Labor Market Reform Given Priority among South Korea’s Big Four Reforms —Trying to Reconcile Youth Job Creation with a 60-Plus Retirement Age—

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Summary
1. In February 2014, the administration of President Park Geun-hye responded to South Korea’s chronic low growth by formulating the “Three Year Plan for Economic Innovation.” Since then the administration has emphasized the need to revitalize the economy through four major reforms targeting the labor market, the public sector, education and the financial sector. Labor market reform has been identified as the most important priority.

2. This focus reflects the need to create jobs for young people, and the fact that the minimum retirement age will be raised to 60 in 2016. The minimum retirement age system will provide economic security for middle-aged and older workers, but there is also a risk that the change will cause labor costs to soar and lead to reduced employment of young people. That is why labor market reform became necessary.

3. One reason for high unemployment among young people is a lack of growth in “high-quality” jobs at a time when a growing percentage of students are entering university with the aim of working for major corporations. This has resulted in labor market mismatching, with small and medium enterprises facing labor shortages due to disadvantages in terms of wage levels, employee benefits and social status.

4. This lack of human resource mobility has resulted in a dual labor market structure, and efforts to remedy this situation have made little progress. Instead, small and medium manufacturers are maintaining a low-wage structure by hiring foreign workers. However, this is frustrating efforts to improve productivity and achieve innovation. In addition, large enterprises are keeping their production costs down by using the low-wage labor of small and medium enterprises.

5. Increasingly serious employment problems led the Roh Moo-hyun administration to implement youth employment measures. These measures had three fundamental goals: ① to drive continuing job creation by raising South Korea’s potential growth rate, ② to strengthen industry-academia cooperation toward the development of a labor force that would reflect the needs of industry, and ③ to develop systems to facilitate the transition from school into the labor market. The Lee Myung-bak administration improved occupational education.

6. The employment policies of the Park Geun-hye administration focus in particular on the spread of a dual work-study system, which is expected to provide solutions for a number of issues, including ① labor market mismatching, ② overheated competition to enter university, and ③ labor shortages affecting small and medium enterprises.

7. Moves toward labor market reform have accelerated in 2015. The wage peak system is seen as the trump card in efforts to establish job sharing between young workers and middle-aged and older people. In May 2015 the government announced guidelines for the wage peak system in public agencies. The government also plans to use tax incentives to encourage the adoption of the system in the private business sector.

8. Labor market reforms are expected to produce benefits, but there are still a number of issues. One is the question of whether the wage peak system will really lead to increased employment of young people. What South Korea really needs is growth in high-quality employment, and progress toward that goal has been slow. Another problem is the risk of escalating labor conflicts over the introduction of the wage peak system.
South Korea’s economic growth rate has slowed to 2-3% in recent years. Reasons for this decline include the economic slowdown in China, the weakness of the yen, and the strength of the won. In February 2014, the administration of President Park Geun-hye responded to this continuing low-growth trend by formulating the “Three Year Plan for Economic Innovation.” This has been followed in 2015 by an increased focus on four major reforms targeting the labor market, the public sector, education and the financial sector. Labor market reform has been given the highest priority. Why is South Korea focusing on labor market reform?

One reason is a worsening employment environment for young people. Youth unemployment is currently at its highest level since 2000. Apart from a falling growth rate, this is attributable to reduced hiring of new graduates by large corporations, and the inability of small and medium enterprises to absorb workers. Reasons for the limited flow of workers into small and medium enterprises include the rising percentage of students advancing to university education, and disparity compared with large corporation. Small and medium enterprises are facing chronic labor shortages. This means that to ease the job-seeking problems of young people, South Korea will need to reform its labor market, including the mismatching problem, and to implement reforms in other areas, such as education.

Another reason why labor market reform is needed is the raising of the retirement age to over 60 from 2016 onwards in response to South Korea’s imminent transformation into an aged society. A higher retirement age will provide greater financial security for middle-aged and older people, but there is also a risk that will lead to higher labor costs and reduced employment opportunities for young people. To avoid these problems, more and more employers are adopting wage peak systems.

For these reasons, the labor market has become the main focus of the problems currently facing South Korea. In this article we will examine issues surrounding South Korea’s labor market reforms, with particular emphasis on youth employment problems. In Part 1, we will analyze the reasons why labor market reforms are needed, while also looking at the current state of the South Korean economy. In Part 2, we will examine labor market mismatching in relation to the dual structure of the labor market. In Part 3 we will look at achievements and problems resulting from the policies implemented by the Park Geun-hye administration and identify outstanding issues.

1. Why Labor Market Reform is Needed

South Korea is currently implementing four major reforms. Particular priority has been given to labor market reform. In Part 1, we will consider the factors that have made labor market reform necessary, while also looking at the current state of the South Korean economy.

(1) Worsening Employment Environment for Young Workers

South Korea’s real GDP growth rate has hovered in the 2-3% range for several years. In the April-June and July-September quarter it was 2.2% and 2.6% respectively year on year. While these figures are not extremely low, they represent significant declines from the 4.4% average during the 2000s (Fig. 1) (1).

South Korea’s growth rate slowed because the export-led growth mechanism that formed in the 2000s, which relied on global expansion by major corporations, ceased to function, and because an alternative growth model failed to emerge quickly enough. (This aspect has been discussed elsewhere and will not be examined in detail here.)

Since 2014, the Park Geun-hye administration has responded to this continuing low growth performance by implementing small-scale stimulus measures, and by pursuing reforms based on medium/long-term perspectives (Table 1). The government’s overall approach is somewhat difficult.
to identify. Around the time when Park Geun-hye took office as President on February 25, 2013, there was intense interest in “Geun-hye-nomics”, but the policy focus has shifted since the establishment of her administration.

In her inaugural address, President Park Geun-hye called for the establishment of a “creative economy” and progress toward economic democratization as prerequisites for economic revitalization. “In order for a creative economy to truly blossom, economic democratization must be achieved. I believe strongly that only when a fair market is firmly in place can everyone dream of a better future and work to their fullest potential. One of my critical economic goals is to ensure that anyone that works hard can stand on their own two feet and where, through the support of policies designed to strengthen small and medium-sized enterprises, such businesses can prosper alongside large companies.”

The keywords in this inaugural speech were “creative economy” and “economic democratization.” The goals identified by President Park in relation to economic democratization were the establishment of a fair market, and the creation of an environment in which small and medium-sized enterprises can coexist with large enterprises.

Table 1 Economic Policies of the Park Geun-hye Administration

<table>
<thead>
<tr>
<th>Date</th>
<th>Main Economic Policies</th>
<th>Political/Social Developments</th>
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<tr>
<td>April 2013</td>
<td>Announcement of economic policy directive of the Park Geun-hye administration</td>
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<td>June 2013</td>
<td>Announcement of roadmap for the achievement of 70% employment</td>
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<td>January 2014</td>
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<td>July 2014</td>
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<td>June 2015</td>
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<td>July 2015</td>
<td>Announcement of first labor market reforms</td>
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<tr>
<td>August 2015</td>
<td>Announcement of additional stimulus measures (consumption stimulus measures)</td>
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Source: Compiled by JRI using data from the Ministry of Strategy and Finance and other sources
In late February 2014, after a year in office, the new administration completed its policy framework, including the realization of the “creative economy,” and adopted a Three-Year Plan for Economic Innovation. The three core components of this plan are (1) the strengthening of fundamentals (including reforms targeting inefficient state-owned enterprises, the reform of the private sector through the correction of market inequities and labor market reform, and the reinforcement of social safety nets), (2) growth through economic innovation (including the realization of a creative economy, investment in the future, including research and development, and the development of overseas markets), and (3) development based on a balance between domestic and external demand (including the expansion of consumption and investment, and the expansion of employment for women and youth).

Compared with the time immediately after her inauguration, President Park has toned down her emphasis on economic democratization and made public sector reform, including the reform of state-owned enterprises, the new priority. This shift is apparent from the formulation of a state-owned enterprise reform plan separately from the Three-Year Plan for Economic Innovation.

This increased emphasis on state-owned enterprise reform reflects the fact that state-owned enterprises account for a large share of economic activity and have massive debts. There was minimal progress on the structural reforms introduced after the currency crisis, and deficits ballooned under the Lee Myung-bak administration. As a result, the reforms became necessary from the viewpoint of restoring a sound fiscal position in the face of an upward trend in government debt in step with demographic aging.

In 2014 the government completed the first phase of state-owned enterprise reforms, including the formulation of debt reduction plans and the rectification of lax corporate governance. The second phase, including changes to functions and wage structures and the reinforcement of social responsibility, began in 2015.

In 2015, the emphasis has shifted to economic revitalization through four major reforms targeting the labor market, the financial sector, the public sector and education. Recently the concept of “four major reforms” appears to have taken on a life of its own, but the positioning of the reforms is not entirely clear. In January 2015, the government released the work report on the Three-Year Plan for Economic Innovation. The report states the government will work to improve South Korea’s economic fundamentals by rectifying market inequities and implementing reforms in four key areas: the labor market, the financial sector, the public sector and education.

Continuing economic stagnation appears to have heightened the need to focus on economic revitalization through the improvement of fundamentals, rather than the medium/long-term goal of economic innovation. Speeches by President Park since then have included frequent references to economic revitalization through the four major reforms.

Labor market reform has been positioned as the most important of the four major reforms. One reason for the government’s focus on labor market reform is the fact that labor market reform is a prerequisite for the reform of state-owned enterprises. However, labor market reform is also essential in order to reconcile the goals of alleviating youth employment problems and raising the retirement age to over 60 (Fig. 2). We will next examine each of these issues in turn.

1. Rising Unemployment

We will look first at the employment environment for younger workers (15-29). South Korea’s unemployment rate remained in the 3% range for several years after 2002, but it is now tending to rise because of a decline in the real GDP growth rate to the 2-3% range over the past few years, compared with an average of 4.4% in 2001-10). The unemployment rate climbed 3.1% in 2013, 3.5% in 2014, and 3.8% in the April-June quarter of 2015. Youth employment is especially high. From 7.9% in 2013, it has risen to 9.0% in 2014 and 9.9% in the April-June quarter of 2015 and now stands at its highest level since 2000 (Fig. 3).

South Korea’s total unemployment rate is relatively low for an OECD member, and many south-
but also structural factors, such as a decline in the number of new graduates hired by major companies, especially the *chaebol* conglomerates, and the failure of small and medium enterprises to absorb labor. There is significant disparity between large enterprises and small and medium enterprises in terms of wages and benefits. Workers are also reluctant to take jobs in smaller companies because of their low social status. On the other hand, the fact that small and medium enterprises are facing labor shortages is evidence of labor market mismatching.

② Withdrawal from the Labor Force

A problem that is viewed with even greater concern than unemployment is withdrawal from the labor force. The non-working population (not included in the unemployment statistics) fell in the first half of the 2000s but shifted to an upward trend in 2006 and has remained high ever since. One reason for this is an increase in the number of people who are not actively seeking work.

Growth in the unemployed and non-labor populations has led to a conspicuous decline in the youth labor force participation ratio. This trend is particularly marked in the ratio for the 20-24 age group, which has fallen from 58.3% in 2004 to 49.9% in 2014 (Fig. 5). This contrasts with the rising labor force participation ratios for older workers, including the 50-54 and 55-60 age groups.⁶

We have already observed that South Korea’s unemployment rate is relatively low for an OECD
member. However, the percentage of people who are not in education, employment or training (NEETs) is ninth highest in the OECD, while the unemployment rates for those aged 20-24 and 25-29 are the sixth and seventh highest respectively. Furthermore, according to the OECD’s Education at a Glance Interim Report, the percentage of university graduates among South Korea’s NEETs is especially high by international standards at 42.6% (Fig. 6).

Around 30% of participants in the Economically Active Population Survey indicated that they were not seeking work because there are no suitable jobs, while another 30% said that they were preparing to look for work. The “no suitable jobs” reason indicates that there is a lack of stable “high-quality” positions with government agencies, state-owned enterprises, major corporations or financial institutions that offer high salaries.

Withdrawal from the labor force is also linked to rising levels of educational attainment. The percentage of students advancing to university education has risen from 33.2% in 1990 to 68.0% in 2000, and 83.8% in 2008 (7). Higher educational attainment brings with it the expectation of higher incomes, but because there has been no growth...
South Korea’s working-age population (15-64) will start to shrink in 2017 because of the falling birthrate. In 2018 South Korea will become an aged society with over 14% of its total population aged 65 and older. By 2027 it is expected to become a super-aged society in which those aged 65 and older will make up over 21% of the total population (Fig. 7). In 2000, South Korea became an aging society (a society in which people aged 65 and older make up 7% or more of the total population). By 2018, it will have made the world’s fastest transition to aged society status.

A key issue linked to the advent of the aged society is aged poverty. According to OECD statistics, the relative poverty ratio (the percentage of the total population with incomes less than 50% of the income distribution median) for aged people in South Korea is the highest of any OECD member at 47.2% (2010). The OECD average is 12.8%. Moreover, in contrast with a downward trend in many countries, South Korea’s relative
poverty ratio is tending to increase. It rose from 43.9% to 48.6% between 2006 and 2011, an increase of almost five percentage points over a five-year period.

One reason for poverty among the aged is the low level of pension payments. This reflects the late introduction of a public pension system, and the fact that the system has not yet matured.

South Korea first introduced occupation-based pension schemes, including systems for government employees in 1960, for military personnel in 1963, and for private school staff in 1975. In November 1973 South Korea’s parliament passed a bill creating a national pension scheme covering all citizens aged 18 and over and under 60. However, implementation of this system was postponed due to deteriorating economic conditions after the first oil crisis, and the assassination of President Park Chung-hee in 1979. The pension scheme was not implemented until 1988, initially covering business establishments with 10 or more employees. It was subsequently expanded in phases to include business establishments with five more employees in 1992, persons engaged in agriculture and fisheries and self-employed persons in urban self-employed people, small business operators, temporary workers and day laborers in 1999.

In addition to this expansion of the scope of the scheme, it has also been modified to reflect changes in the economic environment. First, after the currency crisis in 1998, the income replacement ratio was lowered from 70% to 60%, while the premium rate was raised from 6% to 9%. The next major reform was implemented by the Roh Moo-hyun administration in 2007 in response to renewed concern about the depletion of funds due to a rise in the number of pension recipients after the 20th anniversary of the scheme’s establishment in 2008. The decision to implement reforms was also influenced by the fall in South Korea’s birthrate in the 2000s. Following a review of the system, the government decided to make several changes. First, the premium ratio was left unchanged, but the income replacement ratio was lowered from 60% to 50%, with further yearly reductions of 0.5% taking the ratio down to 40% by 2028. Second, it was decided that the pension entitlement age, which was initially 60, would rise to 61 from 2013 onwards, and to 65 by 2033 through one-year increments every five years.

As has happened in Japan, this rise in the pension entitlement age will lead to a trend toward higher retirement ages. Every five years the Japanese Cabinet Office conducts the International Survey of Lifestyles and Attitudes of the Elderly, which covers men and women aged 60 and over in Japan, the United States, South Korea, Germany and Sweden (multiple responses). The results of the seventh survey in 2010 show that South Korea’s elderly are heavily reliant on income from work and assistance from their children and other sources, and less reliant on public pensions. The percentage of income derived from public pensions is extremely low at 30.3%, compared with 86.8% in Germany, 85.9% in Japan, 81.5% in Sweden, and 77.5% in the United States. This indicates public pensions in South Korea are not functioning adequately as an income guarantee for retirees (10).

Because of the low level of pension payments in South Korea, the aged need to make a living...
People educated to high school level or below make up around 80% of low-wage workers, while around 20% are educated to university level or higher. Small businesses with 10 or fewer employees account for almost 65% of low-wage workers. By industry, the accommodation and hospitality sector has the highest ratio (17.9%), followed by wholesaling and retailing (15.3%) and manufacturing (11.6%).

① The Basic Pension System and the Introduction of a 60-Plus Retirement Age

The government has started to take action in response to the growing seriousness of poverty among the aged. The Park Geun-hye administration is implementing two main policies.

The first is the introduction of a basic pension system. During the election campaign, President Park promised to pay a basic retirement pension of 200,000 won to all retirees without raising taxes. This is the current basic pension system. However, if this system is implemented as promised, the amount of funding required would reach 157 trillion won by 2040, compared with a total government budget of 369 trillion won in 2014. In addition, tax revenues have stagnated because of economic stagnation. For these and other reasons, the government modified the policy, which now states that no pension will be paid to those in the top 30% of income earners, and that a maximum pension of 200,000 won will be paid to the remaining 70%.

In July 2014, a new basic pension scheme was launched. The government’s share of the cost will be set by presidential decree at a level between 40% and 90%, with the remainder provided by local government bodies. Initially the pension was paid to 4.1 million people, with just under 3.82 million receiving the full amount of 200,000 won. In addition, tax revenues have stagnated because of economic stagnation. For these and other reasons, the government modified the policy, which now states that no pension will be paid to those in the top 30% of income earners, and that a maximum pension of 200,000 won will be paid to the remaining 70%.

The second policy is the introduction of a system raising the retirement age to above 60(12). Based on negotiations with labor unions, South Korean employers have hitherto set retirement ages between 55 and 58, though in practice many people stop work earlier through restructuring or “honorary retirement.” In April 2013, South Korea’s national assembly passed a bill banning age-
based discrimination in employment and promoting employment for the aged. Previously employers were only required to “make efforts” to set the retirement age at 60 or older, but this will become mandatory for business establishments with 300 or more employees from 2016, and for those with fewer than 300 employees from 2017. One reason for this change is the fact that with life expectancies rising, there is need to provide employment opportunities for those who are healthy and willing to work. Another key reason is the fact that the pension entitlement age will rise steadily in the future.

With the setting of a retirement age over 60 now mandated by law, a new problem emerged. There was a risk that increased labor costs resulting from this rise in the retirement age would lead to less hiring of young workers. According to one survey (13), the majority of companies have responded to the 60-plus retirement age system by making adjustments to wages, including the adoption of the wage peak system, whereby wages are reduced after workers reach a certain age in exchange for the provision of a guaranteed retirement age and the extension of employment. At the same time, 15.6% of companies were considering reduced hiring of young workers.

After the currency crisis, South Korean companies increasingly abandoned lifetime employment and shifted to performance-linked wage structures (14). However, some companies, especially large corporations, retained seniority-based wage systems. There is a conspicuous upward curve in seniority-based wages (Fig. 9). This steep upward curve is partially attributable to the large number of people who leave companies through restructuring or “honorary retirement.”

As described above, while job creation for young workers will also be a priority, South Korea will start to introduce the 60-plus retirement age system from 2016. Labor market reform will be essential in order to reconcile these two goals. Job creation for young workers will require the correction of mismatching in the labor market, which in turn will require educational reforms, including a shift away from an excessive social emphasis on higher education, and the improvement of occupa-

tional education.

Of course, these are not the only labor market reforms that are currently being implemented in South Korea (15). The government’s labor market reforms include ① reforms to allow work sharing between young and older workers, ② rectification of unfair trading practices between prime contractors and subcontractors, ③ rectification of discriminatory treatment of non-regular workers, ④ elimination of uncertainty concerning definition of normal working wages and reduction of working hours, and ⑤ improvement of inefficient practices in the area of labor relations. All of these perspectives are important, but in this article we will focus mainly on the first and third items (16).

2. Labor Market Duality and Youth Employment

While the youth employment environment worsens, small and medium enterprises face chronic labor shortages. In this section, we will
examine these problems in relation to labor market duality.

(1) Declining Job Creation Capacity of Large Corporations

Rising youth unemployment rate is attributable first of all to a decline in number of new university graduates hired by large corporations due to the economic slowdown. In the 2000s, major companies, especially those in conglomerates, accelerated their global business expansion through exporting and overseas production. Evidence of the rapid trend toward globalization in the 2000s can be found in export and overseas direct investment trends (Fig. 10). This pattern resulted from business opportunities created by sustained growth in emerging countries.

During this period of accelerating globalization by large corporations, the percentage of students entering universities continued to rise, and more and more students opted for foreign language studies with the aim of winning jobs with big companies. This trend also resulted in increasing educational expenditure by households.

South Korea enjoyed continuing export-led growth in the 2000s, thanks to this global expansion by large corporations. As we have already seen, however, the effects of the global financial crisis, the European debt crisis, China’s economic slowdown and other factors have kept South Korea’s growth rate low in the 2-3% range for the past few years. The contribution from export growth has fallen sharply compared with the first half of the 2000s (Fig. 11).

An analysis of trends in hiring by large corporations over the past five years (Fig. 12) shows that the number of people hired fell in 2010, in contrast with a conspicuous increase in hiring by small and medium enterprises (excluding those with 1-4 employees). Large export-oriented companies adjusted their hiring in response to a sharp export downturn after the global financial crisis. However, the crisis appears to have had only a limited impact on small and medium enterprises, the majority of which are active in domestic markets. Hiring by large corporations returned to an upward trend in 2011, but the pace of growth has remained slow.

Apart from economic conditions, this decline

### Fig. 10 Exports and Direct Investment

($billions, %)

Source: Bank of Korea, Economic Statistics System

### Fig. 11 Real GDP Growth Rate, Contributions from Demand Items

(%)
in job creation by large corporations may also be linked to the following factors.

① Companies becoming more technology- and capital-intensive

Manufacturers are becoming more technology- and capital-intensive, with the result that production growth produces less employment growth than in the past. In many countries, service industries have emerged as the main job creators because of the shift to service-based economies, but in South Korea the development of service industries has been slow, as described later in this article.

② Expansion of Overseas Production

As companies expand their overseas production, their capacity to create jobs within South Korea is dwindling. South Korea’s overseas direct investment has declined moderately after a rapid increase in the first half of the 2000s, but it remains at a relatively high level and substantially outweighs direct investment within South Korea (Fig. 10). According to MacKinsey, the overseas production ratio of large corporations surged from 6.7% in 2005 to 16.7% in 2010[17].

③ Globalization of Procurement

Electrical and electronic equipment manufacturing is a major export industry in South Korea. However, the capacity of these manufacturers to induce domestic production and create employment opportunities is limited because they import most of the intermediate goods used.

According to South Korea’s inter-industry relations table, the number of manufacturing jobs induced per 1 billion won of final demand generated fell from 19.3 in 1995 to 13.2 in 2000 and 10.1 in 2005. The equivalent statistic for service industries also declined but remained substantially higher than that for manufacturing industries at 29.5 in 1995, 21.5 in 2000 and 18.4 in 2005.

④ Delayed Growth of Service Industries

In 2014, service industries accounted for large shares of total employment in most OECD countries, reaching around 80% in the Netherlands, the United States and the United Kingdom (Fig. 13). At 70.0%, South Korea’s ratio is appropriate for its per capita GDP level. (Most of the economies with low ratios are former socialist countries.) However, the contribution of service industries to total added value in South Korea is low at 57.4%,
compared with 75.9% in the Netherlands, 78.1% in the United States and 79.2% in the United Kingdom.

This is because while large corporations play a central role in industries in which South Korea is internationally competitive, such as aviation, transportation, engineering and construction, self-employed people and small and medium enterprises are the main players in other sectors. South Korea’s service industries employ large numbers of people, but their productivity is low at around 40% of the level for manufacturing.

Self-employment has become a partial source of income for middle-aged and older people, with many people operating restaurants, bars, retail outlets or other businesses after retirement from corporate employment. For this reason, the government has provided partial protection for small business operators. This situation has hindered innovation and productivity improvement in service industries.

In recent years, the government has used deregulation to stimulate growth in high-added-value service industries, such as distribution, finance and insurance, education, healthcare and software. However, these efforts have yet to produce significant benefits, and the service industry growth rate has generally remained lower than that of the manufacturing sector (Fig. 14).

With the capacity of large corporations to create employment generally in decline, job-seekers have increasingly tended to focus on the recruitment exams for a small number of conglomerates, such as Samsung and Hyundai, that are performing relatively well and hiring large numbers of new graduates.

(2) Labor Shortage Problems for Small and Medium Enterprises

In contrast with this decline in the job creation capacity of large corporations, small and medium enterprises are facing chronic labor shortages, especially in manufacturing industries with poor working conditions. Some small and medium enterprises are trying to meet their labor requirements by hiring foreign workers under the employment permit system.

South Korea’s employment permit system has been analyzed in detail elsewhere and will be explained only in simple terms here. Under this system, the government issues employment permits to South Korean companies that have been unable to recruit workers within South Korea, allowing them to employ foreign workers legally. The system was established for several reasons, including a medium/long-term downward trend in South Korea’s working population, serious labor shortages affecting small and medium enterprises, and problems with the industrial training system introduced before the employment permit system.

Basic principles for the system include complementation of the labor market, equal treatment of workers, short rotation cycles, and transparent acceptance processes. Particular importance is placed on labor market complementation. To ensure that South Korean workers are not deprived of employment opportunities due to the acceptance of foreign workers, permits are issued only to South Korean companies that are unable to hire workers domestically and have passed the labor...
market test by trying to recruit workers.

When the employment permit system was first introduced in 2004, small and medium enterprises faced a labor shortage of 113,000 workers, or 5.1%. The system has alleviated the problem, but reports indicate that there was still a shortage of 56,000 workers in 2013. Manufacturing industries that employ foreign workers include machinery and equipment (14%), rubber and plastic products (14%), processed metal products (13%), motor vehicles (11%), and electrical and electronic products (9%).

While the acceptance of foreign workers has been welcomed as a way of alleviating the labor shortages affecting small and medium enterprises to some extent, the system could also delay the elimination of disparity between large corporation and small and medium enterprises by hindering innovation efforts and the culling of less efficient small and medium enterprises.

(3) Labor Market Duality

South Korea’s labor market is frequently characterized as having a dual structure, and there has been extensive discussion about differences in wage levels and job security between large corporations and small and medium enterprises, and between formal and non-formal workers.

In terms of employment formats, 85% of workers in large corporations are formally employed, compared with 54% of those working for small and medium enterprises. According to statistics released by South Korea’s Small and Medium Business Administration, small and medium enterprises are concentrated in four sectors: wholesaling and retail (27.9%), accommodation and restaurants (20.1%), transportation (10.8%), and manufacturing (10.7%). The top-ranked industries for large corporations are manufacturing (23.4%), business support services (16.0%), real estate (10.0%), construction (9.0%), and wholesaling and retail (8.8%). We cannot be certain about the distribution of employment formats in each sector, but given that wholesaling and retailing and accommodation and restaurants account for almost one-half of small and medium enterprises, we can probably assume that many workers in these industries are self-employed, family workers and non-formal workers.

Disparity between large and small and medium enterprises is widening, as evidenced by the fact that the ratio of average monthly wages in small and medium enterprises to the average paid by large corporations has fallen from 59.8% in 2004 to 56.7% in 2014 (Fig. 15). This widening gap is attributable to productivity differences and differences in employment formats.

There was debate about labor market duality when Japan began to achieve high economic growth in the second half of the 1950s, and the topic was analyzed extensively in the 1957 Economic White Paper. The coexistence of modern and pre-modern sectors within the economic structure of a single country was seen as a problem because of the risk that the stagnation of the latter would impede the growth and development of the former. However, the low-wage base that had supported the dual structure was eliminated.

Fig. 15 Average Monthly Wages in Small and Medium Enterprises as a Percentage of Average for Large Corporations

Source: Statistics Korea, Economically Active Population Survey (supplementary survey)
to a large extent by rising wages and consumer prices during the subsequent period of continuous high growth. In addition, this period saw the emergence of many small and medium enterprises that were able to pay high wages because of high productivity made possible by highly specialized capabilities.

One factor that is maintaining this duality and preventing its elimination in South Korea is a lack of worker mobility due to significant gaps between large and small and medium enterprises in terms of wages, benefits, working environments and social status. There is a vicious circle, in which the lack of worker mobility prevents the elimination of wage disparity, while wage disparity is hindering worker mobility.

Another factor is the slow emergence of small and medium enterprises with advanced specialized capabilities. Reasons for this situation include the concentration of highly skilled people in large corporations, and a tendency toward self-sufficiency based on intra-group trading within the conglomerates. The growth of small and medium enterprises has also been hindered by the business practices of large corporations, which beat down the prices of products procured from small and medium enterprises.

Also significant is the fact that large corporations actively use low-wage small and medium enterprises, including both affiliated companies and companies outside of their groups, to reduce production costs in various ways, such as contract production of large-intensive products. We will look at the Hyundai Motor Group as an example of this pattern.

The Hyundai Motor Group dramatically expanded its presence during the 2000s, and its ranking in terms of world motor vehicle sales rose from 7th in 2004 to 5th in 2008. Expanding market shares in developed countries contributed to this growth, but the main factor was Hyundai’s success in capturing demand in emerging markets. The expansion of Hyundai’s market shares in emerging countries can be attributed to several factors. First, it has developed the volume zone. Second, it has attracted consumers by introducing multiple models in the same segments. Third, it has developed strategic models that match local needs. Fourth, it has raised brand awareness through skillful advertising. The factor that allowed Hyundai to launch multiple models was modularization.

In December 2000, Hyundai consolidated its parts companies to form Hyundai Mobis. In addition to shifting to modularized production of front-ends, cockpits, chassis and other parts, Hyundai also adopted common platforms and the use of standardized parts. Modularized production offers a number of advantages to a manufacturer of finished vehicles. First, cost savings can be achieved by reducing parts management tasks and assembly processes. Second, lead times from development to production can be shortened. Third, parts can be procured reliably. Fourth, management resources can be shifted into other areas, such as research and development and environmental measures.

Kim Woo-jin [2014] attributes Hyundai’s growth not only to modularization, which is a technology-related factor, but also to differences in the employment and wage systems and labor relations systems of Hyundai Motor and Hyundai Mobis. Non-formal workers make up 19.4% of production workers in Hyundai Motor, compared with 51.7% for Hyundai Mobis. This shows that Hyundai Mobis relies on non-formal labor for much of its module production operations. Kim Tae-gil [2008] also observes that the use of non-formal labor in many production processes has allowed Hyundai Mobis to reduce labor costs. Hyundai has been able to cut its production costs by ① shifting assembly processes from Hyundai Motor to Hyundai Mobis, and ② using non-formal workers in the assembly processes of Hyundai Mobis.

3. Youth Employment Policies and Labor Market Reforms

In this section we will examine the youth employment policies and labor market reforms im-
Labor demand-side policies consist of direct job creation policies and policies relating to working conditions. Direct job creation policies include direct employment in the public sector, and the expansion of job opportunities through the payment of employment subsidies to private enterprises. Recent policies relating to working conditions include the setting of minimum wages and the easing of regulations.

Youth employment measures were first formulated in 2003 under the Roh Moo-hyun administration. Changes in the labor supply-demand structure after the currency crisis caused the youth unemployment rate to remain stubbornly high, and there was a need for action based on medium/long-term perspectives rather than short-term unemployment countermeasures.

The government identified three basic strategies for youth employment measures: ① continuous creation of new jobs driven by improvement in growth potential, ② the development of labor resources to match industry needs through improved industry-academia cooperation, and ③ the development of labor market infrastructure and systems to ease the transition from school to the labor market. Based on these strategies, the government implemented measures that included active job creation in the public sector, support for private sector job creation, the expansion of internship programs, and improvements to occupational training and placement systems.

Subsequent youth employment policies includ-

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**Fig. 16 Youth Employment Policies in OECD Countries**

![Diagram showing youth employment policies in OECD countries]

ed the expansion of measures to facilitate the transition from school to the labor market, such as the revitalization of internship programs, the arrangement of short-term employment, overseas internship programs, and support for small and medium enterprises suffering from labor shortages. Steps were also taken to strengthen industry-academia cooperation.

In July 2007, The Social Enterprise Promotion Act took effect. The Lee Myung-bak administration, which took office in 2008, placed considerable emphasis on youth employment policies. Styling himself as the “Economy President,” President Lee introduced new policies. He announced a global youth leader training program in 2008, and an internship program for small and medium enterprises in 2009. The internship program provided a subsidy equivalent to 50% of wages for six months for any young person employed as a result of an internship. Although this system led to formal employment in many cases, concerns were raised about the continuity of employment.

In 2010, the government launched a project focusing on business creation by young people. The program, which provided active support for young people taking up this challenge, included many projects to develop social entrepreneurs in areas relating to culture, tourism and the performing arts.

The Lee Myung-bak administration also expanded occupational training in high schools with the aim of alleviating labor market mismatching and correcting South Korea’s excessive emphasis on academic attainment. In addition to high schools specializing in industrial subjects, meister high schools were also established as specialized educational institutions. The aim of the meister schools was to ensure stable employment for students by working with industry to provide specialized education in such fields as shipbuilding, mechanical engineering and semiconductor fabrication. The industrial high schools were also reorganized as high schools specializing in industry cooperation. The aim of this change was to enable the schools to work with industry to develop customized educational programs covering five or six years and consisting of practical study at the specialized high school level (three years), and basic education and specialized university education (two or three years). The aim is to move students into work as soon as they graduate by combining theoretical and technical education.

A change that has attracted considerable interest as a result of these efforts to strengthen youth employment policies is a marked decline in the percentage of students entering university, which has fallen from 83.8% at the time of the global financial crisis in 2008, to 70.9% in 2014 (Fig. 17). In addition to a reactionary downswing in the wake of a steep rise, this change appears to have resulted from: ① a decline in the affordability of university education for children, ② pragmatic recognition of the increasing difficulty of finding suitable employment after graduation from university, and ③ increased hiring of high school graduates. South Korea’s social emphasis on educational attainment is unlikely to collapse overnight. However, the emergence of new pathways other than the traditional route of university followed by job-seeking is a healthy change.

![Fig. 17 University Entrance Rate](image-url)

Source: Korean Educational Development Institute, Statistics Korea
(2) Youth Employment Policies and Labor Market Reforms under the Park Geun-hye Administration

As stated earlier, President Park Geun-hye said in her inaugural address that her government would aim to create a new future based on a cycle of national advancement and the happiness of the people by building a creative economy and working toward economic democratization, and to use this creative economy as the foundation for the fusion of science and technology with industry, and the convergence of culture and industry.

President Park has put employment at the core of her government’s policies. Her administration has introduced policies designed to raise the employment ratio from a little over 60% to the OECD average of 70% by using the “creative economy” to generate employment, by reforming working hours and employment formats, by mobilizing underutilized labor resources, and by strengthening social responsibility and labor-management consultation (Fig. 18).

In the area of youth employment, the Park Geun-hye administration has maintained existing policies while adding its own unique features. Key elements in the 2013 policy include ① support for overseas employment, ② expansion of “high-quality employment, and ③ support for entrepreneurship. In relation to “high-quality” employment, the policy requires state-owned enterprises to step up their efforts to employ young people, especially in the social services area, and that requirement became one of the indicators used to assess the performance of state-owned enterprises. Under the revised Special Act on the Promotion of Youth Employment, which took effect in May 2013, government agencies and local government enterprises are required each year to employ a number of young people who have never previously worked that is equivalent to at least 3% of their normal workforce.

The Park Geun-hye administration is placing particular priority on the spread of the dual system, which is expected to rectify labor market mismatching, overheated competition for university places, and labor shortages affecting small and medium enterprises.

President Park made the following comments in her inauguration address. “The most important asset for any country is its people…..I have long held the conviction that harnessing the potential of every child is the force that propels a nation forward. Our educational system will be improved so that students can discover their talents and...
strengths in pursuit of their precious dreams and be judged by that. This will enable them to make the best use of their talent upon entering society. We will transform our society from one that stresses academic credentials to one that is merit based."

The work-study dual system was introduced on a trial basis in 2013 and has been implemented actively since 2014. This system enables trainees to complete university degrees and obtain qualifications while employed by companies as workers. Each week they spend two days in classes and three days undergoing practical training in the workplace. The government has decided to expand the dual system in 2015.

Recent youth employment measures are listed in Table 2. Under the government’s policy, the educational community and employer organizations will work together to provide work-linked educational programs at the high school and university levels. In addition, youth employment centers will be established in all universities to provide career guidance and job-seeker support services.

As part of its efforts to rectify labor market mismatching, the government has also prioritized the distribution of information about small but strong enterprises, which are referred to as “small giants.” A list of 10,000 such companies was compiled in July 2013, and by 2015 the number had risen to 12,455.

### Table 2: Youth Employment Policy Guidebook (2015)

- Support for internships with small and medium enterprises
- Matching between young job-seekers and small but strong companies (“small giants”)
- Support for overseas employment
- Work-Study Dual system
- Mentor schools
- Youth employment academies
- Youth employment centers on university campuses
- Support package for low-income job-seekers
- Subsidies based on continuous employment of high school graduates by small and medium enterprises

Source: Ministry of Employment and Labor

① Accelerating Efforts

As observed at the beginning of this article, labor market reform efforts in South Korea have accelerated this year. To reiterate, there is a risk that youth employment will be negatively impacted by the imminent introduction of a system raising the retirement age to 60 or over, which will become mandatory for all businesses and government agencies with over 300 employees in 2016.

The challenge now is to reconcile youth job creation with continuing employment for middle-aged and older workers. The wage peak system has emerged as a trump card for achieving this goal.

In May 2015 the government issued guidelines for the implementation of the wage peak system by public agencies. Starting in 2016, public agencies will be required to apply the wage peak system to workers between five and three years before retirement, while still providing a retirement system for workers aged 60 or older. The government expects this measure to create employment for 6,700 young people over two years.

In July 2015 the government announced Comprehensive Measures for Youth Employment. These focus on three core goals: the expansion of employment opportunities, the reduction of labor market mismatching, and the improvement of employment support systems. Measures to expand employment opportunities will include increased public sector employment in such areas as education for the disabled and care services, as well as the development of service industries. There will also be measures targeting private companies, such as ① tax incentives worth 15 million won for each additional formal worker employed in excess of the previous year’s total, ② wage subsidies for companies that introduce the wage peak system and increase the number of young people employed, and ③ an increase in the number of internships with high-growth SMEs to 5,000 per year.

These measures were reflected in the 2015 tax reform bill, which consists of three core elements: stimulation of the economy, support for workers, and fair taxation. Youth employment incentives form part of the economy stimulus measures in
the bill. The main incentives include a tax credit of 5 million won for each young job-seeker employed over the next three years, 100-150% tax deductions for increases in wages paid to young workers, and tax deductions for donations relating to education in industrial high schools.

In an address to the nation in August 2015, President Park Geun-hye emphasized the need for labor market reform. Based on her awareness of labor market duality as a factor that impedes formal employment by companies, she said that it would be impossible to increase youth employment without labor market reform, and that the solution of the youth unemployment problem would help to build a foundation for social development and would play a key role in raising the birth rate.

In the 2016 budget announced in September, the government indicated that total expenditure would increase 3.0% year on year, with particular large increases in the areas of social security (+6.2%), and employment (+12.8%) (Fig. 19). These expenditure levels are indicative of the government’s determination to tackle labor market reform aggressively.

In line with government policy, Korea Land and Housing Corporation will introduce the wage peak system in 2016. On August 28, management and labor agreed that the retirement age would rise 59 to 60, and that in exchange for extended employment, wages would be reduced in the final 3-4 years before retirement. These measures were approved by the corporation’s board of directors.

There are also indications that the private business sector is responding to the government’s labor market reforms. A number of large companies, especially the chaebol conglomerates, have announced plans to increase hiring of young job-seekers. The Samsung Group has indicated that it will create jobs for 30,000 young people by introducing the wage peak system in its group companies in 2016, reducing wages by 10% from the age of 56 in exchange for extended employment, and investing 100 billion won over the next two years. Of these 30,000 workers, 10,000 will be employed directly by means of new investments, while the remainder will be employed under a new internship program that will include occupational training followed by employment.

On August 11, the Hyundai Motor Group announced that it would create over 1,000 jobs for young people each year by introducing the wage peak system in all group companies in 2016 in exchange for raising the retirement age to 60, and by implementing the wage peak system. However, labor-management agreements have been reached by only a few Hyundai Motor Group companies, Hyundai Motor Company will continue to negotiate with unions.

(3) Problems

While the government deserves praise for its efforts to improve the youth employment rate, its policies are unlikely to produce the anticipated outcomes. Jaeryang Nam observes that despite the extensive efforts made by South Korea to promote youth employment, there is little evidence of any major increase. We can identify a number of issues in South Korea’s recent policies.
Will the Wage Peak System Lead to Increased Youth Employment?

First, there is still room for debate about whether the introduction of the wage peak system will increase youth employment, and many view the system with skepticism. One source of doubt is the fact that even restructuring efforts by companies in the past have failed to yield increases in youth employment. Another is the fact that the benefits from introducing the wage peak system have been limited because the percentage of people who remain in employment through to retirement age is not especially high because many leave work due to restructuring or “honorary retirement.”

In 2015 the Korea Employers Federation published findings from a survey about perceptions concerning factors that limit youth employment (Korea Employers Federation [2015b]). The main bottlenecks identified by employers were the high standard of young job-seekers, the economic downturn, and the raising of the retirement age to 60 or older. Young job-seekers, on the other hand, cited such issues as a lack of effort on the part of the company, over-education, school curriculums, and the economic downturn. When asked about how the youth employment problem should be tackled, companies called for greater flexibility in the labor market and the introduction of performance-based wage systems, while young job-seekers wanted companies to invest more and expand employment.

The view that the labor market reform needs to be accompanied by increased investment and the expansion of employment by businesses seems extremely reasonable.

Possibility of Labor Conflicts

Next we will examine the possibility that the introduction of the wage peak system will lead to escalating labor conflicts. According to the draft summary of a report released by the Ministry of Strategy and Finance on August 5, 11 public agencies had completed the introduction of the wage peak system, while 215 agencies were still in the process of doing so. There are signs of intensifying labor disputes focusing not on the actual introduction of the system, but rather on such aspects as the timing of the transition and the size of wage cuts.

Some companies have unilaterally adopted the wage peak system without going first reaching an agreement with labor. One such company is Daekyo, the largest educational service company in South Korea, which in 2009 introduced a wage peak system that could lead to wage reductions of up to 50%. Employees sued the company on the grounds that had introduced the system after consulting with only a small minority of its workers, and the Seoul District Court handed down a verdict stating that the wage peak system was invalid because the correct procedures had not been followed.

As more employers introduce the wage peak system, there is a risk of labor conflicts over the size of wage cuts and other aspects of the system. Labor disputes are also occurring over changes to pension systems for public sector workers as part of efforts to restore fiscal soundness. South Korea could face proliferating labor unrest.

In Japan the retirement age was raised from 55 to 60 in the 1980s on the basis of labor-employer agreements, and a wage peak system was also introduced. In contrast, South Korea first raised the retirement age to 60 or older by law and then began to introduce the wage peak system. For this reason, the task of winning the support of labor unions will not be as easy as in Japan.

Conclusions

As we have seen, labor market reform has been positioned as the most important of the four major reforms that South Korea is pursuing with the aim of revitalizing its economy. This reflects the emergence of youth job creation as a priority due to a worsening youth employment environment, as well as the fact that the retirement age will be raised to 60 or higher in 2016. A higher retirement age system will provide greater financial security for older workers, but it could also lead to sharply higher costs and reduced hiring of young people. That is why labor market reform is needed.
While labor market reforms are expected to produce benefits, a number of issues still remain. As noted earlier in this article, one of the problems faced by South Korea is a shortage of “high-quality” jobs. Among the policies that are being implemented by the Geun-hye administration with the aim of raising the employment rate to 70%, progress has been slowest on measures targeted toward the creation of “high-quality” jobs through the realization of a creative economy. South Korea’s challenges going forward will be not only the growth of innovative businesses, but also the advancement of existing small and medium enterprises. Further analysis is needed concerning the creative economy and innovative small and medium enterprises.
End Notes

1. Average annual growth rates were 8.7% in the 1960s, 9.1% in the 1970s, 9.0% in the 1980s, and 6.6% in the 1990s. Many countries have experienced a fall in their growth rates as economic development advances.


3. Economic democratization is also mandated in Article 119 Clause 2 of the Constitution: “The State may regulate and coordinate economic affairs in order to maintain the balanced growth and stability of the national economy, to ensure proper distribution of income, to prevent the domination of the market and the abuse of economic power, and to democratize the economy through harmony among the economic agents.”

4. This was probably because tighter regulation of large corporations was seen as having a negative impact on a stagnating economy.

5. Seven are included among the 30 biggest companies based on total assets as of April 2015 (published by the Korea Fair Trade Commission): Korea Electric Power Corporation (2nd), Korea Land and Housing Corporation (4th), Korea Expressway Corporation (11th), Korea Gas Corporation (13th), Korea Water Resources Corporation (19th), Korea Railroad Corporation (21st), Korea National Oil Corporation (23rd).

6. The rise in the labor force participation ratio for the 55-64 age group is part of a global trend. One reason for this is the reduction of pension benefit levels due to worsening fiscal situations.

7. Because of the emphasis on educational attainment in South Korea, education expenditure has become a burden for households. According to household budget surveys, educational costs have risen from 9.1% of total household expenditure in 1990 to 10.6% in 2009, although there has been downward trend since 2010. One of President Park Geun-hye’s election promises was to halve university tuition fees, but the fulfillment of that promise was postponed until 2015 or later due to a lack of fiscal resources.

8. The transition from an aging to an aged society took 115 years in France, 71 years in the United States, 40 years in Germany, and just 24 years in Japan, which made the shift in 1994 after becoming an aging society in 1970.

9. See Mukoyama [2014] for a discussion of issues relating to South Korea’s transition to an aged society.

10. This does not mean that Japan’s national pension schemes provide an adequate income guarantee. In fact, aged poverty has become an increasingly serious problem in recent years.

11. The overall employment ratio is not high in South Korea. This is because of the low employment rate for women.
12. Japan’s Act on Stabilization of Employment of Elderly Persons, which took effect in 1971, stipulates that if an employer specifies a retirement age, that retirement age must not be lower than 60. Since April 2006, employers have been able to choose among three mandatory options: ① an increase in the retirement age, ② the adoption of a continuing employment scheme, or ③ the abolition of the retirement age. In August 2012, it became mandatory for employers to introduce continuing employment schemes up to the age of 65 for any employees who wished to continue working after reaching the retirement age of 60. This change resulted from an increase in the entitlement age for public pensions.


14. This aspect is discussed in Ahn, Heetak [2004]. South Korea introduced performance-linked pay remuneration after the 1997 currency crisis. By far the most common approach is to combine this system with seniority-based remuneration.

15. Labor market reforms implemented in South Korea to date include changes to the restructuring dismissal and temporary employment systems, which were introduced after the currency crisis, and the Non-Regular Workers Protection Act, which took effect in September 2007.

16. The IMF has stated that in order to achieve sustainable growth, South Korea needs to promote the growth of high-added-value service industries while also reforming its labor market. Reasons for this view include the fact that most service industries lack vitality because they are based on small and medium enterprises with low productivity. In relation to the labor market, the IMF’s position reflects mismatching, the low labor force participation rate for women, seniority-based wage structures, and the dual structure of the labor market.


18. Cho Changeun’s article entitled Nihon to Kankoku no Kosaten [Crossroads for Japan and South Korea], which is available on Nikkei Business Online, provides very useful insights about job-seeking in South Korea.

19. See Sano, K. [2014], [2015], etc. The explanation provided here is based on papers by Mr. Sano.


21. According to Hamaguchi [2014], the Japanese government did not recognize the youth employment problem and start to take action until the 2000s. This is basically the same as the situation in South Korea.

22. Kim Sung-won has said that “welfare to work” measures will not solve the problem since they simply push responsibility for youth unemployment and poverty back onto a worsening employment environment. Kim Sung-won [2001] p.113.

23. Chosun Ilbo (Japanese edition, September 11, 2015) recently revealed that interns working for companies under this system had not been able to receive wages.

24. Ministry of Strategy and Finance [2015c]
25. The wages of senior executives (divisional manager or higher) will be reduced to 90% four years before retirement and 70% for the last three years of work. Subordinate workers’ wages will be reduced to 80% three years before retirement and 70% for the next two years.


27. According to the Korea Development Institute [2014], the average retirement age is around 54, but the average age for ceasing work entirely is 68.

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