

# The Korean Way of Financial Rationalization and Discouraged Workers\*

Ji-Whan YUN

## Abstract

*The growing number of discouraged workers—those who leave the labor market despite their willingness to work—is a new employment problem facing the Korean economy. The existing literature has attributed this problem to the internal aspects of the labor market, including the power of labor unions, technological development, and a weakening work ethic. However, such approaches cannot explain how this problem has emerged historically. This study emphasizes two alternative factors. One is financial rationalization that has burdened industries with the pressure of cost reductions since the late 1990s and, thus, reduced their labor demand. The other is the hierarchical structure within Korea’s industries that has accommodated the new financial rule in a way that excludes workers from the labor market. The chaebol’s strategies for cost reductions, particularly squeezing small- and medium-sized enterprises (SMEs) and freezing further employment, have exacerbated the SMEs’ problem of finding employment among young and female workers. The labor supply has shrunk, as families have protected these workers by withdrawing them from the labor market. This analysis implies that the global norm of financial rationalization becomes socially risky in Korea, not in and by itself, but because it is combined with Korea’s local institutions.*

**Keywords:** South Korea, discouraged workers, financial rationalization, hierarchical industrial networks, cost-saving pressure

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## Introduction: Korea's Employment Problem and "Discouraged Workers"

Korea has long been portrayed as a job-rich economy. Scholars have noted that Korea's rapid industrialization caused a "swifter, more abrupt, and more intensive proletarianization" than in other countries (Koo 1990, 669). They have also acknowledged that Korean bureaucrats and industrialists effectively mobilized this proletarianized workforce toward the goal of economic growth (You and Chang 1993). Finally, it was believed that a wide variety of wage-earning opportunities stabilized Korean society (Quibria 2002).

However, the new *employment problem* calls into question the conventional image of Korea as a job-rich economy. During the recent decade, Korea has been able to maintain a relatively steady pace of economic growth while weathering two major economic crises—the East Asian financial crisis of the late 1990s and the global financial crisis of the late 2000s. However, this expansion has not generated a corresponding number of employment opportunities for workers. In other words, Korea has been experiencing the problem of jobless growth. Statistics illustrate this problem more succinctly. This country has achieved gross domestic product (GDP) growth of 4.35 percent in the 2000s, while the members of the Organisation for Economic Cooperation and Development (OECD) have achieved a 2.3 percent growth rate, on average, over the same period. However, Korea's performance in terms of job creation has been worse than the OECD average for the same period. Korea has increased its employment rate by only 0.3 percent annually, while the OECD rate has increased by 0.32 percent.<sup>1</sup> The Korean government often claims that the shortage of job opportunities will soon be remedied when the economy develops further.<sup>2</sup> However, the decade-long job shortage would suggest that

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1. OECD, "Meeting of the Council at Ministerial Level, 27-28 May 2010: 2010 Ministerial Conclusions," C/MIN(2010)6/FINAL, adopted at the Council Meeting at Ministerial Level on May 28, 2010.
  2. *Kyunghyang Shinmun*, "Gyeongje gwallyo-ui seongjang ilbyeondo pyeongyeon" (The Bias of Economic Bureaucrats for Growth Absolutism), April 1, 2010.

Korea's employment problem is structural rather than cyclical.

The employment problem also indicates that this country's industrialists are no longer mobilizing the workforce effectively for economic development. During the period of economic recovery and expansion, Korea's industrialists left a substantial proportion of the workforce out of the labor market. As noted, therefore, Korea has recorded a marginal increase in the employment rate. Also, this country has maintained a lower level of employment than the OECD average (65.5% versus 67.8%).

Finally, the limited employment opportunities have undermined Korea's social stability. A recent survey conducted by the Korea Society Opinion Institute (2006, 16) revealed that more than 70 percent of Korean citizens felt a sense of *job crisis* due to limited job opportunities, growing job insecurity, widening income inequality, and expanding non-regular employment. Together with the high costs associated with education and housing, in particular, a shortage of employment opportunities is one of three major difficulties Koreans face (Shin 2010).

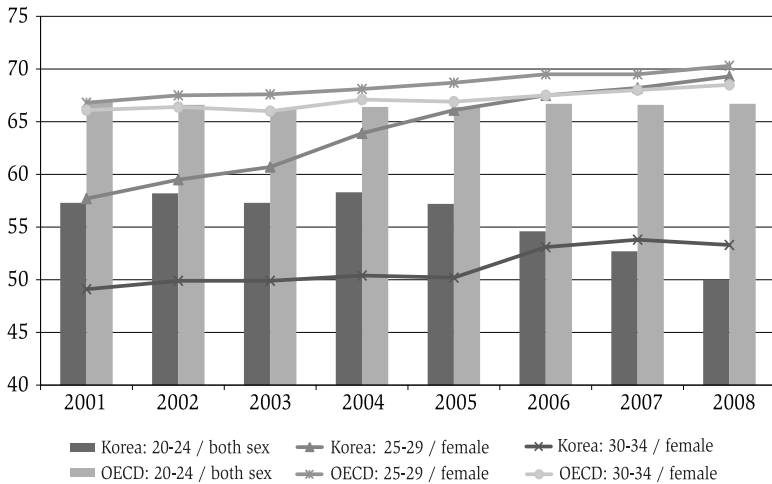
It is important to specify the main characteristics of Korea's employment problem. The first unique feature is that Korea has not faced a serious problem of unemployment. Many OECD countries facing jobless growth today—including Finland, Sweden, Hungary, and Poland—are experiencing structural difficulties in their attempts to address the problem of high unemployment. However, Korea has been relatively free from the problem of persistent unemployment; instead, it has maintained a virtually natural rate of unemployment, i.e., 3.61 percent.<sup>3</sup> Second, the implication of this low level of labor redundancy is not that people find work easily, but that few people are waiting for job offers. Korea's low unemployment rate is possible only because a large portion of the population does not enter—or is prohibited from entering—the workforce, which thereby reduces their

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3. OECD StatExtracts, <http://stats.oecd.org/index.aspx> (object name: Labour Market Statistics; accessed September 1, 2011).

likelihood of unemployment.<sup>4</sup>

The relative absence of workers in the labor market is mainly due to low labor force participation of young as well as female Koreans. According to Figure 1, the rate of labor force participation among young Koreans aged 20-24 has not only been lower than that of other OECD countries, but has also been on the decline during the first decade of the twenty-first century. In 2008, only half of this age group found or sought work. This problem is weakly associated with Korea's compulsory conscription system. Even after the mandatory period of military duty was reduced by two months in 2003, the labor force par-



Source: OECD, 2010, *OECD StatExtracts*, <http://stats.oecd.org/index.aspx>.

Figure 1. The Labor Force Participation Rates of Young and Female Koreans (%)

4. If the unemployment rate is low, a concomitant low employment rate indicates that a substantial portion of the population is absent from the labor market. If the size of employment is  $e$ , unemployment is  $u$ , total labor force  $l$ , labor force inactivity  $i$ , and the working-age population  $w$ , then  $e + u = l$ ;  $l + i = w$ , and, thus,  $e + u + i = w$ . If  $u$  is zero and  $w$  has a constant value, a low value of  $e$  indicates a high value of  $i$ .

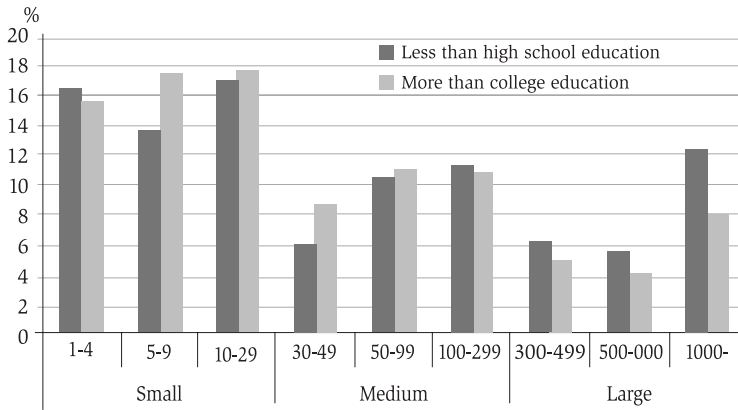
ticipation of this age group declined continuously. Meanwhile, Figure 1 shows that relatively young females represent a group of inactive workers. There is no doubt that the labor force participation of young females aged 25-29 has steadily increased during the 2000s. However, as Figure 1 illustrates, many young females have suddenly stopped developing their careers through the labor market. In their early 30s, these female workers have decided to leave the workforce.

Finally, and most importantly, many young and female Koreans who do not participate in the labor force are “discouraged workers.” These workers are not the same as the unemployed, in that they do not remain in the labor market; instead, they simply abandon all efforts to find a job. However, their departure from the labor market is a structural rather than an optional issue, because it is caused by poor employment prospects, either perceived or real.<sup>5</sup> Increasing job insecurity and poor working conditions at many firms have discouraged many young graduates from searching for jobs. According to a survey conducted by the Ministry of Employment and Labor (MOEL 2009), the gap between the wages that young Koreans have earned and those they have expected to receive has been rapidly increasing over the past decade. Many young females have had to settle for jobs in relatively small firms after leaving school (see Fig. 2). However, they have found the salaries, working conditions, and potential for career development quite unsatisfactory at most of these small businesses. They have, therefore, opted to exit the labor market altogether and become homemakers. This explains the unique, wide gap in the labor force participation rate between female Koreans in their late 20s and those in their early 30s.

This study aims to explain why Korea has been experiencing a growing number of discouraged workers. The current discussions are of little use, because they have focused only on the internal aspects of the labor market, while overlooking the important historical context for this problem. This study argues, instead, that the increase in the number of discouraged workers in Korea has stemmed from a unique

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5. On the subject of discouraged workers, see Finegan (1981).



Source: H. Kim (2006, 270).

Note: X-axis shows the number of the employed in a firm.

Figure 2. The Size of the First Workplaces for Young Female Workers (2006)

combination of two historical factors. The first is a new factor: since the economic crisis of 1997-1998, Korea’s drive for financial rationalization has weakened labor demand by placing pressure on industries to cut costs. However, all industries facing cost-cutting pressures do not see an increase in the number of discouraged workers.

The second historical factor is the traditional hierarchical structure within Korea’s industry. This factor has accommodated the new financial rule in a way that discourages workers from remaining in the labor force. The hierarchical structures in industries have made it easier for the *chaebol* to manipulate subcontracting relationships with small- and medium-sized enterprises (SMEs) and freeze further employment in a way that rationalizes their financial condition. However, SMEs and workers—or their families—have had to absorb the costs externalized by the *chaebol*. SMEs have increased the number of low-paying jobs to deal with the *chaebol*’s pressure to reduce costs, and have ultimately exacerbated the problem of poor job prospects for young and female workers. The labor supply has eventually shrunk, as families have held young and female workers back in order to pro-

tect them from the restricted labor demand.

This analysis leads to the notion of *glocal* risk. Many political economists and sociologists in Korea tend to see new social risks, including the problem of discouraged workers, as being caused by the direct involvement of global norms in domestic society. However, the emergence of new social risks is also determined by how Korea has responded to the global pressure. Korea's problem of discouraged workers stems not only from the global norm of financial rationalization, but also from the unique response of Korea's industrial world to this global pressure.

The argument is presented in the following steps. The next section critically examines whether the existing discussions adequately characterize the growing number of discouraged workers in Korea. The section "The Korean Way of Financial Rationalization and Discouraged Workers" explains how the Korean way of financial rationalization—specifically implemented through a local institution of hierarchical industrial networks—has resulted in the departure of an increasing number of young and female workers from the labor market. This section corroborates this hypothesis by focusing on the sequential adjustment of the *chaebol*, SMEs, and families to the new financial environment. The concluding section offers several lessons for understanding Korea's social problems in the era of globalization.

### **Mischaracterizing the Victims: Involuntary Outsiders, Technological Laggards, and NEETs**

The existing literature has referred to earlier studies of Europe's unemployment problem in analyzing the employment problem facing Korea today. Built upon the European Studies, the current literature is mainly concerned with how the internal aspects of the labor market, such as the power of the labor unions, technological developments, and a weakening work ethic, have shaped the employment problem in Korea.

In this vein, one could characterize the major victims of Korea's

employment problem as *involuntary outsiders*. This hypothesis draws on Europe's experience, in which organized labor prevented employers from adjusting real wages downward, thus creating additional jobs for unorganized labor in a flexible way (Lindbeck and Snower 1989). Bringing this perspective to the Korean context, some economists highlight the growing organizational power of Korea's labor movements as the main cause of the ongoing job crisis. They propose that, since the democratic shift in 1987, labor unions have mobilized militant struggles in a way that prevents employers from adjusting labor demand flexibly and creating new jobs (I. Lee 2009; D. Kim 2005). The conservative media have also stressed that labor unions have long refused to reduce wages and welfare benefits and have, therefore, stunted the growth of new jobs.<sup>6</sup> Even former progressive president Roh Moo-hyun claimed that labor movements were too militant to negotiate with the government over the issue of job creation. He also called for "moral sincerity" from labor activists and cooperation for job sharing with non-regular workers and the unemployed (Dan 2005).

Nonetheless, it is an overstatement to define labor unions as the main cause of Korea's employment problem. Unions may have developed the tendency to wage militant battles, but they do not have enough organizational power to veto the efforts of the government and employers to effect wage adjustments and create jobs. Union membership has been declining since the mid-1990s; now, only 10 percent of workers are unionized. Moreover, the growing struggles of the labor movement have not resulted in strict labor regulations. The degree of employment protection in Korea has been loosened continuously since the financial crisis hit the country.<sup>7</sup> Meanwhile, this perspective was only designed to analyze the persistence of unemploy-

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6. *Hankook Ilbo*, "Cheongnyeun iljari neullineun geon dangyeon-hajiman" (Although It is Appropriate to Expand Jobs for Young People), October 15, 2010; *Munhwa Ilbo*, "Jadongcha haeoe saengsan mageun geumsok nojo-ui yeokjuhaeng" (The Metal Union Blocking Overseas Production), March 22, 2010.

7. OECD StatExtracts, <http://stats.oecd.org/index.aspx> (object name: Employment Protection; accessed August 23, 2011).



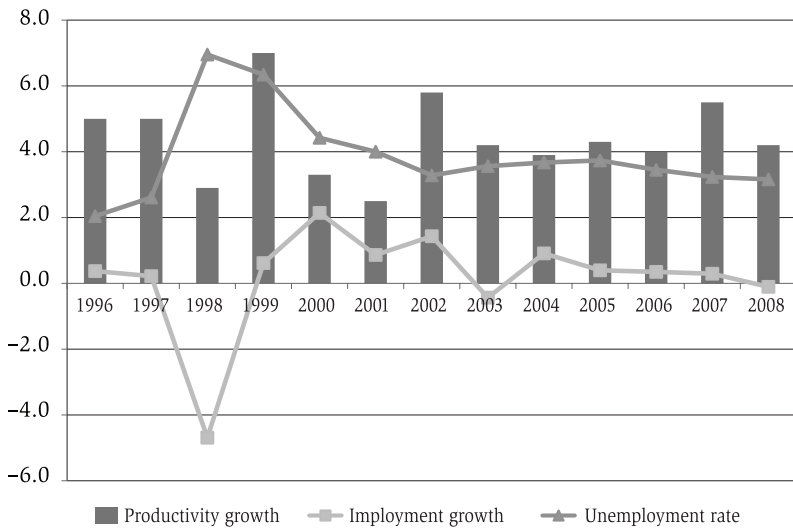
ment in Western Europe, not the current situation of jobless growth in Korea. In the 1980s, when European countries suffered unemployment, they were also confronted with the end of rapid growth. However, Korea is now in a stage of robust growth, while simultaneously experiencing the problem of joblessness. Finally, this hypothesis cannot explain why the main problem in Korea is not high unemployment, but low labor force participation. It must be seriously explored why many Koreans, facing constrained job opportunities, choose to exit the labor market rather than staying there to seek jobs.

The second hypothesis paints the victims of Korea's employment problem as technological laggards. Many labor economists argue that Korea's shift to a knowledge-based economy has affected employment growth. In particular, the development of information technology (IT) has helped firms to create goods with fewer workers. Moreover, as technology has become increasingly crucial in market competition, Korean firms have tended to hire increasing numbers of experienced workers who are immediately available, rather than to invest in educating young recruits over the long term (Kim and Yang 2004; Lee and Kwun 2003).

This hypothesis is related to previous unemployment studies that found a positive relationship between increased productivity and labor redundancy in Europe (Mortensen and Pissarides 1998; Acemoglu 1998). This perspective may account for the weakened connection between economic growth and employment increases in Korea. It is possible to hypothesize that the introduction of new technologies leads to economic growth in Korea, while also causing a reduction in employment opportunities. Indeed, Korea has achieved not only faster economic growth, but also faster productivity growth—in terms of the growth rate—than other OECD members over the past decade. Unfortunately, the explanatory power of this perspective is limited. There is no significant relationship between productivity performance and unemployment (or employment) performance in Korea. Over the past decade, as Figure 3 demonstrates, productivity growth has not exerted a clear influence on either employment reduction or increased unemployment.

Like the first hypothesis, moreover, this hypothesis does not explain the increasing number of discouraged workers, who tend to exit the labor market when facing poor job prospects. Finally, the remarkable growth in productivity and technology pertains only to a few *chaebol* that can rival their global competitors in the high-technology sector. On the contrary, most SMEs in Korea have not progressed toward the same goal. These firms have hardly exploited any new technology, but have depended instead on cheap and low-skilled labor for their market survival. Among the OECD members, Korea is experiencing the most serious gap between large and small firms in terms of productivity (Cho 2009).

The final hypothesis questions the work ethic of young Koreans and regards those who stay outside the labor market, neither working currently nor training for new jobs, as NEETs (Not in Employment, Education, or Training). For example, the newspaper *Chosun Ilbo*



Source: OECD, 2010, *OECD StatExtracts*, <http://stats.oecd.org/index.aspx>.

Figure 3. Productivity, Employment, and Unemployment in Korea (%)

blamed young Koreans for having a weaker work ethic and passion than the old “developmental generation” had in the past, while warning that such social lethargy would eventually undermine Korea’s economic growth.<sup>8</sup> Overeducation is cited as another social problem in Korea. As a result of higher and extended education, an increasing number of well-educated youth have become quite “choosy” in finding jobs commensurate with their qualifications (Oh 2007).

Eroding morality, if any, cannot account for the unique behaviors of many young Koreans. Although an increasing number of young Koreans have recently opted to exit the labor market, they are not necessarily NEETs. As Table 1 clearly demonstrates, the number of NEETs, including those who take a break or give up looking for a job, has only marginally increased. Instead, many young Koreans have struggled to boost their qualifications for jobs through education. In other words, they have delayed their transition from school to work and, thus, remained economically inactive. Overeducation also fails to explain the problem. Well-educated job candidates tend to be cautious when selecting jobs in accordance with their qualifications. However, this does not explain why well-educated Koreans, particularly females, are completely opting out of the workforce, rather than simply being more discriminating than average in the process of identifying job prospects.

One common limitation of the current perspectives is that they fail to highlight discouraged workers as the major victims of Korea’s employment problem. Discouraged workers differ from involuntary outsiders or technological laggards, in that they are not unemployed; instead, they have left the labor market entirely. Moreover, many discouraged workers in Korea are relatively well-educated in comparison with technological laggards. Finally, discouraged workers are hardly NEETs, in that they will prepare for new jobs in academic institutions.

The other limitation is that the current approaches have failed to

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8. *Chosun Ilbo*, “Chwieop uiyok-majeo ireun niteujok hangugin-gwa ilbonin” (The Korean and Japanese NEETs who Have Lost Their Will for Job Search), December 14, 2010.

Table 1. What Young Koreans Are Doing When They Are Not Employed

	(Aged 15-29, 1,000 persons)					
	2003	2004	2005	2006	2007	2008
Unemployed (A)	401	412	387	364	328	328
Learning or preparing for jobs at institutions (B)	268	297	351	413	417	477
Taking a rest (C)	225	258	278	258	245	245
Giving up finding a job (D)	31	30	32	33	30	32
NEETs (C + D)	256	288	310	291	275	277
Labor force non-participants (B + C + D)	524	585	661	704	692	754

Source: MOSF (2009, 2).

consider two historical factors, in favor of analyzing the internal conditions of the labor market. The first important factor is the kind of macroeconomic policy that has substantially influenced the labor market. The most remarkable change is the new drive for financial rationalization since the late 1990s, which has influenced the industrial capacity of job creation. This began with the financial crisis of 1997-1998 and the ensuing requests from the International Monetary Fund (IMF) to tackle the financial position of the highly indebted *chaebol*.

The Korean government accepted the international norm of financial rationality in quite an active manner. When the governments of Kim Dae-jung (1998-2003) and Roh Moo-hyun (2003-2008) faced resistance from the *chaebol*, from conservative politicians, and from the media regarding this rule (S. Lee 2003), they actively defined the close connection between the *chaebol* and the banks as a vestige of authoritarianism. Thus, they were committed to the new financial rule as a condition of democratic consolidation. On the other hand, the government saw this new rule as an important condition, the acceptance of which would qualify the Korean economy to engage in globalized economic opportunities. Consequently, the government abandoned its traditional role as a strong sponsor of the *chaebol*. Instead, it became a

champion for financial rationalization by strongly curbing abusive transactions between the *chaebol* and the banks. Specifically, the government demanded that the corporate sector reduce the debt-to-equity ratio. The Kim administration created the Financial Supervisory Service (FSS) to investigate abusive financial connections between banks and big firms.<sup>9</sup> The FSS forced 14 merchant banks to close for failing to meet capital adequacy ratio (CAR) requirements, and nationalized several major banks that were eventually dismantled.

The other important historical factor concerns how the existing industries have adjusted to the pressure of financial rationalization. The hierarchical relationship of the *chaebol* vis-à-vis other industrial actors has defined the pattern of this response. First, the relationship of the *chaebol* with SMEs is hierarchical, in that it has been a matter of dominance and influence rather than a contractual or mutually obligatory partnership (Castells 2010, 101-103). Furthermore, the relationship between the *chaebol* and SMEs is asymmetric, because stable dependence upon the *chaebol* has been pivotal for the SMEs' market survival. The number of SMEs that have subcontracting agreements with big firms has increased substantially and, in the mid-1990s, approximately 70 percent of SMEs served as subcontracting suppliers for the *chaebol* (Ha 2007, 372).

Families have comprised the last layer of Korea's hierarchical industry structure. Families have paid almost all the costs of protecting and educating workers. It was not until 1990 that the government legislated employment security by amending the Labor Standards Act. Further, the amendment of the Labor Standards Law in 1999 gave employers more leeway to adjust their workforces. As a result, workers have needed to depend on the financial capacity of their households when they cannot find jobs. Also, families have been the prima-

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9. The Lee Myung-bak administration (2008-present) has urged the banks to provide more liquidity to firms. However, Lee administration has not gone far enough to restore collusive *chaebol*-bank networks. It also has not extended policy loans to the specific *chaebol*. Moreover, the world financial crisis in 2008 forced the Lee administration to keep monitoring bank performances carefully.

ry providers of welfare benefits and education. Only big firms with sufficient financial capacities have been able to provide welfare benefits and training programs to their workers. Instead, therefore, the majority of workers have depended upon the family's function of income redistribution and educational support. This practice has long been reinforced by Korea's Confucian tradition. The Confucian virtues emphasize the responsibility of the family to protect and educate individuals, who are the source of future family glory (Jacobs 2010).

This study hypothesizes that the combined effects of the aforementioned two factors—i.e., financial rationalization and hierarchical industries—have resulted in the increasing number of discouraged workers in Korea. On the one hand, the drive toward financial rationalization has placed enormous cost-reduction pressure on industries and has forced them to curtail the demand for labor. On the other, the tradition of hierarchical industries has shaped Korea's pattern of financial rationalization. With this type of network structure, cooperation, and burden sharing have not been the typical strategy for industries to rationalize their financial position. A clear chain of dominance has enabled the *chaebol* to manipulate the subcontracting relationships with SMEs and freeze further employment in a way that rationalizes their financial condition. However, SMEs and workers (or their families) have to absorb the costs externalized by the *chaebol*. SMEs have increased the number of low-paying jobs to deal with the *chaebol's* cost-saving pressures, and have ultimately worsened the job prospects for many workers. Families have internalized the costs of protecting young and female workers by withdrawing them from the perils of the labor market. Gradually, their labor market participation has shrunk.

### **The Korean Way of Financial Rationalization and Discouraged Workers**

This section corroborates the above hypothesis. This study does not necessarily claim that any reform to achieve a sound financial condi-

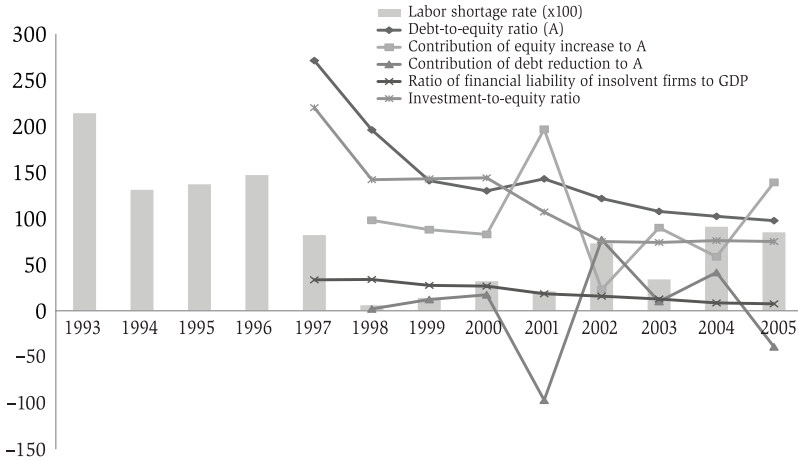
tion results in an unstable labor market. As the following illustrate, the hierarchical industrial structure is a unique factor in Korea, whereby the country's industrial society has accommodated the new rule of financial rationality in a way that excludes workers from the labor market.

### *Financial Rationalization and the Chaebol's Strategies*

Financial rationalization has been Korea's main area of economic reform since the late 1990s and was intended to improve the financial condition of the corporate sector. To a certain extent, this reform has led many Korean firms to regain financial sustainability from the danger of bankruptcy (Fig. 4). As the new regulations have required banks to manage their financial reserves effectively, the banks must restrain themselves from providing additional loans to firms without considering the likelihood of repayment. The regulations have asked the *chaebol* to improve their financial balance, particularly through rapidly lowering their debt-to-equity ratio.

Financial rationalization has exerted enormous pressure on Korea's corporate sector to reduce costs. This is proven by the fact that, as Figure 4 illustrates, the *chaebol's* main route to lowering their debt-to-equity ratio was to increase equity holdings rather than reduce their bank loans. In particular, the *chaebol* have concentrated their efforts on reducing production costs to increase the level of equity holdings. These big firms have also become cautious about directing capital stock into investment. As the decreasing investment-to-equity ratio shows (Fig. 4), a great deal of equity has been hoarded as corporate savings rather than business investments.

In many cases, the *chaebol* have achieved the goal of cost reduction by making use of the hierarchical networks in Korean industries. These hierarchical networks have enabled the *chaebol* to shift the burden of financial adjustment onto their traditional dependents. The first victimized dependents are SMEs. The *chaebol* have squeezed subcontracting SMEs in such a way that the latter bear further production costs (Chu et al. 2009). In particular, they have adopted three strate-



Source: Compiled from Korean Statistical Information Service, [http://kosis.kr/eng/database/database\\_001000.jsp?listid=Z#](http://kosis.kr/eng/database/database_001000.jsp?listid=Z#).

Figure 4. The Effects of Financial Rationalization upon the 300 Largest Korean Firms (%)

gies to pass on production costs.<sup>10</sup> The first is the unilateral reduction of subcontracting prices. The *chaebol* demanded that SMEs lower their subcontracting prices whenever raw material prices dropped. However, when raw material costs increased, the *chaebol* rarely considered adjusting prices. At the same time, small suppliers were forced by the *chaebol* to submit internal financial documents for review, which reduced subcontracting prices based on reviews of the subcontractors' accounts. Second, the *chaebol* often took new technologies away from subcontracting partners by hiring core engineers from SMEs, who had expertise in emerging technologies. In addition, they coerced subcontracting firms to submit internal documents about technology when participating in the bidding process. The final manner in which the *chaebol* squeezed the SMEs involves underpayment. They often paid

10. Interviews by the author with three officials of the Korea Federation of Small and Medium Business, Seoul, September 12, October 23, and December 4, 2010.



contractors less than the agreed-upon amount in exchange for improvements in subcontracting conditions. When SMEs requested shortened payment periods, or cash payments instead of promissory notes, the *chaebol* agreed to such requests on the condition that payments would be discounted substantially.

Two surveys conducted by S. Kim (2008) and the Korea Federation of Small and Medium Business (Kbiz) (2009), respectively, strongly support the argument made above. According to Kim, more than 70 percent of SME-businesspersons felt that the current way of determining subcontracting prices was “unfair.” They stated that at the heart of this unfair system are the unilateral demands by big firms for price reduction (25.8%), the firms’ exertion of oligarchic power (32%), and their selfish attitude with regard to seeking profits (16%). Meanwhile, Kbiz explained why the *chaebol* could reduce subcontracting prices. Almost 60 percent of SME-businesspersons explained that the *chaebol* were likely to shift production costs to their small subcontractors, not only to offset increasing export prices, but also to achieve financial balance.

Workers are the other victims of the *chaebol*’s efforts to reduce production costs. Immediately after the financial crisis of 1997-1998, the *chaebol* trimmed the size of their workforces to streamline corporate organization and reduce production costs. A regulatory change facilitated the *chaebol*’s strategy of mass layoffs. In 1999, the Kim Dae-jung administration inserted a new clause into the Labor Standards Act that would allow collective dismissals for managerial reasons. This strategy resulted in an abrupt increase in the number of small businesses. After being laid off or forced to retire early, salaried workers entered into secondary forms of business, such as self-employment. However, as the transition to new businesses has not been supported by sufficient market information and managerial knowledge, it has eventually resulted in very low marginal profits and a short period of survival, on average, three to five years.

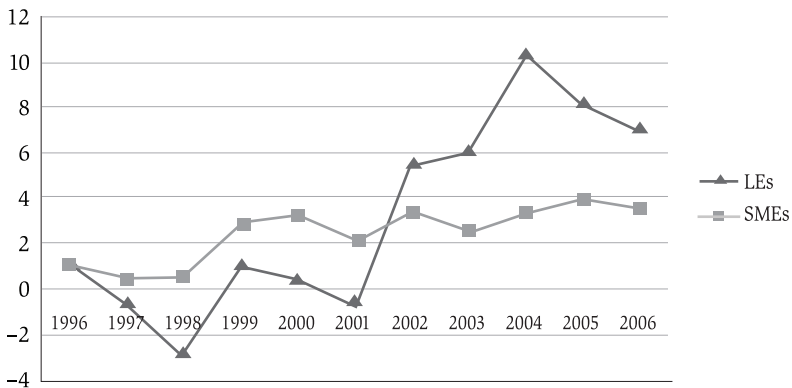
Although the mass layoffs almost disappeared in the mid-2000s, when the economy recovered from the crisis, the *chaebol* have not reabsorbed the workforce they once released. They have, instead,

frozen their recruitment plan as an important policy to keep production costs low and sales margins high. For example, as seen in Figure 4, the *chaebol's* reluctance to hire new workers has resulted in a constant decrease in the labor shortage rate. The *chaebol* still offer better-paying and more secure jobs compared to other firms, but they have hardly increased the number of these good positions.

### SMEs and the Growing Low-Quality Jobs

The *chaebol's* responses to financial rationalization explain a crucial aspect of why Korea has faced an employment problem: the *chaebol's* cost-saving efforts have reduced labor demand directly, because they have become reluctant to offer new jobs under the stringent requirements pertaining to corporate financing.

The *chaebol's* responses have also affected labor demand indirectly. They have worsened the business environment for SMEs and made it difficult for SMEs to offer good jobs. As a result of the *chaebol's* exertion of their strong bargaining power against the SMEs, as Figure 5 explains, the *chaebol* have outperformed SMEs in terms of ordinary profit rate since 2002. A lawmaker of the opposition Democratic Party



Source: Bank of Korea (1996-2006).

Figure 5. Comparison of Ordinary Profit Rate between LEs and SMEs

interpreted this finding as indicating that “unfair subcontracting practices are no better than surplus drains from the SMEs to the *chaebol*.”<sup>11</sup> However, SMEs have no choice but to maintain their unfair relationships with the *chaebol*. The market performance of SMEs has become increasingly dependent upon the *chaebol*'s payments. Among 21.6 percent of subcontracting SMEs in the late 2000s, the *chaebol*'s payments accounted for more than 80 percent of their total sales volumes. Further, 20.3 percent of subcontracting SMEs earned 40-60 percent of their income through subcontracting services (S. Kim 2008). Even the SMEs possessing relatively highly skilled technologies were no exception to this tendency. In industries such as IT services, computer equipment, electronics, and biotechnology, SMEs realized the market value of these skills through dependent transactions with the *chaebol*.

The worsening business environment for SMEs has had an adverse effect on job prospects in the labor market. First, to meet the *chaebol*'s shift-of-production costs, many SMEs have opted to increase the number of low-wage employees. As Table 2 illustrates, wages for SME workers have gradually decreased in comparison with those for workers in big firms. On average, in the mid-1990s, wage incomes for

Table 2. The Performance Disparities between Big Firms and SMEs in Korea (%)

	1995-1997	1998-2001	2002	2003	2004	2005	2006	2007
Wage income (A)	76.3	65.9	62.2	60.9	57.7	57.6	59.9	58.4
R&D expenditure (B)	10.1	20.3	19.4	16.4	14.0	13.6	15.5	16.1

Source: E-National Index, [http://www.index.go.kr/egams/stts/jsp/potal/stts/PO\\_STTS\\_idxMain.jsp?idx\\_cd=1181](http://www.index.go.kr/egams/stts/jsp/potal/stts/PO_STTS_idxMain.jsp?idx_cd=1181).

Note: A = average wage of SME workers when that of workers in big firms is 100; B = the proportion of SMEs' R&D expenditure to big firm's R&D expenditure.

11. Interview by the author, Seoul, December 7, 2010.

SME workers stood at approximately 73 percent of those for their counterparts in big firms. However, the gap has expanded since then, and most recently, the workers at SMEs were earning less than 60 percent of the wages offered at big firms. The growing number of low-paying jobs among SMEs is not temporary; rather, it is a constant issue. A 2009 survey conducted by the MOEL revealed that more than 70 percent of SMEs were planning to hire only low-skilled and manual workers.<sup>12</sup>

In the worst situation, workers in SMEs are forced to accept even less than the minimum wage. In 2000, approximately 530,000 workers were paid less than the law stipulated. Over the next ten years, the number of workers paid less than the minimum wage has almost quadrupled to more than two million, comprising approximately 10 percent of Korean workers (Y. Kim 2010, 18). Overall, SMEs' low gains from subcontracting have caused a downward spiral of decreasing productivity and increasing number of low-paying jobs.

Second, the working environment in SMEs has limited the opportunities for workers to become skilled at using new technologies. These firms have failed to accumulate enough profits to pursue technological upgrades. Table 2 explains that, except for a few periods during the venture boom, SMEs' R&D expenditures have been less than one-fifth of those of big firms. In addition, SMEs could not manage their human resources in ways that promote skills development. The rise in low-paying and non-regular employment has reduced the possibility of any long-term commitment to workers' education.

The worsening business environment has also watered down the government's ambitious policies to strengthen the technological capacity of SMEs. A good example is the policy to promote *root industries*. Referencing the contribution of outstanding design to the success of the Apple iPhone, the Korean government has consistently emphasized the importance of the root industries, including heat treatment, surface finishing, casting, and electroplating. In particular, it has established industrial clusters, in which workers in this industry can

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12. Calculated by the author based on figures from MOEL (2009).

cooperate with IT industrial partners. However, this has hardly been an incentive for small firms in the root industries to perform better. A senior worker said, “A long-term plan for technology support looks quite vague. What we need most is the improvement of the subcontracting environment. Only the latter makes sense of the former.”<sup>13</sup>

### *Families' Response and the Shrinking Labor Supply*

To put it simply, Korea's method of financial rationalization has only made workers' employment prospects worse. It has reduced the number of job opportunities as the *chaebol* have shed the workforce and frozen labor demand to save on production costs. Subsequently, financial rationalization has led to deterioration in job quality, as SMEs have expanded the number of low-paying jobs to meet the *chaebol's* pressure to bear a greater proportion of the production costs.

Workers could have continued to seek better-paid employment, even when the corporate sector diminished their employment prospects. This would have resulted in high unemployment. Otherwise, if SMEs had found enough workers willing to accept low wages, the economy would have arrived at a condition of high employment. However, neither scenario occurred in Korea for two reasons. First, the country lacked an institutionalized system of public welfare that would have strongly supported job searches and vocational programs for workers. Without such institutional support, many Korean workers have been reluctant to put up with the hardships of unemployment or low wages. Second, and more generally, studies show that workers tend to depend on the traditional norms and resources that are associated with the national economic system to survive the new strain of shrinking labor demand.<sup>14</sup> In Korea, an increasing number of workers have decided to halt their job searches and step out of the labor market in favor of seeking the protection of their families, which have long been the last layer of Korea's hierarchical industrial struc-

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13. Interview by the author, Busan, May 16, 2011.

14. See, for example, Romme (1990).

ture. This exodus has provided the Korean economy with an odd form of market equilibrium. The economy has maintained low unemployment, not because of increasing employment, but because of a decreasing rate of labor force participation that keeps the number of job seekers low.

Behind workers' departure from the labor market are the increasing financial costs of families protecting workers from poor job prospects. Specifically, families have helped their struggling adult children with both living and educational assistance. During the past decade, according to a social survey conducted by the Korean government, Korean households at all income levels have increased the financial support they provide to their jobless unmarried adult children (Statistics Korea 2009). The expenses incurred by a typical family in educating their children have also increased and, in 2009, families paid for over 60 percent of tuition and fees, even for graduate studies (Statistics Korea 2009). Relying on this extensive financial support from the family, young Koreans have avoided the deteriorating working conditions *out there* and have, in turn, delayed their transition from school to work. To avoid encountering the inevitable difficulties that accompany job searches, a significant number of college students have intentionally delayed the completion of their undergraduate studies—what used to take six years for males and four years for females is now taking seven and five years, respectively, on average.<sup>15</sup>

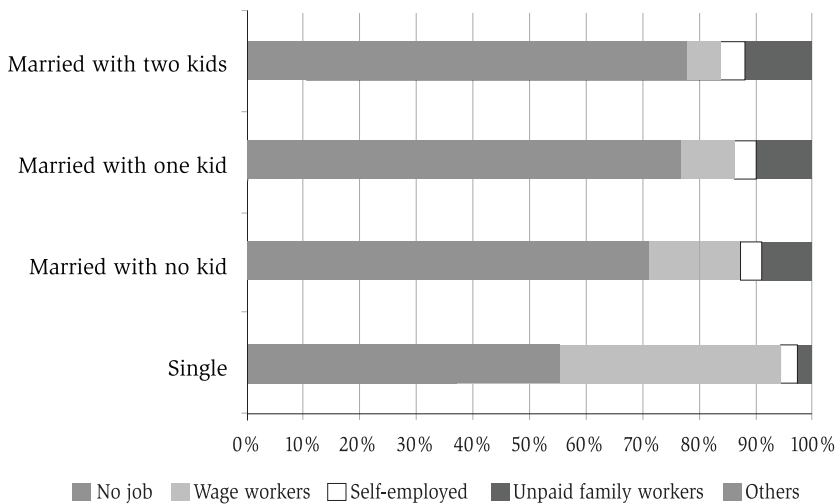
While families have delayed the participation of some of their adult children in the labor market, they have essentially reclaimed many female workers. In particular, this family-centric culture has found it easy to justify female workers' sudden departure from the workforce in their late 20s or early 30s. The decrease in labor force participation among females aged 30-34 years is predominantly due to their decision to quit the workforce to become homemakers. Highly educated women are no exception to this trend. Many of them have

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15. *Kyunghyang Shinmun*, "Daehak 5 nyeonsaeng-eun pilsu, 6 nyeonsaeng-eun seontaek" (It Takes 5 or 6 Years for Most College Students to Graduate), October 27, 2009.

shifted the basis of their social identity from the workplace to the home, because they are less satisfied with the quality of the jobs that are currently available to them, and because they have a better chance of acquiring a high-income spouse.

In some cases, women have struck a balance between family and work by becoming *underemployed* in family businesses, which are officially economically inactive. In the early 1990s, approximately 80 percent of unpaid family workers were women. The rate has now increased to 90 percent (Jung 2008, 127). Figure 6 demonstrates that relatively young Korean women are likely to become unpaid family workers after they marry and bear children. Only three percent of unmarried females participate in the labor market, as informal workers. However, this rate is rapidly increasing according to their marital and reproductive status. Over ten percent of married females who have more than two children are now unpaid family workers. Unpaid family workers in Korea can also be categorized as discouraged work-



Source: Kim and Woo (2010, 30).

Figure 6. Employment Status of Young Korean Women (aged 25-35) according to the Marital and Natal Stages (in 2009)

ers in that they continue to work only informally, although they have the capacity and willingness to work more formally. Together with education, capitalist industrialization has been a key driving force behind women's engagement in public life outside of their traditional role as housekeepers. Ironically, however, the Confucian family is the last bulwark on which Korean women rely when they cannot find satisfactory jobs in industry.

Korea might achieve stabilization in its process of economic reform as a result of the traditional role assumed by families that internalize welfare costs for imperiled workers. However, it has become increasingly difficult for families to continue to play that role. In particular, the extended task of supporting and educating family members has placed an enormous financial burden on low-income families and has driven them to take on huge household liabilities.<sup>16</sup> In particular, such financial burdens will inevitably cause low-income households to suffer further losses.

### **Conclusion: The *Chaebol* Risk**

As opposed to the current approaches, this study highlights the unique nature of Korea's employment problem and its historical background. This study first uncovered the fact that at the heart of Korea's employment problem is a growing number of discouraged workers who are willing to work, but who have left the labor market due to poor employment prospects. This study argued that this new social problem has stemmed not only from Korea's drive toward financial rationalization, but also from its unique way of implementing this new financial rule. The most crucial factor that creates discouraged workers is the hierarchical networks within Korean industries, which have enabled the *chaebol* to externalize the costs of economic adjustment and force SMEs and families to absorb those costs. The com-

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16. *Kyunghyang Shinmun*, "Gagye buchae wiheomseong keojinda" (The Growing Danger of Household Liabilities), February 11, 2010.



bined effects of financial rationalization and hierarchical industries have driven young and/or female workers out of the labor market by rendering their job prospects daunting.

The majority of Korean specialists have directly attributed the emerging social risks, such as job insecurity, income inequality, non-regular employment, and limited job opportunities, to the phenomenon of a globalized economy. Their debates have centered on the extent to which the globally accepted rules and practices have sacrificed the social subsistence of Korean workers and citizens (Onaran 2009; Koo 2007; Kim and Park 2006; Bae and Rowley 2001). This position has some legitimacy, in a sense. However, this study offers a deeper insight into how social risks emerge in the era of globalization. The analysis of this study implies that it is not only the pressure of globalization, but also Korea's unique way of accommodating this pressure, that matters in the emergence of new social perils. As is often emphasized in this study, it is the hierarchical structure within Korea's industries that has shifted economic costs from the *chaebol* downward to SMEs and families, and has thus discouraged workers from participating in the labor force. That is, the risk of a discouraged workforce is not merely globally created, but is also globally originated, in that it comes from Korea's local pattern of response to the global pressure.

The idea of glocal risk points to a new danger facing Korean society: the conventional routes of *trickle-down* economics<sup>17</sup> have now become those of distributional conflicts. In the past, the subcontracting relationship and employment positions were the routes through which the *chaebol's* gains from exportation were channeled to SMEs and workers. This study shows that trickle-down economics does not hold in contemporary Korea. The *chaebol* are the exclusive beneficiaries, as well as the survivors, of the decade-long financial restructuring. Under the pressure of financial rationalization, the previous routes for trickle-down economics have become the new routes of

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17. Concerning the application of this *trickle-down* perspective to Korea, see Kakwani and Son (2008).

trample-down economics, which enables the *chaebol* to shift higher costs to those who are least able to develop on their own, and, eventually, to exclude some of them entirely from the market.

In many industrializing countries today, neoliberal tenets and practices are often blamed for social disability. However, as the Korean case clearly shows, what matters more is how society and politics accept these neoliberal projects. Blind commitment to the neoliberal projects without deep consideration of their social consequences may cause a serious instability in society. As Dahrendorf (1979, 139) has emphasized, a genuine sense of economic development starts with “domesticating conflict by recognizing and regulating it,” rather than laying it aside. Therefore, the daunting task that lies ahead for Korea will be to establish a new institutional formula that adequately combines market dynamics with social stability.

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