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The Labour Market
in Korea: Enhancing
Flexibility and Raising
Participation

Randall S. Jones

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THE LABOUR MARKET IN KOREA: ENHANCING FLEXIBILITY AND RAISING PARTICIPATION

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By
Randall S. Jones

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ABSTRACT

The labour market in Korea: Enhancing flexibility and raising participation

This paper analyses the increasing dualism in the Korean labour market and the need to encourage greater labour force participation. Although the rising proportion of non-regular workers lowers labour costs and increases employment flexibility, it has a negative impact on both equity and efficiency over the long term. Relaxing employment protection for regular workers and increasing the coverage of the social safety net for non-regular workers would help limit the extent of dualism. Population ageing is projected to be exceptionally rapid in Korea, leading to a significant decline in the workforce by mid-century. Steps to boost the participation of women through family-friendly policies are a priority. It is also important to encourage employees to stay at firms beyond the age of 50. Making the wage system more dependent on productivity and less on seniority and implementing a company pension system in place of the retirement allowance would help maintain the employment of older persons. This Working Paper relates to the 2005 OECD *Economic Survey of Korea* (www.oecd.org/eco/surveys/korea).

JEL classification: J11, J3, J5, J7

Keywords: Labour market, dualism, employment protection, non-regular workers, corporate pensions, industrial relations, Tripartite Commission, unemployment insurance, labour force participation rates, female employment, older workers, wage subsidies, Korea.

RÉSUMÉ

Le marché du travail en Corée : accroître la flexibilité et les taux d'activité

On examinera dans ce papier le marché du travail coréen sous l'angle de son dualisme de plus en plus marqué et de l'augmentation nécessaire des taux d'activité. La proportion croissante de travailleurs non réguliers réduit les coûts de main-d'œuvre et favorise la flexibilité de l'emploi, mais elle a un impact négatif à long terme sur le plan de l'équité et de l'efficacité. On atténuerait le dualisme en assouplissant la protection de l'emploi des travailleurs réguliers et en élargissant la couverture sociale des travailleurs non réguliers. Le vieillissement de la population devant être extrêmement rapide en Corée, la population active diminuera très sensiblement jusqu'au milieu de ce siècle. Il est impérieux d'augmenter le taux d'activité des femmes grâce à des mesures favorables aux familles. Il importe également d'encourager la poursuite de l'activité des salariés au-delà de 50 ans. En faisant en sorte que le système salarial fasse davantage intervenir la productivité au lieu de l'ancienneté et en remplaçant l'indemnité de retraite par un régime de retraite au niveau de l'entreprise, on faciliterait la prolongation de l'activité des personnes âgées. Ce Document de travail se rapporte à l'Étude économique de l'OCDE de la Corée, 2005 (www.oecd.org/eco/etudes/coree).

Classification JEL : J11, J3, J5, J7

Mots clés: le marché du travail, dualisme, protection de l'emploi, travailleurs non réguliers, régime de retraite au niveau de l'entreprise, relations du travail, Commission tripartite, d'assurance-chômage, taux d'activité, l'activité des femmes, travailleurs âgés, subventions salariales, Corée.

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THE LABOUR MARKET IN KOREA: ENHANCING FLEXIBILITY AND RAISING PARTICIPATION

Randall S. Jones¹

1. The labour market remains a key item on the policy agenda in Korea. In contrast to the significant progress in the corporate and financial sectors (see the 2005 *OECD Economic Survey of Korea*) labour market reforms are lagging and the institutional framework is poorly adapted to the rapidly changing economy. Given the growing role of high-technology sectors and Korea's increasing integration in the world economy, it is essential to enhance labour market flexibility. Employment protection for regular workers has encouraged the hiring of non-regular workers, who now account for almost one-third of salaried employees, one of the highest proportions in the OECD area. This creates both equity and efficiency concerns. The determined opposition of workers to relaxing constraints on dismissals is due in part to the limited social safety net in place to protect the jobless. Underlying these difficult issues is the problematic state of industrial relations, which has weakened investor confidence. Over the longer term, the transformation from one of the youngest populations in the OECD area to one of the oldest makes it important to boost the labour force participation rate, especially for women, which is still relatively low. In addition, the practice of workers leaving firms at around the age of 50 is inappropriate in an ageing society. This paper focuses on the major challenges of reducing labour market dualism and boosting participation, with the key recommendations presented in Box 1.

Reversing the trend toward increased labour market dualism

2. The revision of the labour law in 1998 to allow collective dismissals for "urgent managerial reasons" has not sufficiently enhanced labour market flexibility in practice. This reflects the conditions attached to dismissals, notably exhausting "all means" to avoid dismissals, discussing proposed dismissals for at least two months with workers and notifying the government.² In practice, rulings by the Supreme Court have introduced some flexibility in certain cases, for example, by not requiring the fulfilment of all the conditions and allowing dismissals aimed at preventing a future crisis. Nevertheless, given the constraints in the labour law, firms have relied on more expensive methods to reduce employment, such as early retirement packages and incentives for voluntary departures. More importantly, companies have increased the proportion of non-regular employees in their workforces to enhance flexibility. In addition, the strength of unions representing regular workers and the seniority-based wage system, which reduces the flexibility of the wages of regular workers, has encouraged the hiring of non-regular workers. Indeed, the proportion of non-regular employees has nearly doubled from 16.6% in 2001 to 29.7% by 2004 (Table 1),³ the second-highest in the OECD area. Workers on fixed-term contracts, primarily for one year or less, account for more than half of non-regular workers.

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1. Head of the Japan/Korea Desk in the Economics Department of the OECD. This paper draws on material originally produced for the *OECD Economic Survey of Korea* published in October 2005 under the responsibility of the Economic and Development Review Committee. The author is indebted to Willem Adema, Andrew Dean, Val Koromzay, Jae-Kap Lee, Willi Leibfritz and Peter Tergeist for comments. Special thanks go to Brooke Malkin for technical assistance and Nadine Dufour and Lillie Kee for secretarial help.
 2. In addition, regular workers in large unionised companies also receive protection in collective bargaining agreements.
 3. In the Labour Force Survey, non-regular employees -- defined as those working for a fixed length of time and those who are not entitled to certain allowances, such as the retirement allowance -- accounted for 49% of employees in 2004. However, this overestimates the precariousness of employment since although many

3. The high and increasing proportion of non-regular employees has negative implications for both equity and efficiency. Non-regular workers are paid 20% to 27% less than regular workers, after adjusting for age, experience, education and other attributes (Jeong, 2003). Moreover, a third of non-regular workers are not covered by any worksite-based social insurance system. In short, the emergence of a dualistic labour market in which one segment is subject to lower wages, less protection from the social safety net and greater job precariousness creates equity concerns and has probably contributed to the deterioration in income equality since the 1997 crisis (see the 2004 *OECD Economic Survey of Korea*). Dualism is reinforced by the limited mobility between different segments of the labour market. Indeed, the probability of non-regular workers becoming regular workers was less than 1.5% during the second half of the 1990s. A rising share of non-regular employees also boosts the rate of worker turnover; the share of employees with tenure of less than one year is 34% in Korea compared to 22% in the United States, a country with relatively high turnover. High turnover reduces firm-provided training in Korea (Chung and Lee, 2005).

Table 1. Non-regular workers in Korea
Per cent of employees

		2001	2002	2003	2004
Workers with a fixed-term contract	Less than or equal to 1 month	5.6	5.2	6.7	5.6
	More than 1 month to less than 1 year	2.8	2.7	4.9	4.7
	Exactly one year	1.5	1.9	3.3	4.4
	More than 1 year to less than 3 years	0.6	0.6	1.3	1.7
	3 years or more	0.5	0.6	0.7	0.8
	Subtotal	11.0	10.9	17.0	17.1
Workers without fixed-term contract, whose job is not expected to continue due to involuntary reasons		2.9	3.8	4.3	7.6
Temporary agency workers		1.0	0.7	0.7	0.8
On-call workers		2.2	2.9	4.2	4.6
Total¹		16.6	18.1	25.9	29.7
<i>Memorandum item:</i>					
Total dependent employment (thousands)		13 540	14 030	14 149	14 584

1. Total is adjusted for overlapping categories. The Supplementary Survey is carried out each August. There have been a few changes that may influence recent results. *First*, the sample of the monthly *Economically Active Population Survey* was replaced starting from January 2003 and the question on fixed-term contracts was moved to this *Survey*. *Second*, workers who assess the durability of their employment to be unlimited because their contract is renewed on a regular basis have been moved to the "temporary" category since 2002.

Source: Ministry of Labour, Economically Active Population Survey; and Supplementary Survey of Economically Active Population Survey.

4. The 2004 *OECD Economic Survey of Korea* concluded that a comprehensive package that balances the interests of labour and management is essential to create a consensus for reform to address dualism. However, progress in the Tripartite Commission toward such a reform package has been limited during the past year.⁴ Relaxing employment protection for regular workers is a key to reducing dualism. In addition, it would be likely to spur job creation and help unemployed persons to find work more quickly. Flexibility could be enhanced by changing the labour law to specify the conditions in which dismissals are allowed, taking recent Supreme Court decisions as a guide. The Research Committee for the Advancement of Industrial Relations Systems, a panel of experts established by the government, recommended in 2004

employees at small companies are not entitled to certain allowances, a significant proportion expect to remain with the same firm on a long-term basis.

4. The Tripartite Commission, which aims at developing a consensus among the social partners on labour market reforms, remains limited by the refusal of the two main labour confederations to participate.

that the required consultation period be shortened depending on the scale of dismissals involved and that companies involved in bankruptcy proceedings be at least partially exempted from the conditions for dismissals.

5. Instead, the main objective of the draft labour bills submitted to the National Assembly in November 2004 is to stop discrimination against non-regular workers and prevent their overuse by firms. The main contents of these bills⁵ are as follows:

- Unjustifiable discriminatory practices against workers with fixed-term contracts, part-time employees and temporary agency workers are prohibited. Employees subject to discriminatory working conditions or wages can submit complaints to the Labour Relations Commission.
- Firms must establish a written contract when hiring fixed-term and part-time workers.
- The maximum duration of fixed-term contracts is extended from one to three years.⁶ Firms cannot dismiss workers after three years of contract work, even when their contract expires.
- Overtime work by part-time employees is limited to 12 hours a week.
- The maximum period for employing temporary agency workers is extended from two to three years, although no maximum period is set for those above age 50.
- The use of temporary agency workers is expanded from 26 occupations at present to all occupations other than those expressly forbidden by the law.

6. However, the bills have thus far failed to pass the National Assembly in the face of strong opposition from both labour and business organisations. Employers argue that allowing workers alleging discrimination in wages and working conditions to appeal directly to the Labour Relations Commission would result in costly and time-consuming litigation and that the prohibition on letting fixed-term workers go after three years reduces employment flexibility. On the other hand, the labour confederations complain that the bill does not go far enough toward their goal of having non-regular workers treated as regular workers. In particular, they want the principle of “equal pay for work of equal value” enshrined in the law. In addition, the unions believe that the maximum length of fixed-term contracts should be shortened and object to the proposed easing of rules covering workers from temporary agencies.

7. Labour’s demand for equal treatment of non-regular workers culminated in a national strike in June and the withdrawal of the Federation of Korean Trade Unions, the nation’s largest labour confederation, from the Tripartite Commission. These developments are indicative of the difficult state of industrial relations in Korea. Over the period 2000 to 2004, the number of working days lost due to strikes (per 1 000 employees) was the sixth-highest among the OECD countries reporting data (Figure 1), and well above other Asian economies, including Japan, Chinese Taipei and Hong Kong, China. Moreover, industrial actions in Korea are sometimes accompanied by violence and occupation of workplaces.⁷ Contentious labour-management relations have a negative impact on business confidence and investment. However, the number of working days lost due to strikes has been on a downward trend in Korea since its

5. The Act on the Protection of Fixed-term and Part-time Employees and the Act on the Protection of Dispatched Employees.

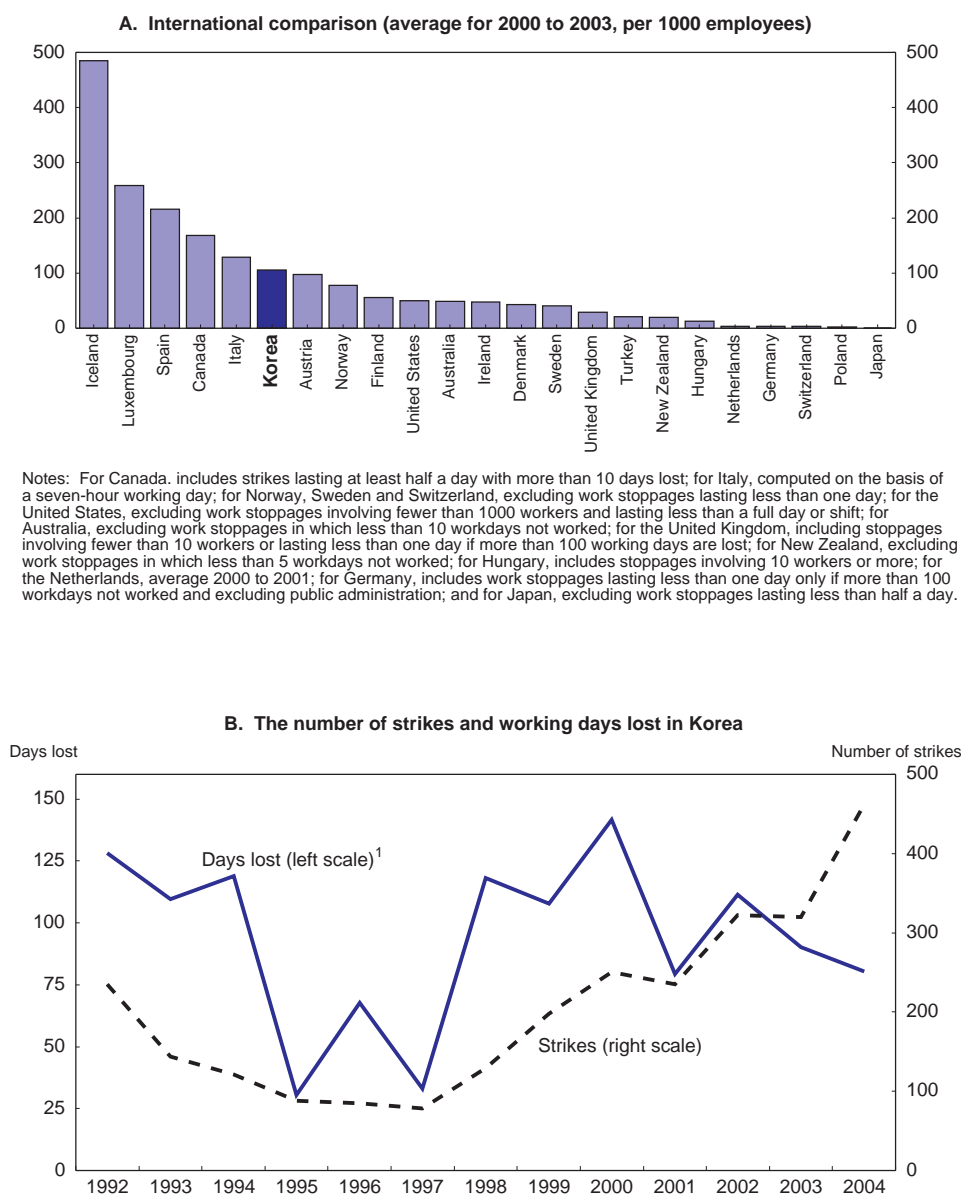
6. The time limit on fixed-term contracts does not apply to those above age 50.

7. In 2004, 13% of the strikes were illegal due to a failure to follow required procedures during negotiations or because the objective of the strike did not fall within the categories permitted in the labour law.

peak in 2000, although the number of strikes is increasing (Panel B).⁸ Implementing the roadmap for improving industrial relations is one aspect of overcoming labour-management problems (see the 2004 *OECD Economic Survey of Korea*).

8. The limited development of the social safety net helps explain the strong opposition of workers to dismissals. In December 2004, only 23.6% of unemployed persons received unemployment benefits, reflecting in part the strict conditions to qualify for benefits as well as their relatively short duration. However, it was also due to the limited coverage of the Employment Insurance System (EIS). The proportion of employees eligible for the EIS jumped from 66% in 2003 to 85% in 2004 (Table 2) as coverage was extended to daily workers employed for less than one month, newly hired persons over the age of 60 and persons participating in public works programmes. In addition, the threshold for part-time workers was lowered from 18 to 15 hours per week. These changes helped to boost the share of employees actually insured to 54%. However, more than one-third of the employees that should have been covered by the EIS at the end of 2004 were not, reflecting the difficulty of ensuring compliance. Increasing the effective coverage is complicated by the frequent turnover of non-regular employees and the large number of small firms. Indeed, there were 2.6 million firms with less than ten employees as of 2002.

8. While the number of working days lost due to strikes fell by 8% in 2004, the number of strikes jumped by 44% to reach its highest level since the late 1980s when the newly independent labour unions staged frequent strikes.

Figure 1. Working days lost due to strikes

1. Per 1 000 employees.

Source: International Labour Organisation, *Yearbook of Labour Statistics*.

Increasing the labour force participation rate

9. The total population and the labour force are projected to peak in 15 years. The extent of the subsequent decline in the workforce will have a significant impact on the prospects for economic growth and the burden of population ageing. The total labour force would fall by about 15% from its current level by 2050 if participation rates for each age cohort were to remain at their current levels for both men and

Table 2. Coverage of the Employment Insurance System
Number of workers in thousands and per cent

	1995 July	1999 July	2000 Dec.	2001 Sept.	2002 Oct.	2003 Nov.	2004 Dec.
Wage and salary earners	12 824	12 603	13 142	13 265	13 932	14 672	14 584
Eligible for EIS	4 280	8 342	8 700	9 269	9 269	9 651	12 389
Actually insured	4 204	5 876	6 747	6 884	7 102	7 180	7 905
Eligible as a per cent of wage and salary earners	33.4	66.2	66.2	69.9	66.5	66.0	84.9
Insured as a per cent of eligible workers	98.2	70.4	77.6	74.3	76.6	74.4	63.8
Insured as a per cent of wage and salary earners	32.8	46.6	51.3	51.9	51.0	49.1	54.2
Proportion of unemployed receiving benefits ¹	...	13.5	...	16.0	...	19.1	23.6

1. Annual averages.

Source: Ministry of Labour.

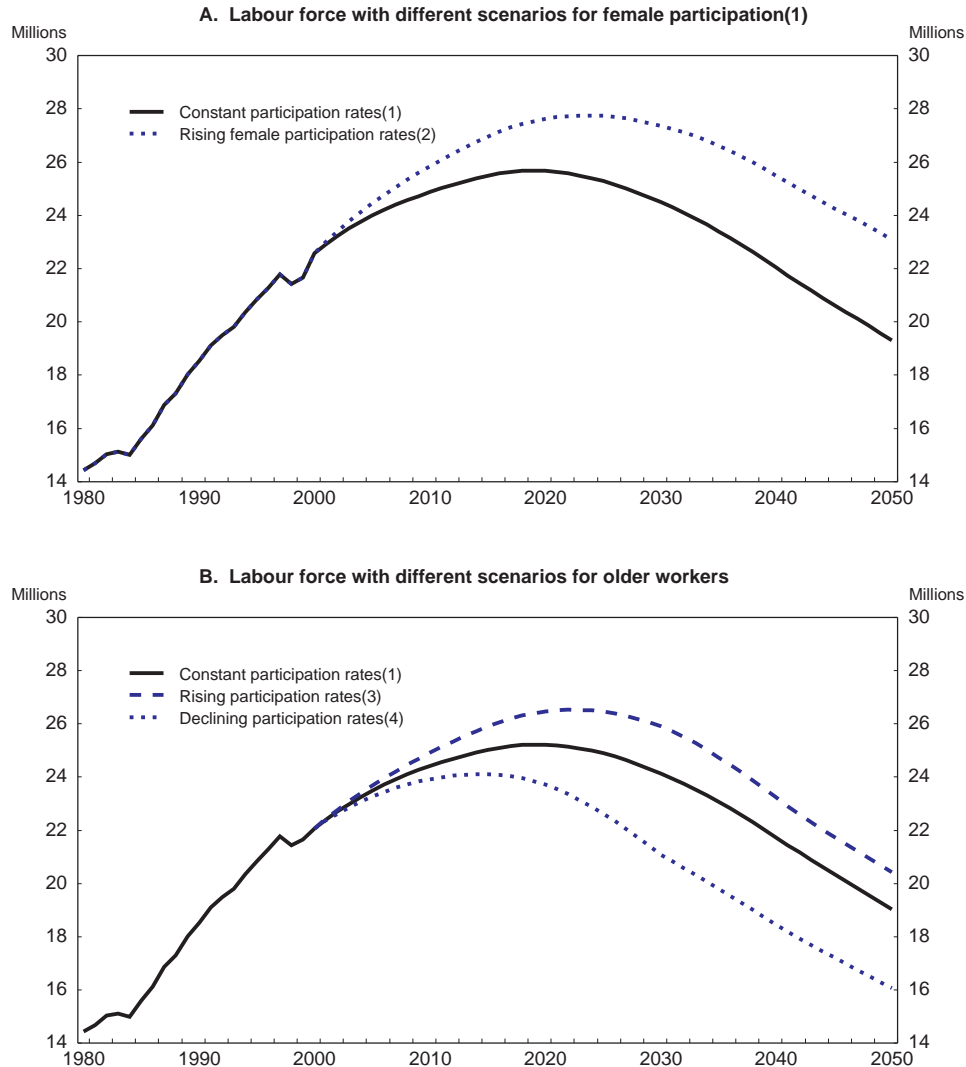
women (Figure 2). Increasing the labour force participation rate - or at least preventing a decline - is a key to coping with population ageing. The rate for prime-age men is near the OECD average, while that for older persons, both men and women, is relatively high (Figure 3). This reflects the fact that many older persons in Korea remain active as self-employed workers after leaving firms in order to supplement their retirement income and savings. Nevertheless, the overall participation rate is below the OECD average, primarily because the rate for prime-age women is the third-lowest in the OECD area (Panel D).

Boosting the labour force participation rate of women

10. If the participation rate for women were to increase to the same level as for men by mid-century, the labour force in 2050 would be 20% higher than in the case of unchanged participation (Figure 2). The low participation rate of women is generally attributed to the traditional division of roles between men and women. Although Korea introduced an anti-discrimination law in 1988, women are paid significantly less than men, as in many other OECD countries. After adjusting for workers' characteristics, the gender gap in wages is estimated at about 20% for regular workers (Jeong, 2003).⁹ A significant proportion of women withdraw from the labour force at the time of childbirth (age 28 on average). Consequently, the life-time participation pattern is M-shaped, with peaks in the 20 to 24 and 45 to 49 age groups (Figure 4). The pattern remains similar to that in 1980, although the trough has been pushed back to the 30 to 34 age group, reflecting the trend toward later marriage.

11. The evolution of family structure may tend to boost the labour force participation of women. *First*, the divorce rate (per 1 000 persons) has risen from 0.4% in 1970 to 2.8%, increasing the number of households headed by women. *Second*, the fertility rate has fallen from 4.5 to 1.2 over the same period, reducing childcare responsibilities. *Third*, the prevalence of three-generation households has declined with the urbanisation of Korea. Only about half of the elderly now live with their children, thus reducing the burden of caring for aged parents, although this also reduces the availability of childcare.

9. The study of the global gender gap by the World Economic Forum ranked Korea 54th out of 58th, placing it below all other OECD countries (Korea Economic Institute, 2005).

Figure 2. Long-term projections of the labour force

1. The participation rates for men and women remain at their current levels for each age group.
2. Female participation rates reach current male rates in each age group by 2050.
3. The participation rates converge by 2030 to the maximum value in the OECD for each gender and age group over 50, while the rates for younger workers remain at their current levels.
4. The participation rates converge by 2030 to the average value in the OECD for each gender and age group over 50, while the rates for younger workers remain at their current levels.

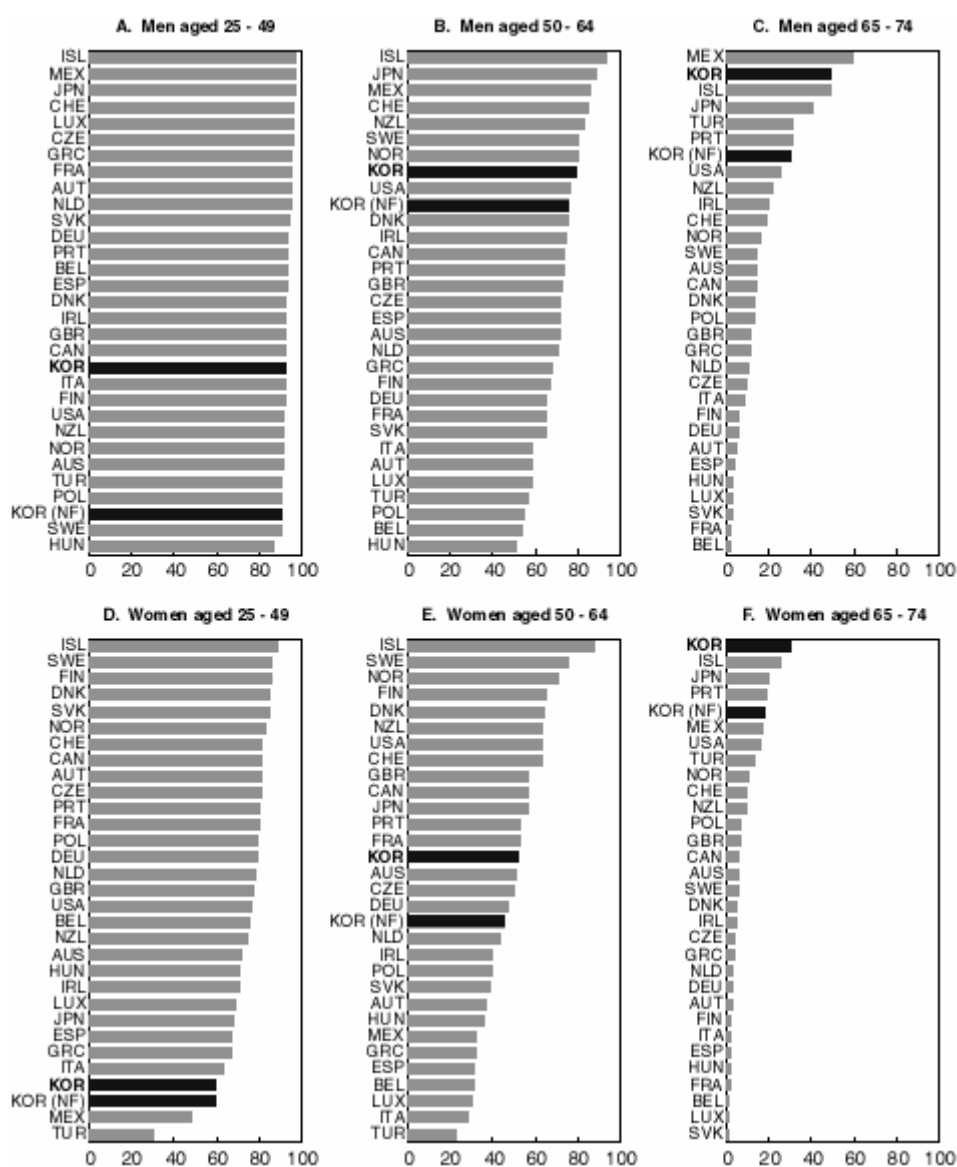
Source: OECD (2004a), *Ageing and Employment Policies: Korea*.

12. Government policies also influence female labour force participation. Korea has avoided policies such as taxing married women more heavily than men or single women and granting child benefits, measures which have been found to reduce female participation in other OECD countries (Jaumotte, 2003).¹⁰ On the other hand, paid parental leave and childcare subsidies have a significantly

10. The marginal rate is 8% on both a second earner in a household and a single worker at two-thirds of the average production worker's wage (APW). It is 10% and 9%, respectively, at the APW level, suggesting that the tax system is not an important influence on participation. In the OECD area, in contrast, the

positive impact on female participation rates. These policies are likely to be effective in Korea as well given that a significant portion of women withdraw from the labour force at the time of childbirth. Maternity leave was lengthened in 2001 from 60 days (paid by the employer) to 90 days, with the additional month paid by the EIS.¹¹ However, to qualify for the last 30 days, women have to have been insured by the EIS for at least

Figure 3. Labour force participation rates by age and gender
Per cent in 2002¹



1. For Korea, the data are shown for all households (KOR) and for non-farm households only (KOR NF).

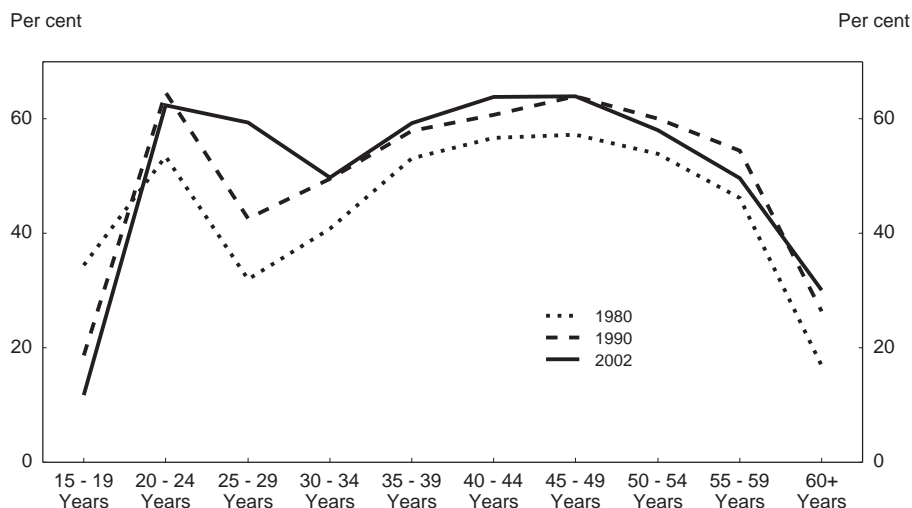
Source: OECD (2004a), *Ageing and Employment Policies: Korea*.

average marginal rate on the second earner is 6 to 7 percentage points higher than on a single person, depending on the income level (Jaumotte, 2003).

11. Childcare leave is also available for both men and women but is not widely used, reflecting a low monthly stipend that is only 4% to 5% of the average wage in manufacturing.

180 days. As noted above, with only about half of employees actually insured, a considerable proportion of women do not receive maternity leave paid by the EIS. The government recently announced that the EIS will pay all 90 days of maternity leave for women working at SMEs in order to reduce their financial burden. However, publicly-financed maternity leave still remains relatively short compared to other OECD countries.

Figure 4. Labour force participation rate of women by age cohort



Source: Korea National Statistical Office.

13. Regarding childcare, about a quarter of children under the age of five in Korea are enrolled in such facilities, with 95% of them in private institutions.¹² The authorities plan to increase the number of public facilities, which have a reputation for higher quality than those in the private sector, by 400 a year. This would double their share of total childcare facilities to around 10% by 2008. However, there is a 16% vacancy ratio for childcare, reflecting underutilisation of more expensive private facilities. This suggests that the scarcity of jobs paying well enough to make the net income gains of employment attractive is a more important factor hindering female employment than the absolute amount of childcare available.

14. While more generous maternity leave and increased subsidies for childcare may reduce the proportion of women who leave the labour force after childbirth, there remains the issue of attracting women into employment once their children are older. Although the proportion of young women leaving the labour force at the time of marriage and childbirth has fallen over time, the peak participation rate (at 64% in the 45 to 49 age group) is no higher than in 1990. This may reflect the increasing educational attainment of women, which makes them reluctant to accept low-skill, low-paying jobs. Indeed, Korea is the only OECD country in which the employment rate of female university graduates (55%) is less than the overall rate for women (56%). In contrast, education strengthens the attachment of women to the labour market in nearly all other OECD countries by increasing their potential earnings.¹³ Indeed, the average employment rate for female university graduates in the OECD area, at 82%, was significantly higher than the 69% rate for all women.

12. About 10% of the 24 000 private institutions receive government support.

13. The Japanese labour market, which shares a number of similarities with Korea, also stands out. The employment rate in Japan for female university graduates is identical to the overall female rate of 62.7%.

15. Female labour force participation is also discouraged by the fact that many of the jobs available to women tend to be non-regular positions, reflecting the rising share of such jobs in recent years, as noted above. Indeed, women are over-represented in non-regular positions: only 37% of female wage employees in 2004 were classified as regular workers, compared to 62% for men.¹⁴ This reflects labour market practices in firms that act as a barrier to outsiders. Even women employed as regular workers prior to interrupting their careers for children find it difficult to return as regular workers (Hwang and Chang, 2004). In addition, part-time jobs and flexible working hours may be preferable to some married women in order to balance work and family responsibilities.¹⁵ The tradition of long working hours - an average of 47.5 hours per week in 2001 - makes it difficult to combine regular employment with family responsibilities. However, the negative aspects of non-regular jobs - significantly lower wages, employment insecurity and less coverage by the social safety net - appear to discourage female participation. Finally, the seniority-based wage system, in which age and tenure play a dominant role, is another negative factor for female participation, as women who have left the labour force are locked into low salaries regardless of their performance. The weaker attachment of women to the labour force is reflected in the drop in their participation rate from 49.5% to 47.0% in the year following the 1997 crisis, while the rate for men was virtually unchanged at about 75%.

16. In sum, more generous childbirth leave and childcare support may reduce the proportion of women leaving the labour force when they have children. As for women who have left employment, the rising share of non-regular jobs and the concentration of women in such jobs may discourage more highly educated females from returning to the labour force. Efforts to reduce labour market dualism may thus also have a positive impact on female employment. In addition, replacing seniority-based wages with a system that links pay to performance would also encourage the employment of women.

Maintaining a high participation rate for older workers

17. By the middle of the century, more than one-third of Korea's population will be over the age of 65 and about half of all workers will be aged 50 or older. Meanwhile, the number of prime-aged persons in the 25 to 49 age group will fall by about half (Figure 5). If participation rates were to remain at their current levels, the labour force would decline by an estimated 19% from 22.4 million in 2004 to 19 million by 2050. However, it would be 7% higher (around 20.4 million) if the participation rates for the 50 to 64 age group were to increase to the maximum level in the OECD area in 2000 (Figure 2, Panel B). Conversely, if the participation rate for older workers were to decline to the OECD average in 2000 for that age group, Korea's labour force in 2050 would be 16% smaller (around 16.1 million) than in the case of unchanged participation rates. The sensitivity of the size of the labour force to the participation rate of older workers demonstrates the importance of policies to encourage those over age 50 to remain economically active.

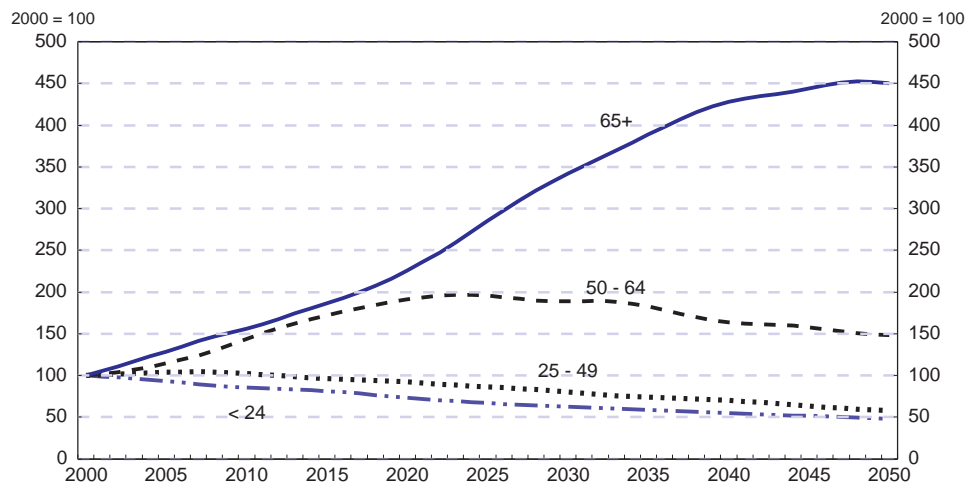
18. In contrast to most other OECD countries, there has been no long-term decline in participation rates for older workers. Indeed, the rate for men in the 50 to 64 age group and for both men and women over 65 remains relatively high, even after adjusting for the large share in agriculture (Figure 3, Panels B, C and F). The high and stable level of participation reflects several factors. *First*, pensions, both public and private, are at an early stage of development. Older persons, therefore, depend to a large degree on earned

14. This is based on the *Annual Report on the Economically Active Population Survey*, which classifies dependent employees into regular, temporary and daily workers.

15. According to a 2001 survey, women spent three hours and forty-five minutes a day on household work compared to 46 minutes by men. In households where both adults work, only 8% of couples shared household duties equally according to the National Statistical Office (Kim and Kim, 2004).

income, as well as transfers from family members, to supplement savings.¹⁶ *Second*, the labour market appears to be functioning efficiently in the sense that employees, who on average leave firms at a relatively young age, continue to work, though at lower wages more in line with their productivity. Nevertheless, the practice of workers leaving firms at around age 50 is not optimal in a rapidly ageing society.

Figure 5. Population projections by broad age group
Index 2000 = 100

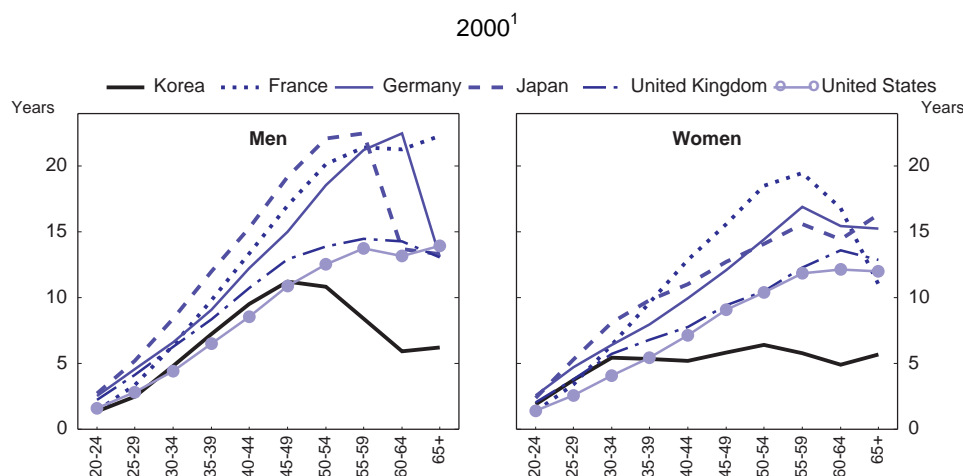


Source: Population projections (medium variant) made by the Korea National Statistical Office in 2001.

Early departure from companies

19. The practice of retiring workers from companies at a relatively young age reflects the importance of seniority – rather than individual performance – in determining wage levels. To avoid being saddled with a large number of expensive older workers, most firms set a mandatory retirement age that is well below the age of 60 recommended in the Aged Employment Protection Act. A mandatory retirement age also helps firms to adjust their workforces, given the difficulty of dismissing regular employees (Cho and Lee, 2005). As a result, average employment tenure peaks at 11 years in the 45 to 49 age group in Korea – compared to the 55 to 64 age group in most other OECD countries – and then drops sharply (Figure 6). Consequently, the wage level also peaks in the 45 to 49 age group, except for men with tertiary education.

16. According to the sixth Labour and Income Panel Study in 2003, 93% of retirees depend on transfers from family and 14% on asset income, but only 12% received public pensions (Ji Kyung Kim, 2004).

Figure 6. Average job tenure by age and gender in selected OECD countries

1. The data for Japan and Korea refer to regular workers in enterprises with ten or more regular workers, excluding the agricultural, hunting, forestry, fishing and general government sectors. The data for the other countries are based on labour force surveys covering all workers.

Source: OECD (2004a), *Ageing and Employment Policies: Korea*.

20. Although some of the employees leaving companies retire, about three-quarters move into self-employment, which on average is characterised by low productivity and income. This boosts the proportion of self-employed in the over 50 age group to 57%, compared to only 27% for those under the age of 50. As for workers who remain as employees past the age of 50, two-thirds worked in firms with less than 100 workers and only one-third were regular workers in 2002. Overall, 65% of workers over age 50 are in physically-demanding jobs, such as manual work, which tend to be low-paid.

Policies to promote the employment of older workers

21. The pattern of employees leaving firms at a relatively young age may have an increasingly negative impact on participation in the future. As the average education level of older age cohorts increases over time, workers over age 50 may become less interested in accepting self-employment and jobs at small companies offering significantly lower remuneration. It is thus important to encourage “continuous employment” at firms through greater flexibility in wages within firms. Requiring firms to set the minimum age for mandatory retirement at an age closer to the pension eligibility age - or forbidding the use of mandatory retirement altogether - would be beneficial. Firms agree to seniority-based wages on the condition that they can force older workers to leave. Without mandatory retirement, firms would insist on wage systems that more closely reflect productivity. One option under discussion is the “peak wage system”, which allows wages to decline after some point in exchange for guaranteed employment to an agreed upon age.¹⁷

22. In addition, the retirement allowance system should be reformed, as part of the introduction of a company pension system, in order to reduce incentives to retire older workers. By law, firms have been required to pay a lump sum of at least one month of wages to each departing employee for each year worked, although in practice many large firms agree to pay about double that amount. Given the short average tenure of employees in Korea, this payment has lost its link to retirement income as most workers

17. One major car manufacturer has proposed such a system that would guarantee employment past the current mandatory retirement age of 56, though at lower wages. The union, though, is demanding that the mandatory retirement age be raised to 58, while maintaining the current wage system.

receive such lump sums numerous times during their working life.¹⁸ For firms, the cost of the severance payment, which is based on an employee's final wage, increases the disincentives to keep older employees. In 2004, the government introduced a company pension system, which will take effect in December 2005, with the following provisions:

- Each workplace may establish, based on an agreement between labour and management, a defined benefit pension plan or a defined contribution pension plan. This is in addition to the current system of lump-sum retirement allowances, which are still mandatory for all firms with more than five employees.
- Firms that adopt pension systems must entrust fund management to financial institutions.
- The above requirements will be eventually applied to all firms, including those with less than five employees, which are exempt from the retirement allowance system.

Employees prefer to keep the lump-sum retirement allowance, which it considers to be deferred wage payments. Moreover, the lump sum is often used to start a small business after leaving a firm. However, funded company pensions would provide a more secure source of savings than the retirement allowance system, which is generally unfunded and whose payment depends on the firm's continued existence. Management, on the other hand, is reluctant to add a company pension system to the existing retirement allowance system.

23. In sum, the government should take several steps to encourage the development of an effective company pension system to reduce incentives to retire employees early and to encourage private-sector savings for retirement. *First*, the tax preferences for the retirement allowance, which allow the lump sum to be taxed over a number of years at low rates, should be removed, thus reducing workers' preference for the traditional system. *Second*, a company pension system based on defined contributions, rather than on defined benefits, should be encouraged, in order to promote pension portability and thereby labour mobility.

24. There is also a risk that the participation rate for older workers will decline as the National Pension Scheme (NPS) matures. It is essential, therefore, to avoid incentives for early retirement, which depend on the combined effect of the replacement rate - the level of pension income relative to wage earnings - and the change in pension wealth when continuing to work. A high replacement rate encourages withdrawal from the labour force as would a loss in pension income if the person continues to work. The planned increase in the pension eligibility age from 60 to 65 in 2033 will limit incentives to retire early. Another concern regarding the pension system is the lack of portability between the NPS and the occupational pension schemes (for civil servants, teachers and the military), which reduces labour mobility. A presidential commission is currently considering how to introduce portability.

25. One major challenge to employing older persons is their relatively low level of education. Two-thirds of unemployed persons over the age of 50 failed to complete secondary school and three-quarters worked previously as daily or temporary workers (Chang, 2004). This contributes to a significantly higher rate of poverty for households headed by someone over the age of 60. The government offers three different subsidies to encourage firms to hire and retain older workers (Table 3) and the take-up of these grants has increased markedly in recent years. The number of workers covered by these subsidies increased from 88 thousand in 1996 to more than a quarter of a million workers in 2004.

18. In fact, employees are allowed to receive this lump-sum payment while still employed to help them finance major expenditures, including housing.

Table 3. Wage subsidies to encourage employment of older persons
Billion won in 2004

Objective of subsidy	Conditions	Amount paid to employers in won	Number of workers subsidised ¹	Amount spent in billion won
1. New employment of older workers	Worker between 50 and 64 who are unemployed for at least 3 months	300 000 per month for first six months, 150 000 for the last six months	664	0.4
2. Maintaining a large share of older workers	Workers over 55 accounting for between 4% and 42% of a firm's labour force ²	150 000 per quarter for every worker over the threshold for 5 years	265 150	40.7
3. Re-employment of older workers ³	Workers between 45 and 60 who are re-hired by a firm between 3 months and 2 years after leaving	300 000 per month for six months	56	0.1
4. Continuous employment past the firm's retirement age ⁴	Workers whose continuous service extends more than 18 months beyond the retirement age or who are re-employed within three months after retirement	300 000 per month for six months	n.a.	0.2
Total			265 870	41.1⁵

1. In number of man-years. With around 2½ million wage earners over the age of 55, approximately one-tenth were covered by employment subsidies, although the exact proportion is uncertain as some workers were covered by more than one programme.
 2. The proportion of older workers necessary for a firm to qualify for a subsidy varies between sectors: 4% for manufacturing, 17% for business services, 42% for real estate services and 17% for other sectors.
 3. This subsidy was abolished in February 2004.
 4. This subsidy was introduced in March 2004. It applies to workplaces where the retirement age is set above 57.
 5. This is equivalent to about 3% of expenditures on active labour market policies.
- Source: Ministry of Labour.

26. The subsidies for the employment of older workers have recently been reformed and expanded as shown in Table 3:

- The coverage of the subsidy for hiring older workers was expanded from the 55 to 59 age group to 50 to 64 and the payment period was extended from six to 12 months. In addition, the amount of the subsidy was increased.
- The re-employment subsidy for firms that re-hired former workers was replaced by a subsidy for continuous employment of workers past the firm's retirement age.
- To limit deadweight costs, the threshold for receiving the subsidy for maintaining a large share of older workers was changed from 6% to between 4% and 42%, depending on the sector, and the maximum duration of the subsidy was limited to five years. In addition, only those who worked more than one year are eligible for the subsidy.

Real estate service firms account for about two-thirds of the companies receiving subsidies and they also receive about two-thirds of the total subsidies paid, with the majority concentrated in building maintenance services. The concentration of these subsidies in one business line raises doubts as to their effectiveness in boosting the employment of older workers. Indeed, 92% of firms receiving the subsidy responded that they would have hired the same number of workers in the absence of any assistance (Chang, 2004). Such an estimate is consistent with research in other OECD countries showing deadweight costs as high as 90% (Martin and Grubb, 2001). Even the impact on the number of older employees appears to be weak. Less than 20% of firms replied that they would have hired young persons instead of older workers in the absence of the subsidy.

27. Given the generally low skills and educational attainment of older workers, improving their employment prospects may depend on training. Government expenditures on lifelong learning, including vocational training, amounted to only 0.8 trillion won (0.1% of GDP) in 2004. Moreover, the participation rate in lifelong learning is less than 10% for those who failed to complete secondary school. The government has moved to increase financial and tax support for the training of middle and old-aged workers, although the return on such training is limited by their relatively short remaining working life. It is also important to ensure that the social safety net limits poverty among older persons during the transition period while the NPS is not yet mature and traditional means of old-age support are weakening.

Conclusion

28. The top priorities for labour market policy should be to reverse the trend toward increasing dualism and to boost participation rates. The key measure to stop dualism is to increase employment flexibility for regular workers in practice, which is also essential in an economy that is rapidly restructuring and specialising in volatile high-technology industries. Higher participation, particularly for women, and measures to extend the employment of older workers are essential to cope with population ageing. Detailed recommendations are shown below in Box 1.

Box 1. Summary of major recommendations for the labour market

Reverse the trend toward increasing labour market dualism

- Reduce employment protection for regular workers, in part by shortening the minimum consultation period necessary before dismissal and specifying in the law the conditions under which dismissals are permitted, drawing on recent Supreme Court rulings.
- Increase compliance with the Employment Insurance System, in part through enhanced co-operation with other social security administrators and the tax administration.
- Expand the coverage of non-regular workers in social insurance systems based in workplaces.
- Resist pressure to level the playing field between regular and non-regular workers by imposing regulations on non-regular employment, as this approach would tend to reduce overall employment.
- Develop more co-operative industrial relations, in part by implementing the roadmap proposed by the Research Committee for Advancement of Industrial Relations Systems.

Enhance labour force participation, particularly of women and older persons

- Encourage greater labour force participation by women by introducing more family-friendly policies, such as lengthening the duration of publicly-financed maternity leave and increasing assistance for childcare.
- Raise the effective retirement age by imposing a minimum for company-set retirement ages, or discourage them altogether.
- Reduce the importance of seniority in setting wages in order to encourage the employment of older workers by allowing wages to reflect productivity more closely.
- Encourage the replacement of the retirement allowance system with a company pension system based on defined contributions in order to enhance labour mobility.
- Ensure that the public pension system does not create incentives, once the system reaches maturity, for older workers to leave the labour force before the normal retirement age.
- Decrease wage subsidies to avoid high deadweight costs, while ensuring that other active labour market policies are cost-effective.

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