Republic of Korea – Case study of past crises

EC-IILS JOINT DISCUSSION PAPER SERIES No. 2
Case study of past crises:
Lessons learned from the Republic of Korea
Case study of past crises:
Lessons learned from the Republic of Korea
Abstract

This paper is part of a series of discussion papers that have been prepared by the International Institute for Labour Studies (IILS) within the framework of the joint project “Addressing European labour market and social challenges for a sustainable globalization”, which has been carried out by the European Commission (EC) and the International Labour Organization (ILO). The discussion paper series provides background information and in-depth analysis for two concluding synthesis reports that summarize the main findings of the project. This paper relates to first part of the project “Addressing the short- and medium-term labour market and social challenges of the current economic and financial crisis” and the concluding synthesis report “Building a sustainable job-rich recovery”.

This paper examines the effects and implications of a number of measures and reforms undertaken by the Republic of Korea during the 1997 crisis. In particular, in some cases reforms and programme introductions laid the groundwork for the government’s current response to mitigating the labour market effects of the crisis. In other instances, reforms while initially successful have created distributional considerations where risks of job loss are unevenly distributed.
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Main Findings

• Even though certain reforms or measures can have overall positive outcomes, there can be unintended negative consequences that often persist well beyond the recovery period. In particular, the example of Republic of Korea shows that labour market regulations – if not properly designed – can compromise social objectives in the long run and shift the risk of job loss disproportionately to certain groups.

• Active labour market policies play an important role in promoting a jobs recovery. Indeed many of the programmes introduced or expanded in 1997, e.g. public sector job creation and job sharing, have been critical tools in promoting a more inclusive recovery during the global financial and economic crisis that started in 2008. Both lessons are particularly relevant for policy makers seeking ways to develop a long-run, sustainable and inclusive growth path.

• The impact of the current crisis on employment was unevenly distributed in the Republic of Korea – highlighting the persistent gap between regular and non-regular workers:
  - Between the fourth quarter of 2008 to the first quarter of 2009, around 318 thousand non-regular jobs were lost, but regular employment increased by 51 thousand in the same period.
  - Less than 40 per cent of non-regular workers have access to employment insurance compared to two-thirds for regular workers.
Non-regular workers’ unionization rate – at 2.7 per cent, is relatively low in comparison to regular workers (23.7 per cent). As a result, non-regular workers tend to be systemically excluded from collective bargaining.

The asymmetric impact and situation facing non-regular workers is partly a function of reforms carried out during the 1997 Asian financial crisis. A number of reforms were carried out in 1997 and 1998 to attain more flexibility in the Republic of Korean labour market with the intention of promoting job growth. However, deregulation – like in many advanced economies – focused almost exclusively on temporary forms of employment rather than regular employment. As a consequence of these reforms, while job growth was strong, labour marker duality in the Republic of Korea widened considerably:

- Within the year following the 1997 financial crisis, Republic of Korea’s temporary EPL index (according to OECD) fell from 2.3 to 1.7 (total EPL thus fell from 2.7 to 2.0).
- Overall employment recovered following the reforms but much of the growth was non-standard in nature – the share of non-standard work in the Republic of Korea increased by 17 percentage points between 2001 and 2008 compared to a 1 percentage point gain in OECD countries.
- The share of temporary employment in 2008 stood at over 33 per cent in Republic of Korea compared to 12 per cent in OECD.

Another lesson which emerges from Republic of Korea’s response to the 1997 Asian crisis is that government-spending on active labour market policies (ALMPs) – although limited in scope – had a positive effect in boosting employment with many new or expanded initiatives helping to mitigate job and income loss in the current crisis:

- More than 60 per cent of unemployed persons participated in a range of ALMPs – total budget for labour and social measures increased from negligible levels in 1997 to the equivalent of 2.2 per cent of GDP in 1998 and to 3.2 per cent in 1999.

Introduction

The impact in Republic of Korea – in terms of growth and employment losses – of the current crisis was much less severe than the unprecedented downturn of the 1997 Asian financial crisis. However, job losses have been rather unevenly distributed – the burden of which has fallen principally on temporary workers. The purpose of this Chapter is to examine in more detail the effects and implications of a number of measures and reforms undertaken by Republic of Korea during the 1997 crisis. In particular, in some cases reforms and programme introductions laid the groundwork for the government’s current response to mitigating the labour market effects of the crisis. In other instances, reforms
while initially successfully have created a distributional considerations where risks of job loss unevenly distributed.

In particular, Section A will analyse the current state of the macroeconomic environment and labour market in Republic of Korea. This will be followed by section B which will compare the impact of the global financial and economic crisis of 2008-09 to the 1997 Asian financial crisis. Section C reviews the measures adopted to address the financial crisis of 1997 including a discussion of the major characteristics of the labour market evolution since that time. The final section will assess empirically the role of labour market and social policies adopted in 1997 in promoting an employment recovery.

A. Current developments

1. Macroeconomic and labour market developments

As a result of the global financial crisis in 2008, the Republic of Korean economy experienced a sharp decline in economic activity, particularly in terms of GDP growth, until the first quarter of 2009. However, supported by an improved global economic outlook as well as a moderate rise of domestic investments and consumption, together with the massive stimulus package introduced by the government, GDP growth has begun to show signs of recovery from the second quarter of 2009 and recorded a positive annual growth rate in the third quarter (Table 1). This development was also accompanied with an improvement of the terms of trade. In fact, in the third quarter of 2009, exports are supporting the overall recovery of the Republic of Korean economy.

1 See also Chapter 1 of World of Work Report 2009 for a review of other measures that have helped support the recovery process.
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<td>16.0</td>
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Source: Bank of Republic of Korea.

As depicted in Figure 1, the rate of employment growth fell below 1 per cent during 2008-2009. In December 2008, employment growth became negative, resulting in a sharp increase in the unemployment rate and the number of economically inactive workers. The unemployment rate reached its peak – 4.0 per cent – in March 2009. Initially, slow employment growth was not fully reflected in the unemployment rate – remaining relatively stable at around 3 per cent. This was due in part to a low participation rate as a large portion of workers exited the labour market based on low expectations of employment opportunities.

During 2010, the unemployment rate fell but not yet fully recovered. However, employment has surpassed its pre-crisis level in the first quarter of 2010. Moreover, inactivity is on the rise. In November 2010, the total number of economically inactive persons aged 15 years and over rose by over 260,000 compared to the same month of the previous year.
However, negative employment growth was tempered via job sharing (and reducing working hours) and strong wage moderation. For establishments with five employees or more, the nominal monthly wage bill per employee in the second quarter of 2009 was about 2,524 thousand Republic of Korean Won, which represented a 1.6 per cent decrease compared to the same quarter of the previous year (Table 2). In real terms, the monthly wage bill decreased by 4.3 per cent. The reduction in wages has been exacerbated by a reduction in working hours. The quarterly hours worked per employee have decreased by from 178.8 hours to 172.6 hours (-3.4 per cent) between the fourth quarter of 2007 and the second quarter of 2009.
Table 2. Monthly wages and hours worked, establishments with 5 employees or more

<table>
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<td>168.7 178.8</td>
<td>170.7 170.2 171.7</td>
<td>172.9 166.2 172.6 176.9</td>
<td>175.4 171.5 176.9 172.6 182.7</td>
</tr>
<tr>
<td>Total hours Worked (Hours, quarterly)</td>
<td>2,604 2,719</td>
<td>2,662 2,563 2,672 2,661</td>
<td>2,612 2,524 2,641 2,711</td>
<td>2,769 2,680 2,846 2,828</td>
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<tr>
<td>Nominal wage (thousand Won, monthly)</td>
<td>- -</td>
<td>- (6.1) (6.4) (2.6) (2.1)</td>
<td>- (1.9) (1.6) (1.2) (1.9)</td>
<td>- (6.0) (6.2) (7.8) (4.3)</td>
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<tr>
<td>Real wage (thousand Won, monthly)</td>
<td>2,472 2,565</td>
<td>2,478 2,339 2,405 2,402</td>
<td>2,341 2,239 2,331 2,389</td>
<td>2,416 2,318 2,441 2,404</td>
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<td>Consumer price indexes</td>
<td>105.3 106 107.4 109.6 111.1 110.8 111.6 112.7 113.3 113.5</td>
<td>114.6 115.6 116.6 117.6</td>
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Note: a) Figures in parentheses are 4th - quarter change rates.  
  b) Real wages are calculated as (nominal wages/consumer price indexes)*100

Source: Ministry of Labour

B. Comparison of current crisis and 1997 financial crisis

The 2008 crisis and the 1997 crisis are different in many ways. While the current crisis is global in scope, the 1997 crisis was regional, mainly linked to the monetary pressure from the neighbouring countries. The impacts on the labour market are also considerably disparate as are the responses to the crisis.

1. Speed of the labour market adjustment to the financial crisis

There are a number of differences in terms of how the labour market is adjusting in comparison to the 1997 financial crisis. First, the change in employment levels during the current crisis has been much slower (and less intense) compared with the previous crisis when employment levels fell dramatically. For example, Figure 2 shows that in the previous crisis, when GDP declined -5.2 per cent in the first quarter of 1998, the numbers of economically active and employed also dropped sharply, by -1.8 per cent and -4.5 per cent, respectively. In contrast, in the case of the current crisis, when GDP turned negative in the fourth quarter of 2008, levels of economically active and employed remained relatively stable, turning negative only in December 2008. Furthermore, the job destruction has lasted for a shorter period during the current crisis.
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Second, there seems to be a slight, but nonetheless important, difference in the ways firms have responded to macroeconomic shocks. During the current crisis wage moderation is relatively slow but more lasting (Figure 3). While the real wage of workers grew with the redress of GDP growth rate in the case of 1997 financial crisis, it continues to decline despite of the prospects of recovery during the current global crisis. In addition, there have been some important distributional effects in terms of employment losses regarding the current situation vis-à-vis the previous crisis.

Note: Economically active population is obtained on the basis of workers who searched job during the last one month prior to the survey.
Source: Bank of Republic of Korea; Republic of Korea National Statistical Office.
2. Labour market impact of the financial crises by different worker groups

The employment adjustments during the two crises have had different impacts on worker groups. The vulnerable workers hit most by the current global crisis are groups of non-regular, female and young workers. The most striking difference is based on employment status. In the case of the 1997 crisis, all categories of workers experienced very rapid employment adjustment following the macroeconomic contraction. While the current situation is characterized by more stable employment losses, the gains in permanent workers – which account for about 40 per cent of total employment – are masking declines in non-regular forms of employment (Figure 4, panel A). Given that female workers make up a disproportionately share of non-regular workers, female workers account for the bulk of employment losses (Figure 4, panel B). Young workers are among those most affected by the economic crisis as firms reduce recruitment of new jobseekers during economic downturn. Different from the 1997 financial crisis when job destruction took place in all age groups due to corporate restructuring, old and middle aged workers appear to secure better employment (Figure 4, panel C).

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2 In the given context of Republic of Korea, the term, non-regular worker, is dominantly used as a variant term of non-standard worker and, hereby, will be interchangeably used with non-standard worker in this paper.
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Figure 4. Job destruction according to the GDP decline

Panel A. By employment status (4-quarter, percentage change)

Note: a) NS refers to the non-salaried workers including self-employed, employers and unpaid family workers; PE refers to the permanent workers whose contract period exceeds 1 year or who are benefiting from bonuses, primes and severance pays even though there is no clear definition of contract period; TE refers to the temporary workers whose contract period is between 1 month and 1 year or who are employed for a specific reason of business completion; DW refers to the daily workers whose contract period is shorter than 1 month. 
b) The reference periods refer to the last quarters before the GDP growth rate turned negative for the two compared periods - the 4th quarter of 1997 for the 1997 crisis and the 3rd quarter of 2008 for the current crisis.
Panel B. By gender (4-quarter, percentage change)

Note: The reference periods refer to the last quarters before the GDP growth rate turned negative for the two compared periods - the 4th quarter of 1997 for the 1997 crisis and the 3rd quarter of 2008 for the current crisis.

Panel C. By age (4-quarter, percentage change)

Note: The reference periods refer to the last quarters before the GDP growth rate turned negative for the two compared periods i.e. the 4th quarter of 1997 for the 1997 crisis and the 3rd quarter of 2008 for the current crisis.

Source: Republic of Korea National Statistical Office, Economically Active Population Survey
C. Policy responses to the 1997 financial crisis and the following labour market evolution

This part of section gives an overview of the labour market reforms introduced to address the financial crisis of a decade ago including a discussion of the major characteristics of the labour market evolution since the 1997 financial crisis. In order to put the economy back on track after the 1997 financial crisis, the Republic of Korean government not only aimed to correct the short-term market disequilibrium and pursue structural reforms, but also intended to mitigate the negative social impacts arising from massive unemployment and the spread of poverty among the working population.

1. Advances in social dialogues and their limitations

The new government’s first action was to launch the “Tripartite Commission” to pursue social dialogue. As a matter of fact, the establishment of the Tripartite Commission was largely supported by economic actors with strategic plans to diminish the damage from the crisis. Faced with restructuring efforts by individual firms, including effective labour reduction, wage cuts or freeze, and annualization of salaries, the president-elect Kim Dae-Jung held talks with labour and management at the end of 1997 to elicit their cooperation in forming a tripartite body.

The most important factor in the establishment of the Tripartite Commission and the following 2.6 Great Compromise was the need to make the provisions of the collective dismissal policy immediately effective. The Federation of Republic of Korea Trade Unions (FKTU) immediately accepted the government proposal, while the other nation-wide labour organization, Republic of Korean Confederation of Trade Unions (KCTU) decided to participate in the body under the conditions of suspension of the legislative process on collective dismissal arrangements and linking the arrangement with the outcome of the tripartite dialogues. In January of 1998, the Tripartite Commission was officially launched and through painful discussions and negotiations, reached the so-called “2.6 Great Compromise”.

The most important factor in the establishment of the Tripartite Commission and the following 2.6 Great Compromise was the need to make the provisions of the collective dismissal policy immediately effective. In return, some compensation was made in favour of trade unions. The political activities of trade unions were to be allowed. The teachers’ union and the workplace association of the public workers were to be legally recognized. Finally, it was agreed that the unemployed workers would join in non-firm-based unions. Also, 90 items of the Great Compromise included: measures to expand social safety networks, promote corporate transparency and restructuring, to improve international trade balance, and to stabilize consumer prices.

3 There are multiple views about the genesis of the social dialogue. Some observers mention that it was largely idea of President Kim Dae-Jung, while others talk that it was suggested by the Republic of Korea Labour Institute or by leaders of the KCTU.
4 The legislation related to the collective dismissal arrangements was made in March 1997, under the former government, with two years of suspension.
From the beginning the new industrial relations system, which the Republic of Korea government tried to put in place, encountered serious challenges. The KCTU Conference in February 1998 refused to accept its leaders’ agreements to the Great Compromise, which led to a general resignation of the leaders. After this incident, the KTCU continuously moved in and out of the negotiation process as a bargaining strategy and finally decided to quit the Tripartite Commission in 1999. The FKTU was left alone to represent labour interests in the Commission. Since then, the KTCU has pursued direct negotiations with government rather than tripartite dialogues. The initial intention of the Tripartite Commission as the organizer of the social pact was severely damaged.

Clearly, the establishment of the Tripartite Commission was a big step forward in the Republic of Korean industrial relations system, which aimed at forming a genuine social pact in order to overcome the economic crisis. However, its function in practice frequently became a target of wide-spread criticism. The labour activists often argue that government and management tried to appease labour with promises to adhere to their end of the bargain, but the gap of distrust among them became even wider when those promises were not honoured (Bae and Cho, 2004). On the other hand, it is thought that the dialogues within the Tripartite Commission tended to privilege the nation-wide labour organizations and organized workers in large firms rather than to reflect the general interests of workers (Kim, 2007).

2. Policies to enhance labour market flexibilities

The need for economic restructuring after the 1997 financial crisis placed labour market flexibility on top of the policy agenda. Thus, the main discussions within the Tripartite Commission focused on collective dismissals and dispatched workers.

Regarding the collective dismissal, the revised labour law drafted through the discussion within the Tripartite Commission prescribes the followings:

- The “urgent managerial needs” include the transfer, merger and acquisition aiming at preventing the aggravation of financial difficulties.\(^5\)

- The management should make all the possible efforts to avoid collective dismissals.

- The employees to be laid off should be selected in fair and rational criterion (in particular, any gender discrimination is prohibited).

\(^5\) The implementation of a number of key provisions in the 2.6 Great Compromise such as political fund reforms and permitting unemployed to join non-firm-based union were suspended or postponed.

\(^6\) The old labour law allowed collective dismissals when there are “urgent managerial needs”. However, as there were not any precision about these latter, the legal justification of collected dismissals had been earned on the basis of the judicial precedents.
• The management should give notice to the unions or employee representatives at least 60 days before the collective dismissals, and declare to the labour minister when the number of employees to be laid off exceeds the prescribed level.

• The management should make all possible efforts to re-employ the laid-off when it wants to employ new personals within 2 years after the collective dismissal. The revised law was to become effective immediately.7

Concerning the dispatched workers, the ‘Act relating to Protection, etc., for Dispatched Workers’ was established on 20 February 1998. This newly enacted law gave a legal basis to the already widespread business practice of using dispatched workers, in allowing firms worker dispatch undertakings for tasks that require specialized knowledge, techniques or experiences (except direct production tasks in the manufacturing), in cases of vacancies due to child birth, diseases or injuries, or of needs for supplement of personnel on the temporary and non-regular basis excluding specific activities. On the other hand, the law provided measures to protect dispatched workers and to prevent abuse of such employments, by prohibiting use of replacement workers for tasks interrupted by the industrial disputes and discrimination of this type of worker from others undertaking the same tasks.

These reforms contributed to relaxing labour market rigidities. Within 1998 alone, the OECD Employment Protection Legislation indicator for Republic of Korea declined from 2.7 to 2.0 and approached to the OECD average (Figure 5)

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7 A similar revision of the labour law was made under the former administration, in March 1997, but its effectuation was postponed to 2 years later.
In the case of the collective dismissal provisions, there is criticism that the provisions have reinforced existing labour market rigidities instead of reducing them. It is often argued that the clauses by which management has to make all the possible efforts to avoid collective dismissals and should discuss sincerely with the workers’ representative are ambiguously defined, so that they pave the way for large scale industrial disputes (Kim, 2007). As a result, firms, especially large companies where the union power is generally strong, tended to prefer ‘contract buyout measures’ to collective dismissals, and relied more on outsourcing and non-standard type of employments, such as replacement workers (see below, evolution of the Republic of Korean labour market post-1997 crisis).8

3. Employment support

To address some of the social consequences of 1997 crisis, the Republic of Korean government expanded public expenditure for labour market programmes. After the 1997 financial crisis, policy options for the Republic of Korean government were the temporary livelihood of protection programmes, public work projects, and the Employment Insurance System (EIS). Based on these policy options, the government established the Comprehensive Unemployment Programme in March 1998, encompassing a wide range of labour market programmes. As the unemployment continued to grow, the unemployment budget increased sharply until 1999 to decline progressively during the

8 For example, during the strike in the Hyundai Motors, the management’s announcement on the collective dismissal of 2,678 workers resulted in the union’s strike of one and half month length. The strike ended when the management decided to lay off only 277 effectives. Finally, the Hyundai Motors achieved the employment adjustment through contract buyout.
subsequent years. Between 1998 and 2000, the government placed 2-3 per cent of the national budget. With an annual budget of 5,326 billion Republic of Korean won, about 4,274 thousand people benefited from the relevant schemes in 1998. In 1999, the budget for the unemployment schemes increased to 7,454 billion Republic of Korean won with 5,744 thousand beneficiaries (Table 3).

**Table 3. Main records of the unemployment schemes after the 1997 crisis**  
(Billion Won, Thousand persons)

<table>
<thead>
<tr>
<th></th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Budget</td>
<td>Spending</td>
<td>Beneficiaries</td>
</tr>
<tr>
<td>Total</td>
<td>5,667</td>
<td>5,326</td>
<td>4,274</td>
</tr>
<tr>
<td>Job maintenance support</td>
<td>122</td>
<td>113</td>
<td>781</td>
</tr>
<tr>
<td>Provision of short-term jobs</td>
<td>1,044</td>
<td>925</td>
<td>438</td>
</tr>
<tr>
<td>Vocational training and job placement services</td>
<td>901</td>
<td>777</td>
<td>386</td>
</tr>
<tr>
<td>Livelihood protection for the unemployed</td>
<td>3,599</td>
<td>3,512</td>
<td>2,669</td>
</tr>
</tbody>
</table>


Public work programmes were the most important measure during the 1997 crisis period in terms of budget spending. In 1999, the budget for this programme increased by 150 per cent (from 925 billion to 2,327 billion Won) and the number of beneficiaries by 250 (from 438 thousand to 1,525 thousand people). The public work programmes included the government-sponsored internship programmes for fresh graduates from high schools and universities. This measure aimed at reducing the youth unemployment rate which increased rapidly due to the firms’ reluctance to hire after the financial crisis.9

The EIS carried out the Employment Stabilization Programme and the Job Skills Development Programme to mitigate the social cost of the restructuring and to help jobless people find jobs. However, the principal measures of the EIS at that time were to promote job sharing and employment maintenance by expanding subsidies to working time reduction, temporary suspension of business, job replacement, and vocational training for job maintenance, rather than the unemployment benefits.

---

9 The youth unemployment rate in 1998 and 1999 rose to 12.2 per cent and 10.9 per cent, respectively.
4. Expanding the social safety networks

As the 1997 financial crisis revealed the vulnerability of the Republic of Korea's welfare system, particularly for poor households with work capability, the Republic of Korea's government took efforts to strengthen the social safety net through several measures, namely the expansion of coverage for unemployment benefits, and the introduction of a temporary livelihood security system and the Basic Livelihood Security system.

**Expansion of unemployment benefits coverage**

The 1997 financial crisis brought several changes in the Republic of Korea's unemployment benefit system: (i) expansion of coverage; (ii) relaxation of eligibility requirements; and (iii) introduction of the Special Extended Benefits System.

The coverage of the unemployment benefits was expanded from establishments with 30 or more employees to establishments with 10 or more employees in January 1998, to establishments with 5 or more employees in March 1998 and to all the establishments in October 1998 (Figure 6). The eligibility requirements of the unemployment benefits were temporarily relaxed for the workers who were separated from their job between 1 March 1998 and the 30 June 1999: an insured worker was eligible for unemployment benefits if he or she had been employed at an insured firm for six of the twelve months prior to job separation instead of twelve out of the 18 months. With the introduction of the Special Extended Benefits System, the benefit duration can be extended at maximum by 60 days, on top of the 30-210 days according to the age and insured employment period of the workers, during the high unemployment periods.
Despite of the comprehensive reforms, the general evaluation is that the Republic of Korean unemployment systems were not sufficiently developed to provide a strong social safety net during the crisis. The workers with high unemployment risks in small firms or with non-regular labour contracts tended to be excluded from the unemployment benefit system. The coverage rate of the unemployment benefit system (share of the beneficiaries in the total number of unemployed) was only 1.8 per cent in 1997 and 10.8 per cent in 1998. The coverage rate exceeded the 25 per cent level only at the middle of 2000s\(^7\) (KLI, 2007).

**Basic Livelihood Security system**

During the crisis period, the existing livelihood security system was expanded temporarily. This temporary livelihood security system aimed at supporting households facing difficulties due to unemployment or bankruptcy.

In 2000, the Basic Livelihood Security system was adopted. The system integrated various social safety schemes implemented on a temporary basis, such as public work programmes, homeless protection, living expense loans, and temporary livelihood security system. The number of beneficiaries of the living expense loans was about 540 thousands in 1999 and increased to 1,490 thousands in 2000. The payment for 4 person households also increased from 739 Republic of Korean Won in 1999 to 1,222 thousand Republic of Korean Won in 2002.
5. **Major labour market evolution after the 1997 crisis**

This part gives an overview of some of the current characteristics of the Republic of Korean labour market, many of which have been shaped by the reforms introduced to address the financial crisis of a decade ago. In order to put the economy back on track after the 1997 financial crisis, the Republic of Korean government not only aimed to correct the short-term market disequilibrium and pursue structural reforms, but also intended to mitigate the negative social impacts arising from massive unemployment and the spread of poverty among the working population.

These included measures to enhance labour market flexibilities to facilitate collective dismissals and encourage aggressive firm restructuring; reduce unemployment risks and help workers maintain their jobs; and expand social safety networks to mitigate income reductions following job loss. To accomplish these goals effectively the newly-elected government needed to earn nation-wide support for the policies after the crisis. As such, some advances in social dialogue with partners were indispensable in this regard. The combination of changing labour market institutions and the introduction of new policies gave rise to some distinctive patterns in the Republic of Korean labour market, notably: (i) new drivers of employment creation; (ii) increasing income inequality and rising non-regular employment and (iii) a shift in focus in industrial relations.

**New drivers of employment creation**

The 1997 financial crisis altered the employment growth pattern of the Republic of Korean economy. The weakening of the forward and backward linkages between industries and low potential for employment creation in new leading industries are often cited as the main causes of this phenomenon. For example, the annual growth rate of employment during the 1981-1997 crisis periods was about 2.8 per cent on average, compared to the post crisis period of less than 2 per cent. An important change in employment creation is the increased role of small and medium enterprises (SMEs) (Figure 7). Traditionally, large firms, in particular the affiliates of Chaebol, were the source of job creation. Although it was significant, the role of large firms for employment creation seems to have been reduced under the restructuring process that followed the 1997 financial crisis. In 1996 a quarter of total employment was in large firms, whereas only 12 per cent were employed by large firms in 2007.
Case study of past crises: lessons learned from the Republic of Korea

Figure 7. Changing role of SMEs in employment creation, 1993-2007

![Graph showing changing role of SMEs in employment creation, 1993-2007](image)


The average employment growth rate among SMEs is relatively stable in comparison with large firms in which rates have fluctuated widely. After the 1997 crisis, “micro-establishments” – small firms with less than 10 employees – began proliferating very rapidly in Republic of Korea. For example, in the manufacturing sector, the number of such establishments increased from 42,192 in 1999 to 58,408 in 2006, and the number of employees increased from 270,382 to 371,556 during the same period. The jobs created by these “micro-establishments” account for a quarter of the total employment in the manufacturing sector and over 90 per cent of total employment in SMEs.\(^\text{10}\)

The shift in the role of employment creation did not apply only to firm size, but also to different industrial sectors. In the era of the “de-industrialization,” the service sector is one of few job creation sources while the manufacturing sector has lost its status of “engine of employment creation” which it enjoyed in the developmental period of the 1960s to the early 1990s. The share of service industries in total employment was about 60 per cent in 1992 and continuously increased up to almost 3 quarters of the total employment in 2008 (Figure 8). However, the number of jobs in the manufacturing sector decreased from 4,980 thousands in 1992 to 4,079 thousands in 2008. These changing drivers of employment creation will be discussed in more detail in the following chapters.

\(^{10}\) The figures are obtained based on the Manufacturing and Mining Survey. As this survey covers only the establishment with 5 and more employees, it is likely that the role of these “micro-establishments” is underestimated.
Rising income inequalities and non-regular employment

The challenge for the Republic of Korean labour market after the 1997 financial crisis is linked more to the quality than the quantity of jobs. A large portion of the employment creation took place in SMEs and service industries, where the wage rates are relatively low and the employment stability is weak, and this evolution had important consequences for the income distribution of the Republic of Korean economy.

The 1997 financial crisis affected low-income households disproportionately. Moreover, the burden born by the low-income households did not seem to be lifted with economic recovery, at least in relative terms, because their income grew less quickly than was the case for high-income households. Income disparity among the Republic of Korean urban households has widened dramatically since the 1997 financial crisis and was not reduced during the post-crisis period, except for a very short period of re-adjustment (Figure 9).

11 Measured by the Gini coefficient.
The widening income inequality is not specific to Republic of Korea. It is important to note that Republic of Korea is one of the countries where income distribution is most unequal among the OECD countries and where inequality is most rapidly increasing.

Growing income inequality in the Republic of Korean economy may be mainly attributed to the skill-based technological progress and a greater exposure to the global market. The impact of the technological changes on income inequality has already been examined. In case of Republic of Korea, a number of studies found that there is a positive correlation between Information and Communication Technologies (ICT) expenditures and wage share of the skilled workers (N.-H. Kwon and J.-I. Kim, 2002; Hur et al., 2002; Seo et al., 2004). There is also evidence that the intensive movement of goods and productive factors influences the skill composition of the labour demand. Ahn et al. (2007) found that, when the skill level of workers is classified by their formal education, the demand for the low-skilled workers reacts sensitively to off-shoring to the lower-income East Asian countries. On the other hand, Ok et al. (2007) found that both the vertical and horizontal intra-industry trades with China are positively correlated with the wage share of the skilled workers. Their research confirms that this correlation remains robust even when the skill-based technological progress is controlled. In general, the ICT diffusion and international trade tend to reinforce the wage inequalities in Republic of Korea.
Income inequality since the 1997 financial crisis, however, is strongly associated with an increase in the number of non-regular workers. With deepening globalization and the subsequent strengthening of the competitive pressures, demand for these non-traditional forms of work arrangements is increasing throughout the industrialized countries. The “de-industrialization” process also constitutes one of the main drivers of this “non-regularization” of work. The share of non-standard workers increased 17 percentage points between 2001 and 2008 in Republic of Korea – compared 1 percentage point in the OECD on average (Figure 10). Much of the increase occurred in service industries where the share of temporary employment stood at 35 per cent in 2008.

The number of the temporary and daily workers has gradually grown since the early 1990s.\footnote{As the data for the non-regular workers classified by type of contracts, which are provided by the Economically Active Population Survey, Supplements, are available only from 2002, the classification by employment status from the Economically Active Population Survey is used here to capture the long-term trend of non-regular type of workers.} According to the Economically Active Population Survey (EAPS), the growing trend accelerated after the 1997 financial crisis and slowed down during the 2000s. However, the share of these non-regular types of workers has decreased in the recent years.

![Figure 10. Share of non-regular workers in the Republic of Korea and OECD, 2001 and 2008 (per cent)](chart.png)
D. Lessons learned and policy assessments

This section provides empirical evidence of the effectiveness of labour and social policies in boosting employment during past crises. The results presented here have been estimated by way of an econometric analysis of the impact of government expenses in active (ALMP) and passive labour market policies (PLMP) on employment creation (See Appendix A for methodological considerations). The study depicts two types of government-spending multipliers: one that measures the effect of fiscal expenses during the average moment of the economic cycle, and another that assesses the same effect but during times of crisis.

1. Government-spending on ALMP has had a positive effect in boosting employment.

This finding is especially important given the unprecedented size of government expenditures in labour market policies and programmes during the 1997 crisis. As discussed in previous sections, total budget for labour and social measures increased from negligible levels in 1997 to the equivalent of 2.2 percent of GDP in 1998 and to 3.2 percent in 1999. Despite this fact, experts affirm that the effectiveness of government
expenses could have being higher had labour and social programmes been better targeted. Indeed, taking care of specific characteristics during the design and implementation faces are equally important in order to minimize the deadweight, substitution and displacement effects often associated with such policies. This was the case of ALMPs in Republic of Korea, which had a lower than expected coverage of the affected population. Out of 1.5 million individuals unemployed in 1999, only 60 percent participated in one of the various labour market programmes.

With respect to passive labour market programmes, although these policies had a certain level of success in terms of number of participants – almost half a million in 1998 and 50 percent more than that in 1999 – their implementation was largely criticized mainly due to the laxity with which the selection criterion for participation was applied.

Still, labour market efforts had some level of effectiveness during the crisis period in Republic of Korea. This is despite the fact that government spending in both active and passive labour market policies in Republic of Korea is negligible – relative to other variables – in boosting employment creation in normal economic times. 13 This in itself is a reason to recognize the benefits – albeit modest – of government efforts during the 1997 crisis.

In particular, ALMPs show a positive link to employment creation at various times in the business cycle. 14 As such, the development and expansion of such programmes in 1997 (notably the Employment Stabilization Programme and the Job Skill Development Project) played a key role in supporting employment creation in Republic of Korea. 15 For passive labour market policies, however, the effectiveness is only positive only when implemented counter-cyclically. 16 In Republic of Korea though, the income support measures such as the social safety schemes and public work programmes introduced were implemented counter-cyclically and on a temporary basis allowing them to mitigate immediate social impacts and avoiding long-term pervasive effects such as higher structural unemployment.

13 Previous evaluations of policies in OECD countries indicate that labour programs usually have at best a modest impact on participants’ labour market prospects (Heckman et al, 1999). But at the same time, they also indicate that there is considerable heterogeneity in the impact of these programs.
14 The interaction term coefficient for this group of policies has a positive sign. See Appendix A.
15 From a theoretical framework, ALMP permanently improve labour market flexibility by offering workers job placement and training, which allows them to improve their skills find appropriate jobs or shift more easily into better-paying jobs. See for example, Nickell (1997) and Scarpetta (1996).
16 The interaction term coefficient for this group of policies has a negative sign. See Appendix A.
2. **Labour market deregulation can have negative long-run consequences.**

Labour law reforms in the wake of the 1997 Asian financial crisis were sought to attain a certain degree of flexibility to better position Republic of Korea to respond to the crisis at the time and globalization pressures more generally. These reforms regarding collective dismissals and the dispatched workers were relaxed significantly but deregulation focused almost exclusively on temporary forms of employment rather than regular employment, and thus non-standard forms of employment have grown in prominence.

While this contributed to a labour market recovery at the time, the impact of the current crisis is asymmetric. In the case of the 1997 Asian financial crisis, all categories of workers experienced rapid job losses following the macroeconomic contraction and economic restructuring. While the current situation is characterized by a labour market recession of considerably smaller magnitude and duration, job losses occurred principally among non-regular workers.

As countries consider ways to promote employment creation in the context of the current crisis, it is important to consider that improper regulation could exacerbate labour market segmentation and need to be balanced with adequate and appropriate social protection measures.
Appendix A – Effects of government expenses in labour and social measures on employment growth – An empirical approach

Section C analyzed the government-spending multipliers of the different labour and social policies put in place during the 1997 crisis in Republic of Korea. These government-spending multipliers illustrate the influence of government expenses in labour and social measures on employment growth during past crises. They were estimated following equation (1), based on Barro and Redlick’s model to assess the effects of military spending and taxes on real per capita GDP growth rate.17

\[
\Delta E_t = \beta_0 + \sum_{i=1}^{n} \beta_{g,i} \Delta g_{i,t} + \sum_{i=1}^{n} \beta_{l,i} (\Delta g_{i,t} \cdot x_{t-1}) + \omega_{t-1} + \epsilon_t
\]

Where \(\Delta E_t\) represents the growth rate of employment in time \(t\); \(\Delta g_{i,t}\) is the growth rate of government spending18 in each labour and social measure in time \(t\); \(n\) corresponds to the number of measures included in the analysis, in this case \(n=2\) since two types of measures, active and passive labour market policies, were included in the empirical model. Moreover, \(\beta_{g,i}\) is the government-spending multiplier, which shows the percentage increase in employment produced by a 1 per cent increase in spending on each labour and social measure. The goal of the analysis is to assess if coefficients are greater than 0. If so, this suggests that an increase in labour and social spending is associated with employment creation at all moments of the economic cycle. However, often these coefficients are not significant given their very low relative size. In fact, previous evaluations of policies in OECD countries indicate that labour programs usually have at best a modest impact on participants’ labour market prospects (Heckman et al, 1999).

To gauge the slack of the economy, the equation considers the lagged output gap, \(x_{t-1}\). The output gap is measured as actual output minus potential output and is expressed as a percentage of potential output. In addition, interaction terms between the output gap and the different variables for government spending were added to the equation in order to measure how the multipliers perform differently depending on the functioning of the economy. As expected, the output gap is highly significant and has a positive relationship with employment growth in our analysis. However when policy variables are included in the regression the sign becomes negative; which might be explained by the fact that labour market policies have a circular relationship, one with employment but another directly with the change in output, which at the same time drives the employment relationship in some way.


\[18\] Note that the real government spending in social measures is considered here; yet, we deflate \(g_t\) using the GDP deflator so as the units of \(y\) and \(g\) are comparable and \(\beta_1\) reveal the effect of an extra unit of government spending on employment.
In terms of the interaction terms, since the output gap is negative when actual performance is less than potential, a negative coefficient on the interaction term shows that labour policies are counter-cyclical.

Finally, $\omega_{t-1}$ represents a set of time-lagged variables of the demand for labour (2). The inclusion of this set of variables keeps the dynamics of the labour market from influencing the estimated coefficients of the fiscal variables.

Labour demand is represented by the following equation:

$$n = \lambda_0 + \lambda_1 w + \lambda_2 q + \lambda_3 t$$

Where $n$ and $q$ are the natural logarithms of labour input ($N$) and output ($Q$), respectively, and $w$ is the natural logarithm of the real product wage. These are incorporated into the first equation in a lagged form, as follows:

$$\omega_{t-1} = \beta_3 \Delta E_{t-1} + \beta_4 \Delta y_{t-1} + \beta_5 \Delta w_{t-1}$$

Where, $\Delta E_{t-1}$ is the annual lag of the dependant variable; $\Delta y_{t-1}$ is the previous year’s Real GDP growth; and $\Delta w_{t-1}$ is the growth rate of the unit labour cost (ULC).

In this way, an average of 10 observations were included in the analysis with information on employment growth and government spending in active and passive labour market policies since 1993 (where policies were first created in Republic of Korea) until today. The analysis finds that:

- The estimated impact of active labour market policies on employment creation are small but highly significant, but only when interacting with the output gap, i.e. only during economic shocks. These results are consistent with previous macro-based studies (Layard et al. 1991, Layard and Nickell, 1992).
- Passive labour market policies, on the contrary, seemed to have had a stronger effect in boosting employment during normal times than when implemented during economic shocks.

Table A1 gives a synthetic review of the econometric estimates reporting these government-spending multipliers.

To take into account the peculiarities of the data set, regressions have been rerun to account for robustness. To ensure that one or some of control variables did not influence the results, reduced regressions were also estimated by excluding the variables one at a time. During the process, government-spending multipliers ($\beta_{g and i,i}$) remained highly significant and the absolute size of the estimated effects changed relatively little between different estimation methods, giving some confidence in the estimated effects.

---

19 This variable although included in the analysis, turned out not to be statistically significant once the output gap variable is included.
Moreover, despite the short time series available for analysis (given that labour market policies were created in the country as late as 1998), there is not an important difference between the R-squared and Adjusted R-squared diagnostic statistics. This gives some confidence to the analysis made and shows that even after having made the degrees-of-freedom adjustments, the model was not penalized with an important loss of parsimony.

Table A1. Regression results and alternative estimators

<table>
<thead>
<tr>
<th></th>
<th>OLS (Baseline)</th>
<th>OLS (FINAL)</th>
<th>OLS (Robust)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Government spending in ALMPs</strong>&lt;br&gt;(Annual growth rate)</td>
<td>0.0022&lt;br&gt;(0.65)</td>
<td>0.009&lt;br&gt;(6.8)*</td>
<td>0.009&lt;br&gt;(18.27)**</td>
</tr>
<tr>
<td><strong>Interaction term for ALMPs</strong></td>
<td>0.009&lt;br&gt;(0.65)</td>
<td>0.009&lt;br&gt;(15.42)**</td>
<td>0.009&lt;br&gt;(18.27)**</td>
</tr>
<tr>
<td><strong>Government spending in PLMPs</strong>&lt;br&gt;(Annual growth rate)</td>
<td>0.011&lt;br&gt;(3.6)*</td>
<td>-0.012&lt;br&gt;(-5.75)**</td>
<td>-0.012&lt;br&gt;(-6.58)**</td>
</tr>
<tr>
<td><strong>Interaction term for PLMPs</strong></td>
<td>-0.0006&lt;br&gt;(-0.23)</td>
<td>+/-0.41&lt;br&gt;(+/-6.02)**</td>
<td>+/-0.41&lt;br&gt;(+/-6.20)**</td>
</tr>
<tr>
<td><strong>Lag 1 of Output gap (1)</strong></td>
<td>+/-0.42&lt;br&gt;(+/-3.96)*</td>
<td>+/-0.41&lt;br&gt;(+/-6.02)**</td>
<td>+/-0.41&lt;br&gt;(+/-6.20)**</td>
</tr>
<tr>
<td><strong>ULC (Annual growth rate)</strong></td>
<td>0.24&lt;br&gt;(3.71)</td>
<td>0.198&lt;br&gt;(6.83)**</td>
<td>0.198&lt;br&gt;(7.25)**</td>
</tr>
<tr>
<td><strong>Real GDP (Annual growth rate)</strong></td>
<td>0.53&lt;br&gt;(5.66)*</td>
<td>0.495&lt;br&gt;(8.63)**</td>
<td>0.495&lt;br&gt;(8.20)**</td>
</tr>
<tr>
<td><strong>Constant</strong></td>
<td>-1.89&lt;br&gt;(-3.05)</td>
<td>-1.60&lt;br&gt;(-5.0)**</td>
<td>-1.60&lt;br&gt;(-4.75)**</td>
</tr>
</tbody>
</table>

| Observations | 10 | 10 | 10 |
| R-squared    | 0.996 | 0.995 | 0.995 |
| Adjusted R-squared | 0.984 | 0.989 | 0.989 |

Estimated based on ordinary least squares. Absolute value of t-statistics in parentheses. Significance levels: *significant at 5 per cent; **significant at 1 per cent. (1) As explained above, the output gap shows a positive and significant relationship with employment growth; yet, this relationship becomes negative once labour market policies are included in the analysis.
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