, using data from the WPS and KLIPS. Table 4.2 provides further detail on the types of training followed by regular and non-regular employees. Non-regular workers receive less employer-provided training as well as less government-sponsored training. By contrast, a larger proportion engages in self-selected education or training schemes. Even in the case of employer-provided training, higher proportions of non-regular workers tend to receive on-the-job training rather than off-the-job training, suggesting that Korean firms are reluctant to provide formal training to non-regular workers. Thus, training policy in Korea needs to be assessed from the perspective of how to reinforce employer incentives to invest in the training of their temporary or non-regular workforce – as part of more general efforts required to bring participation rates in adult education and training up to the OECD average.

139. As opposed to training levy schemes where, as for example in France and the Canadian province of Quebec, employers are required to invest a proportion of their wage bill in education and training (or otherwise pay the levy), grant schemes providing subsidies or grants for training courses are better able to target their expenditure on particular groups. In the Korean system, employers who provide workers with training are awarded grants by the Employment Insurance Fund. *Via* this mechanism, the Korean government in 2004 increased financial incentives for employers to provide more training opportunities to non-regular workers – *i.e.* workers with fixed-term contracts of less than one year, temporary agency workers, part-time workers and daily workers. These grants cover not only training expenses, but also part of the foregone wages.

140. In addition to financial incentives for firms, training subsidies directed at individuals can be an appropriate instrument when the policy goal is to increase training access for groups of workers who tend to receive little or no continuing training from their employers (OECD, 2005*e*). The government has expanded financial incentives and grants for non-regular workers to engage in training (again targeting workers on

fixed-term contracts for less than one year, temporary agency workers, part-time workers and daily workers). From 2008, the Labor Ministry plans to implement a “Skill Development Card system” to raise participation in adult learning among the same target group: under this scheme, the government plans to pay training expenses of up to KRW 1 million per person per year. The Ministry has also established a taskforce consisting of union, management and related experts who have been charged with preparing a more advanced action plan to facilitate training for non-regular workers, and setting up a loan programme for living costs during the training.

Table 4.2. **Types of training taken by regular and non-regular workers**

	Regular workers		Non-regular workers	
Total	100.0		100.0	
Employer-provided training	74.7	(100.0)	63.0	(100.0)
On-the-job training	36.0	(48.2)	40.8	(64.7)
Off-the-job training	33.2	(44.4)	18.5	(29.4)
Others	5.5	(7.3)	3.7	(5.9)
Government-provided training	15.1		11.1	
Self-chosen training	8.5		22.2	
Others	1.7		3.7	
<i>Memorandum item</i>				
Proportion of workers who participated in training over a 12-month period^a	14.8		2.3	

a) Based on 2004 data collected by KLIPS.

Source: Ahn (2006).

141. There is a need to monitor closely whether financial incentives are sufficient to induce employers to provide training for temporary or non-regular workers. Due to this group’s high turnover rate, it may be more appropriate to focus training incentives on the individuals themselves. Efficient career guidance services and the provision of higher-quality information on training courses could also play an important role in stimulating the demand for training and in facilitating a better match between workers’ demand for training and the courses offered by training providers (OECD, 2006, Chapter 4).

4.4. Strengthening ALMPs and Social Security Schemes

142. Active Labour Market Policies (ALMPs) play an important role in reinforcing employability by facilitating the transition from unemployment to employment, while unemployment benefits provide income support during the time that the jobseeker is looking for work. Section 3.4 has pointed out that Korea is spending less on ALMPs than most OECD countries and that understaffing makes it difficult for the labour administration to pursue coherent activation strategies. To reinforce the role of the PES and increase its market share, the Korean government launched an ambitious reform project in 2004/05. Reforms range from employment service design to the introduction of performance management, and include the liberalisation of private placement, the establishment of regional networks, and the outsourcing of certain services to private providers.

143. More generally, Denmark’s *flexicurity* approach which combines low EPL, high benefits and high ALMP spending and ensures that the unemployed return rapidly to work, has emerged as an alternative policy model in the Korean public debate (OECD, 2004c, Box 2.6). However, it should be noted that the Danish flexicurity model has been developed over many years and not without difficulty (*e.g.* unemployment rates in Denmark were high in the 1980s and early 1990s), and that Denmark spends over 10 times more on labour market policies than Korea. Moreover, the Danish approach relies heavily on consensus and social dialogue, which are largely lacking in Korea. The Danish approach can nevertheless serve as a useful reminder for ongoing Korean labour market reform.

A. *Reform of PES and ALMPs*

144. With the objective of providing tailor-made employment services, the PES reform package introduced jobseeker profiling and an individual employment assistance plan. Jobseekers are classified into three groups in terms of their distance from the labour market through a diagnosis at their initial interview, aptitude tests and other personal and job information obtained shortly after initial registration for placement. Jobseekers who are job-ready are classified into Group A and provided with job information to facilitate independent job search. Jobseekers who have insufficient job skills or are unemployed for more than two months are classified into Group B and are provided with job training opportunities or group sessions for enhancing job-search skills, together with placement assistance. Jobseekers who lack both job skills and willingness to work or are unemployed for more than six months are classified into Group C and are provided with intensive employment services.⁵¹ The latter include an individual intensive interview, group counselling sessions for the long-term unemployed, job training, and job-interview techniques. These employment services are set out in the individual employment assistance plan. Meanwhile, the frequency of visits to the PES for monitoring independent job-search activities and unemployment status has been changed from once every two weeks to between one and four weeks, based on jobseeker characteristics.

145. The reform package aims to create *enterprise-support teams* in order to mobilise local vacancies. Target enterprises in the local area are selected and are provided with a consultancy service on recruitment or comprehensive human resource management. In some areas, the PES offers to set up training programmes based on the skill needs of local enterprises. In addition, a local employment network is established, which includes the PES, municipalities, business organisations, labour unions, education and training institutions and private placement services. In order to create local partnerships, the PES began to fund municipal local employment projects, and the PES is cooperating with municipalities in providing employment services for recipients of municipal welfare services. In addition, in 2006 the Ministry of Labor carried out a pilot project for outsourcing employment services, targeted at vulnerable groups of unemployed workers, to private placement service agencies. Currently, an evaluation system for contracted providers is being developed.

146. The reform package also aims to renovate PES organisation. The number of PES offices was increased to 168 in 2001, in order to complete a nationwide network. However, since the number of government staff was not increased, in line with the policy of small government during the period, large numbers of job counsellors were hired with private-sector employment status on fixed-term contracts, and the average number of staff at PES offices declined. In this situation, high workloads reduced the effectiveness of the PES and high turnover prevented the accumulation of professional experience. Recently the Ministry of Labor has started to tackle these problems; it plans to improve the status of job counsellors in order to encourage long-term employment, and has increased the number of public servants working in PES offices. Meanwhile, the Ministry has closed down many smaller-size PES offices and as of 2005 the PES was operating at 112 locations. In addition, performance management is being gradually introduced: PES office managers will have performance contracts and will be competitively hired. As the PES is now introducing such performance-management mechanisms and is outsourcing services to private providers, it is important to consider how to effectively measure and reward performance, especially if performance management develops to become a major driver of PES activity at the local level (see the examples given in Box 4.5).

51. Field visits in 2006 have shown that some offices use a four-way classification.

Box 4.5. Quasi-market provision and performance management of employment services

PES performance management and the quasi-market provision of employment services face similar requirements for success: performance must be measured accurately, and poor-performance organisations or methods must be replaced with other organisations or methods that have a good track record. Both steps take time to implement correctly.

Australia introduced a quasi-market for employment services in 1998. However the first ratings of the performance of different providers – based on the employment outcomes achieved by the unemployed people referred to them – became available in 1999, and performance ratings with regression adjustments for local labour market and client caseload characteristics – factors that also affect the number of employment outcomes – first became available in 2001. About 40% of the original 300 service provider organisations were eliminated (mainly on the basis of their relatively poor performance record) when the second contract period started in 2000, and another 40% were eliminated on the basis of the more precise performance information for the third contract period starting in 2003. In terms of aggregate employment outcomes, performance increased modestly in 2001 and 2002 (despite the recession which affected OECD countries in these years) and increased sharply in 2003 and 2004. Unemployment fell steadily and is now at its lowest level for nearly 30 years, and Australia has also made a promising start on reducing dependency on *non-employment* benefits for certain target groups among older workers, lone parents and the partially-disabled.

Employment Zones in the United Kingdom use a different method of outsourcing. Services are outsourced only for certain groups of clients (in particular, the long-term unemployed) in certain localities. The contracts relate service provider funding to performance: when providers achieve the same level of employment outcomes as the PES achieves with comparable client groups, a certain level of funding is provided, but providers are paid more for higher employment outcomes and can benefit from any savings in spending on unemployment benefits during the six-month period of their (potential) responsibility for the clients. In this approach, provider outcomes are benchmarked against PES outcomes for comparable client groups and good performance is financially rewarded, whereas in the Australian approach providers are benchmarked against each other and the elimination of poor providers from the market by terminating their contract has been a more significant driver of performance. However, both countries use elements of both methods, and these are only differences of emphasis.

One key recommendation for performance management given by OECD (2005*f*, Chapter 5) is that contracts with providers should specify the client groups to be served (e.g. the inflow over a three-year period of unemployed workers having particular characteristics), and then during contract implementation the purchaser (government) should accurately define which clients are members of this client group and measure its employment outcomes. For any given contract, providers should not be able to select the clients whose outcomes will be measured and should not report outcomes themselves (otherwise, providers are rewarded for actions to *game* the measured outcomes rather than genuinely improving them). A second key recommendation is that outcomes should be measured in terms of client rates of dependency on unemployment benefits, employment, and earnings after the return to work. The objective for employment services should be to reduce average rates of benefit dependency and increase employment and earnings on average over a relatively long period – rather than rewarding labour market transitions at particular times or of particular durations. Two issues arising with this recommendation are:

- Quasi-market arrangements, as implemented by Australia, the Netherlands and the United Kingdom, use relatively simple and short-term measures of outcomes. Since these do not necessarily capture the positive impact from longer-term training programmes, to encourage training separate financing streams earmarked for training need to be introduced;
- More effective measurement of longer-term employment and earnings outcomes requires the use of employer wage and salary records, as reported to tax and/or social security contribution institutions.

With a measurement framework which rewards providers for increasing clients' employment rates and earnings as reported by employers to tax and/or social security institutions, providers could be rewarded primarily in terms of their success rate in getting a wider range of client groups into declared employment. This approach focusing on promoting entries to declared employment – rather than paying unemployment benefits and then promoting exits from unemployment benefits – could be an effective approach for PES engagement with irregular workers.

For sources and further reading see OECD (2001*b*; 2005*f*, Chapter 5); Tergeist and Grubb (2006); and Grubb (2006).

147. In order to develop best practices for the reforms, the Ministry of Labor in 2005 operated six pilot centres where it significantly increased staff and finances. After operating for 6 months, the increase in performance at these six pilot centres was substantial. Registered vacancies almost doubled, while the job placement rate increased from 18% to 30%. Customer satisfaction ratings also increased somewhat. The performance of the six pilot centres suggests that the approach taken could be rather effective. However, the good performance of the pilot centres was related to the input of additional staff and financial resources, and maintaining and broadening this performance will require further investment.

148. While the PES reform is in the right direction, access to the PES by temporary or non-regular workers needs to be facilitated. Although over 80% of all temporary workers are working in service industries (see Table 2.8), almost half of the vacancies registered by the PES come from manufacturing industries. This means that the PES does not have enough vacancy information to induce temporary workers to visit its front-line offices. It also means that the PES lacks the tools to effectively monitor and enforce Employment Insurance among the unemployed who were in temporary jobs in service industries, where small workplaces operate and many workers are not reported to the Employment Insurance. This suggests the need to strengthen the role of the PES in the service sector while reducing informal employment, as described in the next section.

B. *Towards a more tightly-knit social safety net and activation*

149. As noted above, Korea should seek to increase the ratio of unemployment benefit recipients to total unemployment from its level of less than 30% in 2004 for several reasons. This would not only improve income security for unemployed workers but also ensure that unemployed workers maintain contact with the PES. Improvements in the social safety-net and PES effectiveness are linked through *activation* strategies, which make benefits conditional on continuing contact with the PES or participation in labour market programmes (OECD, 2003, Chapters 3 and 4).

150. One possible alternative method for increasing the ratio of beneficiaries to the unemployed would be to increase the duration of UI benefits, which is relatively short in Korea. However, this may not be desirable if the PES is unable to monitor work availability effectively or if undeclared employment is prevalent. Moreover, as shown in Grubb (2005, Chart 2), OECD countries with ratios of unemployment beneficiaries to the unemployed above 70% often achieve this without long duration of UI benefits.⁵²

151. One reason why the ratio of beneficiaries to the unemployed is low in Korea is that voluntary quitters are not entitled to UI benefit. In Korea, according to EIS statistics 66% of total job separations in 2004 were voluntary (Hwang, 2005) and about half of those unemployed for less than one year who previously had a job are voluntary job quitters.⁵³ Moreover, only about 40% of insured involuntarily separators are eligible for benefit (this may be because in repeat unemployment situations, which are common, only two months of benefit are paid after 6 to 12 months of employment contributions). As a result, only 14% of insured separators overall were eligible for the unemployment benefit.⁵⁴ An expansion

52. Given that some categories of the unemployed – such as full-time students seeking work and the long-term unemployed in families with other income earners – do not necessarily have to be covered, a benefit system with a ratio of beneficiaries to unemployment of 70% to 80% can provide a reasonably adequate safety net.

53. *Source: Employment Trends by EAPS, Korean National Statistical Office.*

54. Voluntary separators in most cases move rapidly into another job, and many might better be called job-changers. As noted below, the average duration of insured unemployment spells (which follow involuntary separation) is about twice the average duration of labour force survey unemployment. This can explain why the percentage of unemployment with benefits in stock terms is much higher than it is in flow terms (using total separators as the denominator).

of benefit entitlements to cover voluntary quitters would increase the ratio of beneficiaries to the unemployed, even if a sanction was imposed for a specified period, but this would also tend to increase labour turnover, particularly in those SMEs where working conditions are not satisfactory.

152. A more urgent concern for Korea is to increase the rate of compliance with the EIS. Compliance is particularly low in small establishments, where precarious jobs are concentrated, which implies that the EIS fails to provide income security for temporary or non-regular workers, and also makes it difficult for labour market programmes designed for benefit recipients or the EIS-insured population to be effective for this population. This issue is discussed below.

153. The NBLSS requires its beneficiaries who have been assessed as having working ability and willingness to work – called *conditional beneficiaries* – to participate in *self-support* programmes (Table 4.3). The type of self-support programme is decided based on an assessment of working ability and willingness. Beneficiaries with low working ability and willingness are required to participate in employment–maintenance programmes, while beneficiaries with relative higher working ability and willingness are required to participate in market-entry type, social-job type and internship or business start-up programmes. However, most of these programmes are basically public sector job-creation programmes. Only relatively small numbers of beneficiaries are required to contact the PES so that they can be hired in private-sector jobs.

Table 4.3. **Participants in self-support programmes (as of Dec. 2004)**

		Persons							PES Employment Service (b)
		Municipalities							
		Type of scheme							
Total (a+b)	Subtotal (a)	Business start-ups, etc.	Market-entry jobs	Social jobs	Internships	Maintenance of work habits	Community service, social adaptation program		
Participants in an average quarter	57 990	54 895	3 430	5 480	13 854	287	28 611	3 233	3 095
Total annual participants	112 771	107 393	6 848	11 714	25 403	521	56 229	6 678	5 378

Source: Ministry of Health and Welfare.

154. According to the Ministry of Health and Welfare, only 5% or 6% of participants each year are able to increase their income above the poverty line through participation in the self-support programmes. This may partly reflect the fact that only highly-disadvantaged working-age people qualify for NBLSS, but it suggests that performance of the self-support programmes needs to be enhanced. Along with delivery of more effective employment services, there is a need to strengthen incentives to find a job under the NBLSS. At present the NBLSS suspends benefits for three months when the beneficiaries refuse to participate in required programmes, and the PES or contracted agencies for the programme are asked to report non-compliance by beneficiaries to municipalities.

155. In-work benefit programmes are increasingly used by the OECD countries as a means of raising the financial returns from work. The main idea is that offering a top-up to the earnings of low-paid workers makes employment more desirable compared to non-employment. Therefore, in-work benefits are not paid unless hours of work exceed some minimal threshold, and in-work benefits typically increase proportionately with earnings until a maximum benefit level is reached. A number of empirical studies

have concluded that a well-designed system of in-work benefits can have a positive overall impact on employment. In particular, where in-work poverty is of concern, in-work benefits have proved to be an effective tool of raising family income of low-pay workers (OECD, 2006, Chapter 3). The Korean government has decided to introduce in-work benefits – *i.e.* the Earned Income Tax Credit scheme – in several years' time, and the government expects this to increase work incentives.

156. Although the effectiveness of in-work benefits depends basically on their design, a major problem in Korea is the tax authority's lack of adequate data on earnings. As discussed further below, the tax authority lacks wage information for over a quarter of wage and salary earners, and income information for most of the self-employed is lacking or is estimated without book-keeping. Reforms to improve income reporting should therefore be given a higher priority.

C. Policies to minimise undeclared employment

Tax and social insurance coverage in Korea

157. Korea adopted a global personal income tax (under which virtually all personal income is aggregated and taxed together, in contrast to the previous system with separate schedules for five different types of income) in 1974, and introduced a value-added tax at a 10% rate in 1977. However, financial incomes remained largely outside the tax net. In 1993 the introduction of the *real-name system* for all financial transactions and property registration, to replace the practice of using false names to avoid taxation, was announced. However, a key measure – the inclusion of financial income in excess of KRW 40 million in the global income tax base – only began to be implemented in 1996 and 1997, and was suspended in the 1998 economic crisis, but reintroduced in 2001 (Chun, 2002; and Hong, 2002). The Korean tax administration in the 2000s has been active in seeking to improve compliance and maintain safeguards against lobbying, bribery and arbitrary tax assessments. But despite rapid progress, difficulties in taxing the incomes of small businesses remain significant.

158. Of Korea's four major social insurance systems, Industrial Accident Compensation Insurance was introduced in 1964; Health Insurance in 1977; the National Pension in 1988; and Employment Insurance in 1995. Contributions for regular employees are paid by their employers. However, employers have not (until 2006) been required to provide details of the wages they pay to daily workers, *i.e.* they were able to list wages paid to daily workers as a tax-deductible expense without identifying the individual recipients of wage payments. At the same time, as noted above, there continue to be many wage and salary workers who do not personally submit an income tax return.

159. In this context, SME employees, non-regular workers and daily workers have in principle been covered – along with the self-employed – by personal contributions to regional health insurance funds (Park, 2003). Many regional health insurance funds were created in the 1980s. Proposals to integrate regional health funds with occupational funds started in the 1980s and continued throughout the 1990s but have remained controversial since – given the low contribution levels in the regional funds – integration would involve cross-subsidisation of regional funds by the occupational funds. In 1999, the principle of integration was enacted. However, the collection of premiums from the self-employed continues to be based on a system of contribution classes, which can be determined on the basis of proxies such as an individual's property and car ownership, as well as income.⁵⁵ Ishizuka (2003) suggests that the incomes reported by the self-employed for health insurance can be only 30% of their real incomes. Thus, difficulties in assessing the incomes of the self-employed also remain significant.

55. Premiums for Public Health and National Pension insurance are based on the classification of contributors into 100 grades for Public Health insurance and 45 grades for National Pension insurance (Jang, 2007).

160. According to administrative statistics, in 2005 8.1 million employees were insured in the Employment Insurance System (EIS), which is similar to the number insured as employees in the Health Insurance System and National Pension systems (8.3 million and 8.0 million respectively).⁵⁶ However, overall coverage rates for the EIS are much lower because many employees have separate Health and Pension coverage through contributions to regional insurance funds. The Ministry of Labor finds that the enforcement of EI contributions in smaller establishments is very difficult. Administrative data suggest that in 2005 wages were reported to the EIS in respect of 64% of workers (other than daily workers) in workplaces with less than five workers and 81% in workplaces with more than five workers (Table 2.11 above). Staff working at the social security administration explain that reasons for the difficulties in enforcement include: *a)* start-ups and closures of small enterprises are too frequent for the social security administration to be able to inspect the workplaces; *b)* hirings and separations are too frequent for employers to be able to easily report them to the social security administration; and *c)* wage records are not well maintained in small enterprises.

Integration of the collection of different social insurance contributions

161. Integration of the collection of different social insurance contributions is likely to reduce administration costs and achieve higher coverage than separate collection by different social insurance institutions (Box 4.6). One barrier to integration in Korea has been the difference in the income base used for calculation of premiums. Premiums for Public Health and National Pension insurance are based on *taxable income* as defined by the Income Tax Act in the previous year, while EIS premiums are based on the *wage* defined by labour law in the current year. Some deductions are allowed against taxable income under tax law but not against the wage under labour law, and *vice versa*, although the amounts involved are not large.⁵⁷ The Public Health and National Pension insurances therefore have a relative advantage in terms of information exchange with the tax authority. These differences arise partly because each social insurance has been designed and implemented by different ministries, but also because UI entitlements require the most complex record-keeping, being ideally based on records of the individual's monthly contributions up to the month of separation from the last job.

162. In November 2005, the Korean government announced a plan to unify the collection of social insurance contributions and to promote the sharing of information with the tax authorities. Some key elements of the plan were (Jang, 2007):

- all social insurance premiums will be calculated based on taxable income used by income tax;
- the amount of each social insurance premium will be notified by each administration based on *taxable income* in the preceding year, reported in tax returns early in the year;
- the form of the monthly tax withholding report, which employers are required to submit to the tax authority each month, will be changed so that social insurance administrators can easily identify the workers and their taxable income by the tax identification number.

56. The figures cited in this sentence are reported by Jang (2007, Tables 2.1, 2.3 and 2.4). Table 3.2 here cites a figure of 8.7 million workers actually insured for EI in 2005 (a somewhat higher number, perhaps because it includes insured unemployed workers).

57. Allowances which are treated differently for *taxable income* and the *wage* include the performance-based bonus, which is included in *taxable income* under tax law, but is not included in the *wage* under labour law. The Korean government estimates that the *wage* represents on average 95.8% of the *taxable wage* (*i.e.* the wage component of *taxable income*) However, the gap is different by size of enterprises. In large enterprises, the *wage* is smaller than the *taxable wage* due to the performance-based bonus, but in small enterprises, the *wage* is larger.

Box 4.6. The case for integrated collection of social insurance contributions

Unless they can use existing sources of information, social insurance administrations often need to visit worksites to determine the number and the names of the workers present and their taxable wages. In the small firm sector, due to high enterprise and worker turnover, such visits and inspections need to be frequent to be effective, but this would be very costly. Low EI contribution rates (up to 1.75% of wages for the employer and the employee together in Korea), given that collection costs cannot reasonably exceed a few percent of the amount collected,⁵⁸ are a structural barrier to full coverage of the small firm sector by the EI administration acting in isolation.

Economies of scale are possible from coordinated collection (*via* exchange of information between administrations) or fully integrated collection of different social insurance contributions premiums and income taxes. Barrand *et al.* (2004) describe the *commonality of the core processes involved* in collecting contributions and claim that countries which have integrated collection “have found that the marginal costs of expanding systems used for tax administration to include social security contributions are relatively minor”. In an integrated system, employers and other contributors remit single payments for all their obligations to the revenue administration, often including withholding of employee liabilities for tax and social contributions. So far as possible, reporting requirements are aligned and the number of separate reports that employers must make based on payroll information is minimised. Integrated collection thus reduces the total administrative burden for individuals, employers and the revenue administration. Further advantages are that:

- Integrated collection ensures that information-sharing (e.g. between corporate tax, personal income tax and social security contribution records) is considered legitimate in terms of data protection safeguards.
- Total contribution rates for income taxes and social contributions are relatively high (in Korea, the employee and employer contribution rates for the four main social insurances total about 15%: Hur, 2003). For an integrated collection agency, additional work on improving the coverage of small-firm and high-turnover employment is more economically viable than it would be for any separate administration that collects only a few percent of the detected earnings.
- Integrated collection prevents workers from contributing to insurance schemes *strategically*, i.e. contributing to each insurance only in circumstances or at times in the life-cycle when they expect to claim back more than they contribute. If social insurance schemes do not enforce contribution payment by individuals who are unlikely to get back as much as they contribute, they are financially non-viable and thus are unlikely to provide universal coverage in the long term.

Social security and income tax collection are integrated in nearly half of OECD countries (OECD, 2004c, Chapter 5). Formerly separate systems have been integrated in Ireland (1981), Sweden (from 1975 to 1985), the United Kingdom (1999) and the Netherlands (from 1997 to 2005) (Jang, 2007). Barrand *et al.* (2004) also note that the majority of Eastern European countries have either implemented integrated collection or are in process of integrating. However, the categorisation of countries is not precise since many countries combine elements of an integrated collection system with elements of a *parallel* system where the social security administration and income tax administrations collect revenues separately but exchange data and co-operate in other ways (Zaglmayer *et al.*, 2005).

163. This plan was expected to remove most obstacles to sharing information among social insurance administrators and the tax authority, but not to achieve full integration of the functions of collection or workplace inspection. But following further work, a bill proposed to the National Assembly on 16 November 2006 now anticipates the creation of a new agency for the collection of all social contributions under the administration of the National Tax Service (Jang, 2007).

164. The government also decided to introduce in several years' time an *Earned Income Tax Credit*. It mandated all workers including daily workers to submit tax returns as from 2005, and increased penalties

58. Barrand *et al.* (2004, p. 7) comment that “In mature, well-run social security systems, administrative costs of pension programs are often less than one percent of contribution collections... A higher cost structure may be experienced in the early years of a new pension system, or when reforming an existing system to meet current needs.”

for non-compliance, since the collection of information on income for low-income workers is important for this measure. This measure will make it possible to convert the criteria for exemption from social insurance contributions away from minimum working-hour or working-period thresholds to a minimum-earnings threshold, and to monitor compliance with social security schemes more effectively.

Taxation of profits

165. The integrated management of income tax and social insurance contribution liabilities does not remove incentives for employers and employees to collude in the non-declaration or under-declaration of employee earnings. The declaration of wages and salaries is most effectively implemented through a *top-down* approach where the tax authorities focus their detection efforts on business incomes, *i.e.* firms' sales. When business sales are accurately documented, employers are motivated to hire their low-earning employees on a formal basis, whenever possible (Box 4.7).

Box 4.7. Employer taxation and the declaration of employees

Effective taxation of profits is achieved when tax authorities reliably document business sales of goods and services. Profits – the difference between sales and input costs – are taxed at a relatively high marginal rate because:

- Self-employed owners of unincorporated businesses typically have higher total incomes than their employees;
- If the business is incorporated, profits paid out to owners of the business are subject to double taxation (corporate income tax on profits as well as personal income tax on any dividends that are distributed to the owners of the business).

When sales are detected, employers are only able to pay their employees in cash out of profits that have already paid tax at a high rate. It becomes more tax-efficient for employers and their employees in co-operation to declare their wage payments, so that they can be treated as deductions from taxable profits. This is particularly the case for low-paid employees, who are taxed at a low rate. This reflects the general principle that under progressive individual income taxation, private sector actors have an incentive to split declared incomes across as many individuals as possible. For example, under progressive taxation it is tax-efficient for a family business to declare its profits not as the income only of a *head of family*, but rather as the shared income of several business partners and/or employees.

The tax authorities require employers to list the amounts paid to each employee – *i.e.* wages and salaries should only be allowed as a deduction from sales income when this information is provided. Employers then act as *agents* for the tax authorities in collecting taxes based on wages and salaries throughout the economy. This arrangement is essential to ensure high levels of declaration of low-paid work, since tax and social security inspectorates never have enough resources to directly detect all labour input in the economy through direct inspection methods. Because employers bear the administration costs of documenting their payments to individual workers, they have, to the extent that highly unstable employment patterns are costly to document, an appropriate incentive to reduce labour turnover which is not present if the costs of documenting erratic earnings are borne only by the tax administration.

Use of this system can largely remove the need for labour or social security inspectorates that concentrate on directly detecting undeclared work through worksite visits and related techniques. Labour or social security inspectorate activity to detect undeclared work is a significant feature in the labour markets of European countries such as Belgium, France and Spain, and in many middle-income countries with large informal economies.⁵⁹ However, this function hardly exists in English-speaking OECD countries, and seems also to be relatively unimportant in Nordic countries. Citations in OECD (2004c, Chapter 5) describe how the tax authorities in Australia and the United Kingdom focus their efforts on the detection of undeclared business incomes (sales), rather than on detecting undeclared work as such.

59. However, enforcement efforts vary. Some middle-income countries appear to treat the payment of social insurance contributions (which is often the only tax directly payable by most employees) as optional in large areas of the labour market, and engage in little enforcement activity for this reason.

Book-keeping by the self-employed

166. To achieve low levels of undeclared work through the *top-down* approach described in Box 4.7, self-employed people with employees must reliably be taxed on the basis of their real incomes (*i.e.* profits from their business activity), rather than on the basis of "simplified" tax regimes (lump-sum taxes, or assessment on the basis of weak proxies, such as the floor area of a shop). OECD (2004c, Chapter 5) noted that the self-employed in the Czech Republic, Greece and Portugal were allowed to pay lump-sum contributions or lower contribution rates than employees, and the self-employed in Hungary, Mexico and Spain had access to special simplified tax regimes. Under simplified tax regimes, the marginal tax rate on business incomes is zero or close to zero, and this leaves the self-employed with a strong incentive to pay their employees in cash.

167. In Korea, although there are about 5 million self-employed, only 2 million employers and 1 million individual taxpayers in 2004 made a VAT return based on book-keeping, the remainder either being tax-exempt or paying VAT based on simplified book-keeping and estimated reports (Jang, 2007, Tables 4.5 and 4.6).⁶⁰ The Korean government plans to gradually expand the proportion of self-employed who are required to report their income based on book-keeping rather than estimation.

168. The submission of detailed tax returns involves significant compliance costs (administrative burden) for taxpayers as well as the tax authorities. In countries with low levels of self-employment and undeclared work, low-paid and less-educated workers will typically prefer an employee status to self-employment partly because tax compliance is much simpler in the former case. This approach minimises tax compliance costs in the economy as a whole. Effective tax systems therefore promote a long-term transition towards a salaried economy, where the remaining self-employed are mainly in two categories: employers, who have relatively high earnings and handle the bulk of the paperwork for their employees as well as themselves; and other self-employed who, by the nature of their business, need to work for different employers or customers throughout the year and thus cannot easily work as employees. In Korea (probably related to the shortage of regular employee jobs), the proportion of workers who are self-employed has scarcely fallen since 1997 (Table 2.2), but it is likely to fall as part of any strategy for ensuring high rates of tax compliance by the self-employed.

169. One type of informal employment is so-called "false self-employment", when a relationship which is in fact dependent employment is declared as a purchase of services from a self-employed person. In Korea, as firms increase outsourcing to self-employed workers in certain industries, the issue of how to protect these workers in labour laws and social insurance has been debated for a long time without a conclusion. Other OECD countries seem to apply two policies in this area: *a*) they align tax treatments so that there is in principle no tax advantage to self-employed status, although the self-employed may in practice have greater opportunities for evasion; and *b*) on the basis of several criteria used in combination, they determine whether particular situations are legally permitted to be interpreted as self-employment, rather than an employer-employee relationship.

Documentation of labour inputs by a labour or social security inspectorate

170. In many OECD countries and other middle-income countries, a labour inspectorate or social security inspectorate plays a central role in detecting undeclared work through site visits to workplaces.

60. Korea for some years had tax incentives for consumers to use credit cards for purchases, in order to improve the reporting of transactions at the end-point of the VAT chain. The total of 1 million individuals paying VAT based on book-keeping reports in 2004 represents fairly rapid progress; Song (2002) cites 461 000 book-keeping taxpayers in 1996 and 680 000 in 2000.

For example, employers may be required to keep a register at the worksite where all employees at the worksite are listed. Random worksite inspections can then verify that workers who are present at the worksite are in fact being included in the register.

171. Worksite inspections can only directly detect the presence of workers at a worksite, not their earnings, and they can only with difficulty detect hours worked, which is necessary to ensure that taxes are paid on all hours that are worked.⁶¹ To limit under-declaration of earnings, the tax authorities need to assume that work is full-time and permanent in the absence of convincing evidence to the contrary. Over-reliance on the direct detection of labour inputs as the basis for taxation tends to lead to strict regulation of employment, in conjunction with private sector practices that conceal labour inputs so far as possible. These factors tend to depress the economy's aggregate employment rate, particularly as measured in terms of formal employment.

172. To avoid over-reliance on the direct detection of labour inputs, tax rates on labour (often mainly social security contributions) should be kept lower than tax rates on distributed profits in order to reinforce the tax incentive for employers to declare their employees described in Box 4.7. When undeclared work is detected, the authorities should not use the information only to collect unpaid contributions and a fine; they should also take this as evidence of under-reporting of sales or failure to keep books. This is an important reason why integration, or at least close cooperation, between the social security and income tax administrations is an efficient arrangement.

Detection of undeclared work through unemployment benefit administration

173. Unemployment benefit entitlements are targeted on groups that are likely to be working – those who have a good employment record over recent months and years in the case of insurance benefits, and adults with no other family income in the case of assistance benefits. The payment of unemployment benefits reduces workers' need for low-paid undeclared work, and helps the PES to make labour available to employers who have job vacancies in the formal sector.

174. At the same time, some unemployed workers will seek to engage in undeclared work while drawing unemployment benefits. PES offices, through contacts with local employers and regular face-to-face meetings with the unemployed, are well-placed to detect undeclared work. Unemployment benefit administrations have a financial incentive to detect low-paid undeclared work and can exploit public sentiment against benefit fraud (which is stronger than public sentiment against undeclared work) in order to achieve this. In this way, unemployment benefit administrations may be the most effective actors in suppressing undeclared work at the lower end of the labour market where income tax authorities have lesser incentive. In some OECD countries (such as Australia and the United Kingdom, which have a nationally-financed indefinite-duration unemployment assistance benefit), much of the fieldwork to detect undeclared work seems to be done by unemployment benefit fraud units.⁶²

61. As described in OECD (2004c, Chapter 5), in Belgium employers must either give part-time workers a contract that specifies their hours of work, or publicly display a rota at the workplace which says when part-time workers will be present. Devices such as these are needed to allow the inspectorate to detect situations where a worker with a part-time contract is in fact working full-time.

62. Hur (2001 and 2005) analyses relationships between unemployment insurance and informal employment. He suggests, for example, that extending the coverage of UI can help bring parts of the informal sector into the formal sector, and that spending to improve the administrative capacity of social insurance administrations, to support compliance monitoring as coverage expands, can yield budgetary savings in the medium- and long-term perspective.

Daily workers and Korea's e-card system for construction site workers

175. In the Public Health scheme and National Pension scheme, daily workers are allowed to continue in the regional-based schemes instead of the workplace-based scheme. In case of the EIS, which does not have such a regional-based scheme, daily workers began to be covered in 2004; 528 000 workers were insured by December 2004 and 722 000 by December 2005 (Jang, 2007). Outside the construction sector, as from 2006, the mandatory submission by employers of tax returns concerning their daily workers is expected to have had a positive effect on their social security coverage.

176. Chain subcontracting is prevalent in the construction industry in many OECD countries. At the bottom of the chain, recipients may be declared as self-employed and then escape taxation on earnings through disappearance, or very small enterprises may disappear without handing money from tax withholding over to the tax authority. Furthermore, subcontractors can evade taxes and social security contributions by over-reporting material costs and under-reporting their wage costs (OECD, 2004c, Chapter 5). In Korean construction sites, there is a longstanding practice of subcontracting work to a team leader, called a *ship-jang*, who brings his team of workers to the construction site, without the workers in his team being identified. Only the global payment to the *ship-jang* is recorded. The construction workers are classified as daily workers, since they do not work for a long time at the same construction site. As a result, accounting books on construction sites do not provide reliable wage records.

177. Even the plan announced in November 2005 for coverage of daily workers excludes *ship-jang* work at most construction sites: social security schemes for daily workers in construction sites will be kept as they are. However, the Ministry of Labor in 2004 initiated a pilot e-card reporting system for construction daily workers, which is currently implemented in 700 relatively large construction sites. The e-card allows attendance at construction sites to be reported and managed in real time. Total wages paid to each daily worker are calculated from his/her days worked, which is reported electronically, and his/her daily wages, which must be reported when the e-card is issued.

4.5. Policy recommendations

178. This report has analysed various factors behind the growth of temporary employment in Korea, including demographic change, expanding service industries and companies' externalisation strategies. The latter were shown to have been reinforced by EPL mechanisms, wage-setting practices and labour/management relations, all becoming more important in the aftermath of the 1997/98 financial crisis. Korea's labour market evolution since then can illustrate the emphasis of the recent reassessment of the OECD Jobs Strategy on interactions between adverse macroeconomic shocks (like the financial crisis) and structural policy settings and institutions (OECD, 2006, Chapter 6). One distinguishing feature of Korea is that this interaction has given rise to increased labour market duality.

179. Thus, remedies against labour market duality go beyond issues in the labour market itself and need to tackle the interactions between labour and product markets. Large companies dominating product markets, along with significant bargaining power of regular workers, may have reinforced insider-outsider effects. In turn, these companies have tended to reduce hiring of regular workers, resorted to "honorary retirement" of a large number of existing workers and attempted to reduce labour costs and/or increase workforce flexibility by hiring under temporary contracts and outsourcing certain production processes. Subcontracted companies have also tended to rely on non-permanent staff to reduce their own labour costs when faced with cost-cutting pressures from their chief contractors. Therefore, policies to address labour market duality in Korea would benefit from more competitive product markets which would weaken insider-outsider effects – along with a stable macroeconomic environment that can produce business confidence.

180. Labour market reforms also have a critical role to play in reducing labour market duality while maintaining the strong job creation record of Korea. The discussion above has shown that labour market institutions and policies need to concentrate their reform efforts on ensuring more stability in employment relationships, reducing insider/outsider cleavages, and combating undeclared forms of employment. These policies need to tackle the areas of employment protection regulation, severance pay practices, anti-discrimination legislation, minimum wages, coverage of the social safety net, compliance with social security schemes and training programmes. Wage determination structures, as well as trust and consensus-building between labour and management, constitute other important issues where the government may have less immediate leverage, but needs to give a strong impetus for reform.

181. The above should not be taken to imply that there have been no reforms in the Korean labour market in recent years. On the contrary, the Korean government has already undertaken many important reforms in labour market regulation. In the coming years, after the passing of the bills on non-regular employment and of the Roadmap for industrial relations reform, the *five-year comprehensive plan for non-regular employment* is on the agenda.

182. Based on the discussion in the main body of this report, some of the recommendations of the restated OECD Jobs Strategy – in particular, Pillars B and C on impediments to labour market participation and labour demand – seem especially relevant to Korea. Indeed, many of the policy proposals below show how the Jobs Strategy could be used in the Korean reform process. Other proposals are more specific to the Korean context.

A. *Pursue reforms in employment protection legislation so as to achieve greater balance in the treatment of regular versus non-regular forms of employment*

- Continue to ease the strictness of EPL for regular contracts, thus making the hiring of permanent workers more attractive, while also better protecting non-regular workers; reinforce mechanisms for the speedy resolution of dismissal disputes;
- Strengthen the incentives for workers and employers – for example, through preferential taxation – to convert the existing severance pay system (retirement allowance) to a corporate pension scheme (preferably one based on defined contributions), and expand eligibility to the scheme to employees with less than one-year tenure, in order to reduce the existing labour cost differentials between permanent and temporary workers.

B. *Combat discriminatory wage differentials between regular and non-regular employees*

- Combat discriminatory practices related to wages, employee welfare benefits and other terms and conditions of temporary or non-regular workers by implementing anti-discrimination legislation;
- Set minimum wages at levels that tackle excessively low wages or under-declaration of earnings, but do not exceed the true productivity of low-wage workers, while using other anti-poverty programmes for appropriate income redistribution;

C. *Modernise the seniority-based wage and mandatory retirement systems*

- Encourage the social partners to modernise the existing seniority-based wage system, which makes older workers relatively expensive, with a view to transforming it into a remuneration system more closely linked to performance and productivity. Promote labour-management dialogue on the subject and monitor closely the impact of the *wage-peak system*;

- Encourage firms to raise their company-specific mandatory retirement age towards official retirement ages;

D. *Improve employment prospects of non-regular workers and disadvantaged employees*

- Remove obstacles faced by women in the labour market by introducing more family-friendly policies, such as increasing child-care support and ensuring that part-time work is not at a disadvantage *vis-à-vis* full-time work;
- Promote equal access to training programmes for non-regular and disadvantaged employees. To this end, strengthen financial incentives for *i*) employers to provide training opportunities to non-regular workers, and for *ii*) individual workers to engage in continuing training, for example through the planned *skill development card* scheme.

E. *Increase employability and income security of temporary or non-regular employees by enhancing employment services and expanding the social safety net*

- Continue on-going reform of the public employment service, including improvement of staff/client ratios. Expand the PES market share in the service sector; facilitate access to the service by temporary/non-regular employees and improve job matching for this clientele;
- Use personal follow-up, intensive interview techniques and individual action plans for effective activation of unemployment beneficiaries, combined with moderate benefit sanctions, if necessary;
- Improve links with private employment agencies and base contracting-out arrangements as far as possible on provider outcomes;

F. *Promote further transition towards a salaried economy*

- Expand the workplace-based coverage of employees by social insurance systems. Increase compliance by unifying the collection of social security contributions.
- Motivate employers to report wage and salaries, by promoting book-keeping and auditing the accounts of small employers, and by implementing the requirement for all employers to report the wage payments they make to daily workers;
- Require all workers to submit an annual income-tax return. Enhance co-operation between social insurance administrations and the tax authority;
- Monitor the effectiveness of the pilot e-card report system for daily workers in large construction sites, and consider expanding the use of the resulting employment records for calculating wages;
- Reinforce PES efforts to detect undeclared work by people on unemployment benefit and to help employers recruit workers for similar declared jobs, which tend to be more stable.

ANNEX I

DIFFERENT DEFINITIONS OF NON-REGULAR WORKERS IN KOREA

183. The term *non-regular worker* – rather than temporary worker – is widely used in Korean economic literature, among policy makers, and within the media. The term tends to be used for all workers who are not *regular* workers, irrespective of employment duration. Nevertheless, a full consensus on the definition among scholars is still lacking, and the term *non-regular worker* (or sometimes *non-standard worker*) may refer to different definitions.

184. Two surveys implemented by the National Statistical Office (NSO) can be used for analysis on non-regular employment; the *Economically Active Population Survey* (EAPS) which collects monthly data on *employment status*; and the annual *Supplement to the EAPS* which was designed to collect more detailed information on various *employment types*. A third data set often used for the analysis of non-regular employment is the *Korea Labour and Income Panel Survey* (KLIPS) undertaken by the Korea Labour Institute (KLI).

Four different definitions on non-regular workers are used in Korean economic literature.

185. Definition A relies on data on employment status collected by the EAPS since 1989. This definition categorises wage and salary workers into *regular employees*, *temporary employees* and *daily workers*. *Regular employees* are defined as those who work more than one year at a firm and are paid standard wages, *plus* bonuses and overtime. Using a *residual approach*, the NSO defines all other employees as non-regular and divides them into *temporary employees* and *daily workers* by the length of their respective employment relationship. This approach has drawbacks when trying to analyse the data in terms of labour market duality and precarious employment. The criteria for distinction – such as whether specific benefits are paid or not – may not be suitable for the measurement of precarity, since many workers (including permanent ones) in small firms are not paid such benefits. Therefore, data on *temporary employees* collected by the EAPS rather illustrate disadvantaged forms of employment, but not, strictly speaking, *precarious* employment.

186. Definition B relies on data collected by the EAPS Supplement since 2000. In this supplement, the questionnaire was designed to define a number of specific employment types. Workers who have a fixed-term contract or expect limited duration of the work arrangement for involuntary reasons are defined as *contingent workers*.⁶³ The EAPS Supplement also collects data on *part-time workers* and *atypical workers*. The latter category includes temporary agency workers, individual contract workers, at-home workers, on-call workers and other new forms of employment (*i.e.* a grey sector located at the margin between wage earner and self-employed). The Korean economic literature using the supplementary data set tends to define non-regular employment as the sum of contingent workers, part-time workers and atypical workers, although slight differences in detailed definition have not been resolved among scholars. The

63. The reason for such a definition based on the actual or expected duration is that there is no universal practice of signing a written employment contract in Korea.

Ministry of Labor also uses this definition for calculating the size of non-regular employment, based on a 2002 agreement on the use of statistics for non-regular workers in the Korean Tripartite Commission.

187. Data from the EAPS and from the EAPS Supplement can be matched category by category since the two data sets are collected at the same time, from the same sample households. Table A.1 compares classification results using the two definitions in the form of a matrix. Non-regular workers under definition A are the sum of sectors II and III, while under definition B non-regular workers are the sum of sectors I and II. Sector I represents workers with fixed-term contracts of over one-year duration. Meanwhile, sector III tends to include workers in *quasi-permanent jobs*. This is because the latter are categorised as *temporary employees* and *daily workers* by the EAPS since they are not paid specific benefits. However, they are not classified as *non-regular workers* by the EAPS Supplement since they are neither *contingent*, *part-time*, nor *atypical*.

Table A.1. **Classification of non-regular workers by the EAPS and its supplement, 2005**

Number of workers in thousands, and in percent

		Definition B: status in the EAPS Supplement (where workers who are not contingent, part-time or atypical are "regular")				
		Non-regular workers			Regular workers	Total
		Contingent	Part-time	Atypical		
Definition A: status in the EAPS (where workers with tenure over a year and paid bonuses and overtime are "regular")	Regular employees	I		IV		
		1 512		6 414	7 926	
		(10.1%)		(42.9%)	(53.0%)	
	Temporary employees and daily workers	II		III		
	3 970		3 073	7 043		
	(26.5%)		(20.5%)	(47.0%)		
	Total	5 483		9 483	14 969	
		(36.6%)		(63.4%)	(42.9%)	

Source: EAPS and EAPS Supplement, August 2005, as reported by the Ministry of Labor, Korea.

188. Table A.1 shows that almost half of *temporary employees* and *daily workers* under definition A are not classified as *non-regular workers* under definition B. Some researchers argue that workers listed under sector III in the table represent workers who work under less favourable working conditions in small firms, calling them *disadvantaged* or *seemingly-discriminated workers* (Ahn, 2004; and Hwang, 2003). This view is supported by the fact that most workers in sector III work at very small firms. Table A.2 shows that about 85% of workers in sector III (the *seemingly discriminated workers*) work at small firms with less than 30 employees, and over 40% of them work at very small workplaces with less than five workers. Thus, any results on non-regular employment based on definition A tend to be biased by including *permanent* or *quasi-permanent workers* in small firms.

189. Definition C argues that workers in sector III of Table A.1 should be included in the definition of non-regular employment simply because data on temporary employees and daily workers collected by the EAPS should not be excluded from the definition of non-regular employment. Supporters of this definition do not believe in the reliability of data on establishment size used in Table A.2, and argue that sector III may represent workers who are discriminated against as temporary workers in workplaces irrespective of their employment contract (Kim, 2001 and 2005). According to this definition, non-regular employment corresponds to the sum of sectors I, II and III from Table A.1. This definition is supported by the Korean trade unions.

Table A.2. **Share of non-regular workers by employment type and establishment size, 2003^a**

Percentages

	Firm size (number of workers)					
	Total	1-4	5-9	10-29	30-299	300 and over
Wage earners	100.0 (100.0)	100.0 (20.1)	100.0 (16.4)	100.0 (21.9)	100.0 (19.4)	100.0 (22.3)
Official standard workers	70.1 (100.0)	50.5 (15.1)	60.4 (14.7)	66.3 (21.6)	72.4 (17.5)	83.4 (27.7)
Standard workers	41.6 (100.0)	5.7 (2.6)	27.2 (10.0)	44.8 (22.0)	60.8 (26.4)	77.9 (39.0)
Seemingly-discriminated workers	28.5 (100.0)	44.7 (39.7)	33.3 (24.1)	21.4 (20.7)	11.6 (9.9)	5.5 (5.4)
Official non-standard workers	29.9 (100.0)	49.5 (30.2)	39.5 (19.7)	33.7 (22.5)	27.6 (16.3)	16.6 (11.3)
Contingent workers	9.5 (100.0)	21.4 (26.1)	20.2 (20.2)	17.1 (22.8)	13.8 (16.3)	10.7 (14.6)
Alternative workers	20.4 (100.0)	28.1 (34.3)	19.3 (19.2)	16.6 (22.1)	13.8 (16.3)	5.9 (8.0)

a) Items in this table correspond to each sector in Table A.1. The item *Standard workers* corresponds to sector IV; the item *Seemingly-discriminated workers* corresponds to sector III, and the item *Official non-standard workers* corresponds to the sum of sectors I and II.

Source: Cited from Ahn (2004), based on the August 2003 EAPS Supplement.

190. Definition D is related to the *Korea Labor and Income Panel Survey*. The KLIPS definition includes, first, temporary and daily workers who are defined by contract duration – *i.e.* temporary workers are defined as workers with a fixed-term contract longer than one month and shorter than one year, and daily workers are defined as on-call workers and workers with contracts of below one month's duration. In addition, the definition includes those that *declare themselves* to be *non-regular workers*.

There has been a contradictory trend between the number of non-regular workers as reported by the EAPS, and the extent of temporary employment as reported by the EAPS Supplement.

191. The share of *temporary employees* and *daily workers* collected by the EAPS – *i.e.* non-regular workers as under definition A – declined from 52.1% in 2000 to 47.9% in 2005 (see Table 2.2), while the share of temporary workers – who are the largest category of non-regular employment under definition B – has increased significantly during the same period (see Table 2.4). What could explain this contradictory trend?

192. Table A.3 shows how the proportions of single categories in a matrix composed of employment status data from the EAPS and employment type data from the EAPS Supplement have changed between 2001 and 2005. The most significant changes are the decrease in the cell corresponding to sector III of Table A.1, *i.e.* workers who are *permanent* according to Definition B but *temporary employees* and *daily workers* according Definition A (these are the *seemingly discriminated workers*); and the increase in the cell corresponding to sector I of Table A.1, *i.e.* workers who are *temporary* according to Definition B but are *regular* according to Definition A. The decrease in the number of sector III (*seemingly discriminated*) workers might be related to the decline of employment in *Wholesale and retail trade, restaurants and hotels* 27.2% in 2000 to 26.0% in 2004. The increase in the number of sector I workers indicates that temporary employees increasingly have tenure of over a year and are paid bonuses and overtime.

Table A.3. **Changes in the incidence of temporary or non-regular employment by different definitions**

Number of workers in thousands, and in percent

		Employment type by EAPS Supplement (definition B)			
		Permanent	Temporary	Total	
Employment status by EAPS (definition A)	2001	Regular employees	6 923 (46.5%)	413 (3.1%)	6 706 (49.5%)
		Temporary employees and daily workers	5 087 (37.6%)	1 747 (12.9%)	6 834 (50.5%)
		Total	11 380 (84.0%)	2 176 (16.0%)	13 540 (100.0%)
	2005	Regular employees	6 546 (43.7%)	1 379 (9.2%)	7 925 (52.9%)
		Temporary employees and daily workers	4 026 (26.9%)	3 017 (20.2%)	7 043 (47.1%)
		Total	10 572 (70.6%)	4 396 (29.4%)	14 968 (100.0%)

Source: Ministry of Labor, replies to an OECD questionnaire, January 2006.

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