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## The Potential Role of an Employment Guarantee Scheme in Korea's Social Safety Net

Gary S. Fields

*Cornell University*, [gsf2@cornell.edu](mailto:gsf2@cornell.edu)

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# The Potential Role of an Employment Guarantee Scheme in Korea's Social Safety Net

## Abstract

[Excerpt] Beginning in November 1997, the Republic of Korea underwent a devastating economic crisis. Declining macroeconomic conditions brought about major labor market disruptions in 1998: a quadrupling of unemployment, a fall of 9% in real wages, informalization of the remaining jobs, increased job insecurity, and rising poverty and inequality. Disadvantaged groups suffered a disproportionate impact. The result was not only economic misery but also social pain: increased homelessness, rising crime, heightened school dropouts, an accelerating divorce rate, and an overwhelming sense of social malaise.

1999 marked a major turnaround for Korea. GDP grew by 10.7%, and real wages are growing apace. The unemployment rate is now less than half of its peak level. Women are again returning to the labor force and are finding employment. A sense of guarded optimism is returning to the Korean society.

Nonetheless, important labor market problems remain (and social problems as well). The unemployment rate now is twice as high as it was before the crisis. But high unemployment is the tip of the proverbial iceberg. Income inequality is 15% higher and poverty is twice as high as before. What recommendations, taking into account cost and other considerations, can be made on the reporting of recommended indicators?

## Keywords

Korea, employment insurance, poverty, economic security, income inequality

## Disciplines

International and Comparative Labor Relations | Labor Economics | Labor Relations

## Comments

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# The Potential Role of an Employment Guarantee Scheme in Korea's Social Safety Net\*

Gary S. Fields\*

## The Current Employment Insurance System

Beginning in November 1997, the Republic of Korea underwent a devastating economic crisis. Declining macroeconomic conditions brought about major labor market disruptions in 1998: a quadrupling of unemployment, a fall of 9% in real wages, informalization of the remaining jobs, increased job insecurity, and rising poverty and inequality. Disadvantaged groups suffered a disproportionate impact. The result was not only economic misery but also social pain: increased homelessness, rising crime, heightened school dropouts, an accelerating divorce rate, and an overwhelming sense of social malaise.

1999 marked a major turnaround for Korea. GDP grew by 10.7%, and real wages are growing apace. The unemployment rate is now less than half of its peak level. Women are again returning to the labor force and are finding employment. A sense of guarded optimism is returning to the Korean society.

Nonetheless, important labor market problems remain (and social problems as well). The unemployment rate now is twice as high as it was before the crisis. But high unemployment is the tip of the proverbial iceberg. Income inequality is 15% higher and poverty is twice as high as before.

This report is part of a larger study looking at Korea's social safety net and ways of improving it. One component of that larger study is an assessment of how the unemployment insurance (UI) component of the nation's Employment Insurance System (EIS) should be redesigned or supplemented. Official recommendations are contained in a Korea Labor Institute report "Supplementing Korea's Unemployment Insurance System." What follows are additional recommendations reflecting my own personal views and not those of KLI or any other institution.

Cornell University, USA.

What Korea has is not just an "unemployment problem" but a more general "employment problem." (Fields, 1999) The unemployed are not the only ones who are suffering. Those who lost jobs and have become re-employed in less good ones; those who have kept their old jobs and whose real earnings have declined; those who are employed as daily workers and temporary workers and who have fewer work days than before; and those who face precarious employment and earnings prospects - all these are part of Korea's employment problem too.

Before the crisis, Korea had put into place an ambitious employment insurance system (EIS). The three components of this system are traditional unemployment insurance (UI), job training, and a job information service. Other elements of Korea's social safety net system include a Livelihood Protection Program for the poor, a Life Stabilization Fund for those unemployed whose assets fall below a certain level, public works jobs for the unemployed and for the spouses of low-wage workers, employment maintenance subsidies, support for venture enterprises, and many other smaller programs.

Despite all that Korea has done, the nation's social protection system still has more holes than net. In 1999, there were 35.8 million Koreans aged 15 and over. The average number of unemployed in any given month was 1.4 million. Yet, in a typical month, just 0.1 million received unemployment benefits and 0.3 million participated in public works programs. 1.7 million Koreans received Livelihood Protection benefits at some time during 1999. Taken together, about 0.5 million unemployed had been covered by those assistance programs.

It is important to be clear about the risk being faced. Unemployment insurance in Korea, as elsewhere, protects against the risk of income loss because of unemployment. To date, the system has protected against the risk of losing all of one's income because of the complete loss of job. The EIS provides people with a temporary income after they have been completely unemployed for two weeks. The broader risk, not yet covered in Korea, is unemployment because of a less-than-full work week. UI is not intended to be an income supplementation program for people who are working but earning little; rather, it provides those who are not working with a temporary income while they are searching for employment. Thus, the millions of Koreans who have suffered income losses while remaining in a job are excluded from the EIS. Economic growth and other programs are needed to take care of their problems.

It is also important to adopt a guiding framework for the EIS. One possible model is social insurance. Under this model, in so far as possible, everyone in society pays in and all of the insured who become unemployed can collect. Under the social insurance model, benefits are limited only by the overall financial solvency of the system.

A second model is the private account model. Private accounts can be publicly-run or publicly-mandated. In either case, the individual has his or

her own account. In the event of unemployment, the account balance can be drawn down to provide an income to the unemployed. Otherwise, the money belongs to the individual, to be used in some other way, e.g., for old age spending, home-buying, or medical expenses. Under this model, UI is a type of compulsory savings with self-insurance against unemployment.

The third model is social assistance. Here, the nation taxes itself in order to provide benefits for the needy members of society. Under this model, benefits are means-tested - that is, beneficiaries must prove not just that they are unemployed but that they are poor in order to collect UI benefits.

Korea's system has been set up on the social insurance model. I recommend that this model be continued.

The next question is: Keeping the social insurance framework, what are the issues in providing the best unemployment insurance possible for Korea at the present time? Three concerns are central.

The first is incomplete coverage. Only half of wage workers are insured by the UIS. 60% of employed people are wage workers. Therefore, only about 30% of working Koreans are insured by UIS. The first issue, then, is how to expand coverage so that more Koreans are insured against income losses due to unemployment. The paper prepared for this conference by Dr. Hur (2000) details a plan for doing this.

The second concern is inadequacy of benefits. The problem is that in Korea, UI benefits replace only a fraction of workers' prior earnings, and the benefit duration is shorter than the typical spell of unemployment. The issue, then, is how to redesign the benefit formulas in order to provide better social insurance. The KLI report already mentioned (Korea Labor Institute, 2000) recommends doing this by extending the maximum benefit duration to 49 weeks.

The third concern is weaving a social safety net. The problem is that the employment insurance system, the livelihood protection program, and the other programs in Korea, taken together, still leave major gaps. Gaping holes would remain even if the Refined Employment Record-Keeping System recommended by Dr. Hur were to be enacted, permitting UI benefits to be paid to non-regular workers in the construction sector. Accordingly, the next section of this report proposes that the gaps be filled further by creating an Employment Guarantee Scheme as a second pillar of the unemployment insurance component of the EIS.

Before proceeding, let it be noted that financing is apparently not an issue. KLI studies conclude that the EIS is on sound financial footing, even after the IMF Crisis. Alternative financing arrangements are not likely to be enacted any time soon, and so that issue is not addressed in this report.

## A Proposed Employment Guarantee Scheme for Korea

### *Key Features*

In order for the nation to provide all workers with social insurance against the risk of income loss due to unemployment, I propose a second pillar of the Employment Insurance System. This new pillar is an Employment Guarantee Scheme for Korea (EGS). This new scheme would be a formal part of the EIS and would work alongside traditional unemployment insurance as follows.

As its name implies, an Employment Guarantee Scheme would consist of public works jobs, offered on a daily basis to all who want them. Under this proposal, anybody who is unemployed and wants to receive a day's benefit in exchange for doing a day's work would be eligible for an EGS job. There would be no requirement of having worked previously, no prior contributory period, and no limitation on the duration of benefits. All who are unemployed - including daily workers, temporary workers, new entrants, re-entrants and anybody else who might be interested - would be eligible, with one important exception: because the EGS would be Pillar 2 of the EIS, no worker currently receiving UI benefits under Pillar 1 would be eligible for EGS benefits under Pillar 2.

Under such a scheme, establishing eligibility is not an issue. Doing a day's work would qualify the participant to receive a benefit at the end of the day. In other words, the work performed is itself *prima facie* evidence that the worker is deserving of benefits.

What would be an appropriate wage to set? International experience has shown that guaranteed jobs cannot be too remunerative, otherwise workers will prefer the EGS jobs over private sector jobs. High EGS wages would result either in a very large and expensive system, or else the employment guarantee feature of the system would have to be sacrificed in order to maintain financial solvency. The solution that has been found to work in other countries is to set the wage for the EGS at below-market-levels - in the case of Korea, the national minimum wage might be an appropriate amount - so that only those who cannot find more attractive jobs elsewhere in the economy would opt for the guaranteed jobs. In this way, the EGS would be self-targeting, so that those with poor market opportunities, and only those people, would participate in the EGS.

The jobs themselves should be designed so that EGS participants will perform socially useful tasks. The work sites would have to be dispersed throughout the country, otherwise the guarantee aspect of the job does not have much meaning. Still, in the best of circumstances, it may be necessary

for workers to have to travel considerable distances in order to get to where the jobs are.

The EGS would replace Korea's current system of public works. Public works were the largest single expenditure item for social protection for the unemployed in Korea in 1999, covering an average of 300,000 participants per month.

The new EGS would differ from the existing public works system in several respects. First, it would be open to everyone except for persons currently receiving UI benefits; the present system, by contrast, has a detailed selection process. Second, it would be a guarantee scheme; the present system is not. Third, jobs would be offered for a period as short as a day; the present system provides continuing, ongoing jobs lasting as long as several months. And finally, the benefits would be below the minimum wage level; the current system pays benefits at or above the minimum wage. (This last feature would have to be carefully explained as a way of enabling the country to afford to offer guaranteed employment on even a daily basis.)

Because the EGS will be a central part of the nation's system of social insurance and will have to be regarded as such, the benefits will need to be paid for by the larger society. Participants would make their contributions in kind by contributing a day's work in exchange for a day's wage, which will have to come from other sources. One possibility would be to levy a tax on "regular" employers; the justification for this would be that is their failure to create full employment that is creating the need for an EGS in the first place. Another possibility is to pay for the benefits out of general revenues, on the grounds that it is society's responsibility to assure earning opportunities to all of its citizens.

### *Lessons from International Experience with Public Works Programs*

As the details are worked out, the Korean authorities will be able to draw on much relevant international experience. Such public works programs to create employment for the poor have been established in the Maharashtra state of India, the principal city of which is Mumbai (formerly Bombay), as well as in Argentina, Bangladesh, Bolivia, Chile, Honduras, Cape Verde, and Botswana.

Lipton (1998) has conducted a thorough review of these programs and recommended the following design features: design employment for low opportunity cost individuals; seek alternatives to direct targeting; use scheme rules and conditions to discriminate for the poor; allow for poor workers' frequent physical difficulties; minimize poor participants' transactions costs; reduce covariate stresses on public works resources; use retailer, employer, and public works competition 'for the poor'; before starting, check that low demand for labor causes poverty; subsidize coverage,

sustainability, and graduation; encourage grassroots pressure groups to improve the scheme; seek complementarities among employment schemes; build up capacity of schemes and workers before works begin; and use performance incentives for officials and participants.

Another source of guidance is the World Bank's forthcoming *World Development Report 2000/2001*, which reaches the following conclusions.

- The wage rate should be determined by the local market wage for unskilled labor, not by the program's budget.
- Using additional eligibility criteria for screening is to be avoided.
- Wage schedules should be gender neutral.
- Labor intensity should be higher than the local norm for similar projects.
- n* Communities should be involved in project selection to derive maximum benefit from the infrastructure created.
- To maximize risk mitigation effects, the program should be available at all times, expanding automatically during crises, as demand increases.

A final aspect, not touched upon in either of these reviews, is a technological one. When this new system is created, it would be an ideal opportunity to introduce Smart Cards. Smart Cards are small cards like credit cards or bank automatic teller machine cards which are embedded with computer chips that can be written on. These are used, for example, throughout France as debit cards and throughout much of Europe as telephone cards, where they complement and more often replace coin telephones. The bus card used in the Seoul metropolitan area is similar to a Smart Card.

Making EGS payments to Korean workers by Smart Card would have a number of advantages. It would get Korean workers accustomed to dealing with Smart Cards. It would assure that workers who receive benefits under Pillar 2 would not simultaneously receive benefits under Pillar 1 - these benefits would also be paid by Smart Card. It would enable the Ministry of Labor to track usage of EGS jobs person by person. And it would reduce the scope for misappropriation of funds by local EGS administrators.

## **Diagnosis and Principal Recommendations**

In my view, Korea's unemployment insurance system has three major problems. First, despite recent extensions, coverage remains quite incomplete. Second, even if all wage workers were to be brought into the system, a large proportion of Koreans would remain without social protection. And third, the maximum duration of benefits is shorter than the typical spell of unemployment.



This diagnosis leads to three major policy suggestions. First, because temporary and daily workers face serious risks of unemployment and are not now covered by the current UIS, coverage should be extended to this group. In order to be able to do this, a new Refined Employment Record-Keeping System (RERS) has been recommended.

Second, even if the UIS were extended to include temporary and daily workers, there would still be important groups who would be left out of the social protection system. These include some regular workers (government workers and teachers), the self-employed, new entrants and reentrants to the labor force, and those out of the labor force. In order to include those now excluded, it has been recommended that Korea create an Employment Guarantee Scheme (EGS) that offers an assured job to all who wish to work.

And third, because UI benefits do not last long enough to cover a typical spell of unemployment, benefit duration should be extended. It has been estimated that with current financing rates and coverage ratios, the system could afford benefits lasting as long as 49 weeks (Korea Labor Institute, 2000).

However, I would not recommend that benefits be extended to this length for two reasons. First, the EIS needs to protect itself against a serious future adverse shock, such as occurred in the 1997/98 financial crisis. Second, part of the current surplus would be better used, I think, to extend benefits to those who do not now receive them rather than lengthening benefits for those now covered. Accordingly, I recommend that the surplus funds in the EIS be used in part to extend the maximum benefit duration and in part to finance an Employment Guarantee Scheme.

This combination of measures - extension of EIS coverage to temporary and daily workers, a second pillar guaranteeing public works jobs to all who want them, and longer benefit duration for the insured unemployed - would make major contributions to Korea's social insurance system. In addition to providing more substantial benefits to workers now insured who become involuntarily unemployed, the expanded UIS would also cover daily and temporary workers, the self-employed, new entrants and re-entrants to the labor force, and the re-unemployed.

Still left out would be the old, the sick, and the infirm. For them, what is needed is an expanded livelihood protection program, guaranteeing an escape from poverty. Such a program has already been promised for October 2000 and is now being implemented.

If this proposal were enacted, Korea would have a social insurance scheme with three major components: the current unemployment insurance system, extended to cover more wage and salary workers; an employment guarantee scheme for all who are capable of working; and an anti-poverty program for all, whether capable of working or not. The result would be a true social safety net for the first time in Korea's history. This would be a great national achievement.