

Globalization, Labor Market Flexibility and the Korean Labor Reform

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This paper addresses the question of labor market flexibility in Korea. It starts out with a conceptual discussion on different notions of labor market flexibility, identifying market-driven flexibility and strategic behavior-driven flexibility as two basic alternatives. It is then argued that globalization tends to create pressures toward market-driven flexibility, with mixed and uncertain results. Finally, reviewing evidence on labor market flexibility and the saga of the recent law reform, this paper suggests a need to devise a systematic approach to move toward strategic behavior-driven flexibility. (JEL classification: J50)

I. Introduction

In the mainstream economic discourse labor market flexibility has become one of the key consensus policy objectives. The extent of this consensus seems to encompass at least a significant section of the political left, as underlined, for example, by the recently victorious British Labour Party's commitment to maintain the Thatcherite labor market policies. The ideals of collective bargaining and social protection, ideals that used to be the reigning conventional wisdom during the postwar Golden Age in the context of the general commitment to using Keynesian macroeconomic policies to ensure full employment, have now fallen into disrepute. They are now blamed for labor market rigidities that allegedly contribute to

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unemployment and stagnation.

One of the important arguments in favor of labor market flexibility relates to globalization. Globalization of the economy is, it is argued, transforming the policy environment in a way that labor market flexibility becomes a more and more important determinant of international competitiveness of an economy. This kind of argument featured prominently in the recent debate over the labor law reform in South Korea. Initially dubbed as a project to transform the labor-management relations from those of 'suspicion and confrontation' to those of 'participation and cooperation', the reform effort was soon dominated by the confrontation over flexibility-enhancing measures.¹ In the end the new labor laws took effect in March of this year without ever reaching a semblance of compromise, if not agreement, between the labor and the management.² While the government hailed the outcome as laying the foundation for sound labor relations and promoting labor market flexibility (Ministry of Labor 1997), the idea of 'participation and cooperation' was badly wounded.

With its attention exclusively focused on the bargaining power calculations, the labor side has simply opposed all the management-side proposals without effectively presenting its own vision of efficient and equitable labor institutions that can improve labor relations as well as competitiveness. It may have won some important battles, but lost the war of ideas. The government has taken up enhancing labor market flexibility as one of the "national tasks for the 21st century" and is proposing many new controversial measures (*Maeil Business Newspaper* 8/1/97).

It seems therefore important to face up to the question of flexi-

¹Three measures proposed by the employer side were especially controversial allowing redundancy layoffs, allowing flexible scheduling of work hours, and legalization of temporary worker dispatching services. The unions feared that flexible work hours would lead to reductions in overtime pay and that expansion of temporary work would weaken their membership base and bargaining power.

²This reform process went through a great political turmoil. With the negotiations stuck on important points, the government staged a pre-dawn railroading of a reform bill that favored the business one-sidedly in December of 1996. This was called a "coup" by the opposition parties and was followed by a series of general strikes unprecedented in the Korean history. The government relented in the end, and produced re-revised labor laws with the agreement of the opposition parties in March of 1997.

bility and ask seriously what the best option for the Korean economy and the Korean workers is. In the hope of starting a real debate on this issue, this paper presents rather provocative views on the flexibility question. The next section discusses different notions of labor market flexibility and presents a new conceptual framework within which to organize our thoughts on them. On this basis, it is argued that there are basically two different directions in which flexibility can be enhanced—either toward market-driven flexibility or toward strategic behavior-driven flexibility. The following section takes up the question of the relationship between globalization and the labor market flexibility. It is argued that globalization tends to create pressures toward market-driven flexibility, with mixed and uncertain results. Section IV considers the flexibility question in the Korean labor market. After reviewing evidence on flexibility and rigidity in the Korean labor market and evaluating the process and the outcome of the labor law reform, it argues in favor of making systematic efforts to move toward strategic behavior-driven flexibility. The final section summarizes and concludes.

II. A Conceptual Discussion on Labor Market Flexibility

A. Numerical Flexibility and Functional Flexibility

Flexibility is a hard concept to define, but generally it means the ease and the speed with which economic adjustments are made.³ Although there are many different ways in which economic agents can adjust to a given change in environment, the neoclassical economics assigns a privileged status to quantitative adjustments in response to price signals. In this spirit, labor market flexibility is conventionally defined in terms of the adjustments of the wage rate and the amount of labor input in response to demand fluctuations. As emphasized by Dore et al. (1989: 3), however, adjustments of human resources involve another quite distinct process by which “workers and organizations adapt to new technologies, changing markets and other factors.” Following Boyer (1987), we refer to the

³See Killick (1995), however, for the complexities of the concept of economic flexibility and Boyer (1987) for an extensive discussion on various aspects of labor market flexibility.

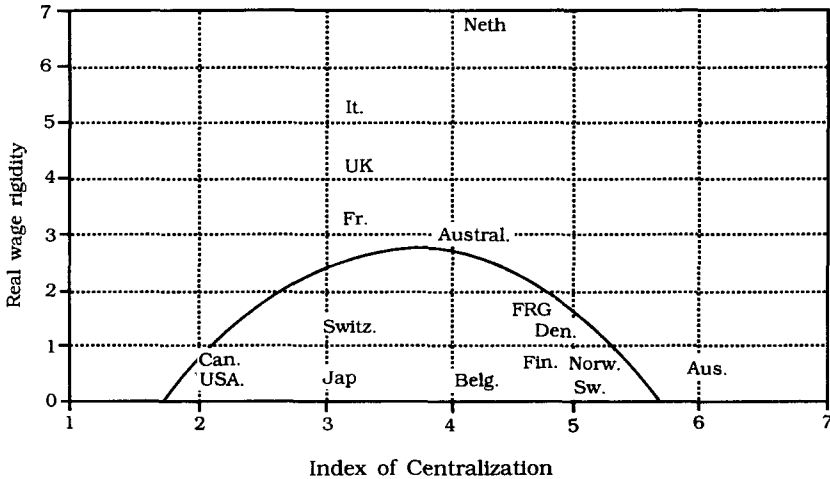
former as *numerical flexibility* and the latter *functional flexibility*.⁴

The conceptual distinction between numerical and functional flexibility corresponds to the two aspects of the crisis of Fordism in the 1970s (see e.g. Boyer 1995). With increasing volatility and intensifying competition in international markets in addition to the severe oil and commodity price shocks, the Keynesian aggregate demand management became more difficult. This made the wage rigidity built-in the Fordist institutions of collective bargaining and wage indexation to the cost of living more problematic. At the same time, with the assurance of stable demand growth gone, the Fordist production method relying on special purpose machines and machine-paced work could no longer be expected to generate productivity growth on the basis of increasing returns to scale. To serve the varied and volatile markets as well as to make the most out of the rapidly progressing information technologies, more flexible production system was needed. It was Piore and Sabel (1984) who did the most to direct economists' attention to the emergence of the flexible production system based on general-purpose machines and more flexible use of highly skilled labor.

Since the 1970s there has been a long and varied process of searching for labor market flexibility in the Western countries. To risk oversimplification, numerical rigidity was blamed for rising unemployment and functional rigidity for productivity slowdown. Both the left and the right shared broadly similar views on this, but their policy responses have been different. In this connection, it is important to recognize the existence of the very different ways in which labor market flexibility may be pursued and attained.

First, consider wage flexibility. The elementary theory says that the flexibility of the real wage is central to good macroeconomic performance, especially to employment stability. The neo-liberal governments, starting with those of Mrs. Thatcher and Mr. Reagan, focused on enhancing labor market competition by reducing union

⁴Boyer also uses the terms 'quantitative flexibility' and 'qualitative flexibility'. In Boyer (1988) five different meanings of flexibility are given (i) adaptability of productive organizations, (ii) ability of workers to move from one job to another, (iii) laxity of legal constraints governing the contract of employment, (iv) adaptability of wages, (v) the possibility of companies to relieve themselves of some of their social and fiscal payments. The first two concepts correspond to our functional flexibility, and the 3rd and the 4th to our numerical flexibility. The last indirectly affects numerical flexibility.



Source: Calmfors and Driffill (1988)

FIGURE 1
CENTRALIZATION OF THE BARGAINING STRUCTURE
AND REAL WAGE RIGIDITY

power and deregulating the labor market. This may be called a *strategy of wage flexibility by market competition*. The literature on social corporatism (Bruno and Sachs 1985; Calmfors and Driffill 1988; Pekkarinen *et al.* 1992) has shown, however, that real wage flexibility can be obtained under two very different institutional settings. That is, either a highly decentralized or a highly centralized wage bargaining leads to greater flexibility of real wages and thus better employment performance than the intermediate cases (see Figure 1). Social corporatist countries such as Sweden, Austria and Germany, normally led by social democratic parties, obtained real wage flexibility not by competitive wage formation but by strategic coordination between the employers and the unions, with the state playing a greater or lesser role.⁵ This may be called *wage flexibility by strategic coordination*.

The other side of numerical flexibility, i.e. flexibility of the amount

⁵Japan is sometimes classified as a social corporatist country even though its unions are not centralized and its unionization rate is relatively low, since it has a strong tradition of seeking consensus and mechanisms for coordination among unions.

of labor input, can also be obtained in different ways. The amount of labor input can be decomposed into employment (number of employed workers) and work hours (hours of work performed by each employed worker). It has been found that, compared to European countries, the US shows much greater flexibility in employment but less flexibility in work hours while Japan shows just the opposite tendencies (Tachibanaki 1987). This is not an accident, since under the life-time employment system of Japan adjustments in employment would be minimized and a greater part of adjustments would fall on working hours. On the other hand, the US employers have freer hands to layoff workers than others. Since, compared to workers, employers prefer to adjust employment rather than hours, we may expect that competitive labor markets will lead to greater employment flexibility relative to hours flexibility.⁶ Flexibility by strategic coordination makes the opposite likely and inevitably entails some restrictions on labor input quantity adjustment.

Functional flexibility also has two faces. It requires both flexible skills of workers and flexible use of those skills. Flexible skills mean that workers possess multi-skills and deep understanding of the production processes so they can perform various tasks easily and take appropriate steps under various contingencies. The skill level tends to be very high, backed up by high levels of job training and education. But it may not be so, in which case flexible skills are not much more than combinations of rather simple skills. Flexible use means that workers readily accept changes in job assignments and schedules. This can be achieved in quite different ways: *functional flexibility by domination* and *functional flexibility by commitment*. Flexibility by domination means employers' freedom to boss around, based on effective absence of worker rights in a situation of labor surplus and/or an anti-labor regime. In this case, of course, the skill level cannot be very high. Flexibility by commitment is, in contrast, obtained when workers are committed to productivity improvement. It is based on providing workers with sufficient incentives and ways in which they can get involved in decision making. This kind of functional flexibility is therefore

⁶By adjusting employment firms can keep longer work hours and save on non-wage labor costs. It can also enhance worker discipline by making the threat of dismissal more effective.

connected to job enrichment and worker empowerment.⁷

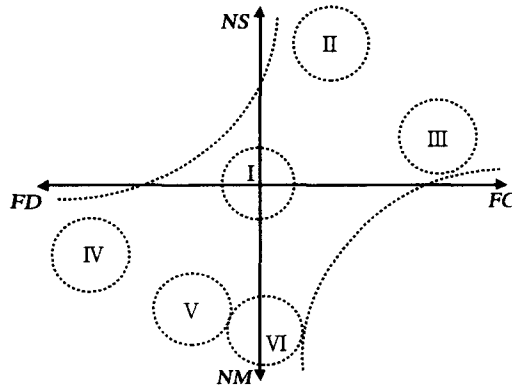
The literature on flexible specialization focuses only on flexibility by commitment, but You (1995) notes the non-Taylorist aspects of the production processes in certain industries in Korea under a regime of labor repression and employer domination. We may characterize such a situation as functional flexibility by domination. Sometimes, the Neo-liberal strategy of enhancing labor market competition entails a pursuit of such functional flexibility. In this strategy, greater competition in the labor market is expected to improve productivity performance by weakening the rigid union control of the job assignments and job contents and exerting greater competitive pressures (oppression of the market) on individual workers.

We have identified two typical ways in which numerical and functional flexibility may be achieved. It does not mean, however, that the alternative methods will yield identical performance. Numerical flexibility by strategic coordination may have difficulties in securing flexibility at the level of individual firms or industries, while it may work better than numerical flexibility by market competition at the aggregate level. Also, it is quite clear that, at least in skill-intensive industries, functional flexibility by commitment would be more conducive to achieving high productivity than functional flexibility by oppression.

B. Models of Labor Market Flexibility

From the above discussion we may construct a 2-dimensional space, with the horizontal axis representing numerical flexibility and the vertical axis functional flexibility (Figure 2). The origin represents the combination of complete numerical rigidity and complete functional rigidity. Flexibility increases away from the origin, with different directions representing the alternative methods by which flexibility is increased. Upward from the origin, numerical flexibility

⁷Critics of flexible production have pointed to the existence of "large numbers of workers whose incomes, working conditions, job security and life chances are radically changed, if not seriously jeopardized, by the quest for flexibility" (Bray and Taylor 1991: 2). This is however a problem associated with numerical flexibility by market competition and functional flexibility by domination. There is no reason why flexible production based on functional flexibility by commitment would necessarily produce more marginalized workers.

**FIGURE 2**

A CONCEPTUAL MAP FOR LABOR MARKET FLEXIBILITY

is increased by strategic coordination (NS). It is increased by market competition (NM) downward from the origin. Rightward and leftward movement from the origin represents an increase in functional flexibility by commitment (FC) and by domination (FD), respectively. We can characterize the flexibility characteristics of a labor market by a point in this space. However, not all points in the space seem feasible.

First, note that FD is by definition incompatible with a strong labor union presence and that NS requires strong union involvement. This means that the 2nd quadrant, particularly the regions further away from the origin, may be ruled out as infeasible. Second, FC is predicated upon a reasonable assurance of stable long-term employment. Without it, employers will hesitate investing heavily in training, and workers will make little effort to acquire firm-specific skills and a deep understanding of the production processes. Hence, FC is in conflict with NM.⁸ This fact effectively rules out much of the 4th quadrant from the feasible set. From these considerations, we may suppose that the feasible set is something like the dotted area in Figure 2. Generally speaking, as

⁸Management people seem to understand this better than most economists. Pfeffer (1994: 24) writes, for instance, "The biggest disadvantage of contingent employment arrangements is the difficulty in obtaining loyalty, dedication, or willingness to expend extra effort on behalf of the organization."

indicated by the two arrows, flexibility may be sought in two directions. The bold arrow shows a pursuit of flexibility as a combination of NS and FC, which we call strategic behavior-driven flexibility. The dotted arrow shows a pursuit of flexibility as a combination of NM and FD, which we call market-driven flexibility.

Figure 2 also shows typical models of labor market flexibility. Region I around the origin, where both numerical flexibility and functional flexibility are low, corresponds to the Fordist model. It is of course possible to identify many variants of the Fordist model, depending on which way they are away from the origin. In the 1st quadrant, we may identify two typical models. With both numerical flexibility by strategic coordination and functional flexibility by commitment substantial, the social corporatist model (Region II) emphasizes the former while the flexible production model (Region III) emphasizes the latter. In the 3rd quadrant we may again find two typical models differentiated by the way in which the management dominates the workers. When the management uses paternalistic co-optation for flexible uses of labor, functional flexibility by domination will be relatively more effective and numerical flexibility by market competition will have to be somewhat limited. This is the paternalistic co-optation model (Region IV). In contrast, the sweatshop model (Region V) relies on maximum numerical flexibility by market competition and tries to obtain functional flexibility by naked oppression with, inevitably, only limited successes. Finally, Region VI represents the contingent labor model, with maximum numerical flexibility by market competition and complete functional rigidity. The textbook model of a competitive labor market is precisely this and turns out to be only a very specific case out of many possible models.

These models of labor market flexibility normally suppose national economy as the unit of economic organization. It is often the case, however, that there are more than one models in a national economy. Traditionally, labor market segmentation referred to the institutional division between the unionized Fordist (primary) sector and the non-union competitive (secondary) sector. More recent trend, however, indicates a polarization between the flexible production sector and the contingent labor or sweatshop sector in countries that deregulated the labor markets. Unlike the full-fledged social corporatism, which must be a national model by definition, the flexible production model may well be practiced on a limited

basis—certain industries or certain firms or even certain workers in a firm. One such example is the 'core workers' in Japan that enjoy effective life-time employment and number about 30 percent of the total workers. Many US firms coming out of restructuring are extending employment guarantees to their workers in return for workplace reforms, creating islands of flexible production sectors in a sea of deregulated labor market.⁹

III. Labor Market Flexibility Strategies in the Age of Globalization

A. Globalization and Labor Market Flexibility

In light of the discussions in the previous section, the present obsession with market-driven flexibility by means of labor market deregulation, weakening of social protection, curtailing union power, etc. seems unwarranted. Market-driven flexibility is only one way of enhancing flexibility and, in terms of social consequences, generally inferior to strategic behavior-driven flexibility. At least to some extent, it seems, the trend toward market-driven flexibility is connected to and even driven by globalization.

The faith in competitive labor market is not a whimsical event in the history of economic ideas. In fact, it persisted among a large number of economists even in the heydays of Keynesianism. They were instinctively opposed to any kind of regulations hindering the free workings of the labor market. A good illustration of this is the persistent research "proving" the adverse employment effect of the minimum wage law in the US, which has recently been beautifully criticized by Card and Krueger (1995).

However, the argument that the changes brought about by globalization necessitate a more market-driven flexibility in the labor market is a less ideological and more serious one.¹⁰ It goes without

⁹See, for example, Lee (1995) for case studies of Saturn Corporation, Xerox Corporation, Corning Inc. and AT&T.

¹⁰*Design for New Labor-Management Relations of the President* that initiated the labor law reform process in the spring of 1996 contains the following passage: "Laws and institutions ... must be changed in the direction of flexibility in order to keep up with the age of globalization" (my translation).

saying that flexibility becomes relatively more important in more unstable and volatile environment that globalization brings about. Unless, however, the need for numerical flexibility becomes extremely large, the road for meeting the flexibility requirement by strategic coordination and commitment still remains open. And if there is at least a marginal effect favoring market-driven flexibility, there is also greater technological opportunities produced mainly by the development of information technologies that could make strategic behavior-driven flexibility more attractive.¹¹

A different kind of argument relates to the balance of power between capital and labor. That is, globalization is making relocation and outsourcing of production so much easier that employers are getting more and more advantaged in their bargaining with workers (Greider 1997; Rodrik 1997). This upsetting of the balance of power produces a bias toward market-driven flexibility. Furthermore, with increasing mobility of capital and employment, national economies are under pressure to provide more attractive business environment in order to preserve or expand employment. The recent success of the British economy in attracting foreign direct investment is often cited as an evidence of this effect. It does not mean that all firms will prefer maximally deregulated labor markets not only because labor cost is just one of the many considerations for the locational decision such as the market size and the infrastructure. Certain firms in certain industries may prefer a labor market that provides functional flexibility based on high skills and commitment. Nonetheless, given the wedge between the social desirability and the business advantage, it remains true that the tilting of the balance of power between capital and labor in favor of the former would produce a pressure to deregulate at least at the margin.

Finally, financial globalization and liberalization may be producing a bias in favor of market-driven flexibility. Globalized and liberalized financial markets tend to force business firms to put a greater emphasis on short-term profit maximization. Since by nature strategic-behavior driven flexibility rewards firms in the long term

¹¹Like many other labor market trends, technological changes are perhaps as important a factor as globalization in explaining the trend toward flexibility. We must, however, bear in mind that technologies are not completely autonomous but socially conditioned.

but market-driven flexibility gives firms an immediate cost advantage, shorter time horizons of firms will lead them to favor market-driven flexibility.

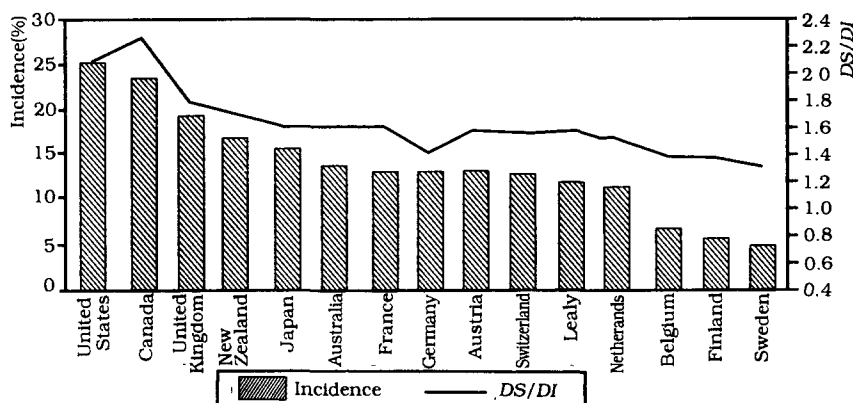
The more countries take the road of market-driven flexibility, the greater will be the pressure to follow suit for any one country. Thus, even those who are concerned about the social costs of labor market deregulation tend to accept it as an inescapable choice in the age of globalization. They distinguish themselves from those who hold a Panglossian view of globalization only by arguing for training and welfare policies to help the disadvantaged in the labor market. There is a real danger that the world economy would fall into the trap of a Pareto-inefficient Nash equilibrium in which all countries seek to increase market-driven flexibility.

Indeed, since the 1980s, not only the US and the UK but many European countries have to a greater or lesser extent pursued flexibility (Boyer 1988; Blank and Freeman 1994). There is, however, a great diversity in specific responses. While a broad trend toward declining union membership, decentralization of collective bargaining and deregulation has emerged since the 1980s, it is by no means a universal phenomenon (ILO 1992). The coverage of collective bargaining could be high even when the unionization rate is low, and the coverage rate has been stable in countries like Germany, Finland and Spain, while it has increased in France. The trend of decentralization is unequivocal only in the UK and New Zealand and quite mixed in other countries (Chapter 5, OECD 1996). There have also been significant signs of enlargement of union involvement in such areas as employment security, training and job satisfaction. In a word, market-driven flexibility does not rule the entire world, at least yet.

B. Problems of Market-Driven Flexibility

Loud political rhetoric on the virtues of market notwithstanding, the actual movements toward market-driven flexibility are hesitant and unsure not only because of the vested interests aligned against market reforms but because of the many drawbacks of market-driven flexibility.

It is quite obvious that market-driven numerical flexibility is not an unmixed blessing. Too much flexibility can easily lead to excessive volatility and instability. In the labor market, it may cause



Notes: Low pay is defined as less than two-thirds of median earnings for median earnings for all full-time employees.

The inequality measure is the D5/D1 ratio.

Both the incidence of low pay and the D5/D1 ratio refer to full-time workers only.

Source: OECD (1996)

FIGURE 3
INCIDENCE OF LOW PAY AND EARNINGS INEQUALITY

a serious social problem by creating uncertainty and insecurity in workers' lives. Social insurance and other protection programs may help, but they are themselves mechanisms of injecting institutional rigidities and, as such, attacked by the advocates of flexibility. Numerical flexibility by strategic coordination can reduce the instability of worker incomes, but it also achieves such a feat by limiting numerical flexibility in some respects.

It is also quite clear that, as noted by many critics of flexibility and deregulation, market-driven flexibility tends to increase earnings inequalities as well as insecurity of employment.¹² Since the 1980s the most dramatic rise in earnings inequality has been observed in countries like the US, the UK and New Zealand that have sought deregulation most dramatically (see Chapter 3 of OECD 1996). Figure 3 shows that there is a considerable variation in the incidence of low wage and earnings inequality among the OECD

¹²There is a serious on-going debate on the causes of the widening income inequalities. Frequently discussed causes include technological change, trade, labor supply changes and flexibility-related institutional changes (see, for example, the symposium on wage inequality in Spring 1997 issue of the *Journal of Economic Perspectives*).

countries in the 1990s and that the above countries occupy the top of the list. Even the Economist (June 21st, 1997, p. 16) comments that "(in the US) the gap between the rich and poor, skilled and unskilled, remains far wider than a civilized country should accept." It was in a similar spirit that, during the Denver G-8 Summit, Khol and Chirac refused to accept the US example as the model to emulate. The problem with the European critics, however, is that many European economies are generating their own kind of profound labor market inequality in the form of longterm unemployment.

Another important cost of market-driven flexibility is reduction of commitment. This becomes an obstacle to the formation of firm-specific skills and high-class functional flexibility, as discussed earlier. Put another way, over-emphasis on numerical flexibility and allocative efficiency may be detrimental to productivity growth in the long term in which the process of learning and innovation is of foremost importance (Johnson and Lundvall 1991). In this connection, it needs to be borne in mind that the US and the UK have shown worse productivity performances in the postwar period in comparison to Europe as well as Japan.

Perhaps, all these concerns may be put aside if it can be established empirically, not just in the textbook theory, that market-driven flexibility is a surefire cure for unemployment problems. The most frequently mentioned piece of evidence in support of market-driven flexibility is the relatively low US unemployment rates in comparison with the European countries. With many European economies suffering from two-digit unemployment rates, the US economy was viewed as a job-creating machine. Many came to believe that it was the flexibility of the US labor market and the rigidity of the European labor markets that made the difference. More recently, the UK performance in reducing unemployment has become another weapon for the advocates of market-driven flexibility.

This kind of argument based on anecdotal evidence, however, is far from convincing. The assessment on the performance of different countries vary according to the business cycle ups and downs so much so that one becomes skeptical of the current swing of the opinion. For instance, the current enthusiasm for the UK and the US performance contrasts with the following assessment only a few years ago: "In the United Kingdom, policies for greater flexibility appeared to do little on the employment front. ... In addition, the

cyclical downturn in the US economy in the early 1990s showed that flexibility did not guarantee permanently lower unemployment or an ongoing strong economy. ... Reforms to increase flexibility by weakening welfare state did not deliver what they promised" (Blank and Freeman 1994: 28-30). Furthermore, we must also remind ourselves of the fact that the literature on social corporatism mentioned above arose in order precisely to explain low unemployment rates in countries such as Sweden, Norway, Austria, Japan, etc. These latter countries have historically had much lower unemployment rates than either the US or the UK despite their high degrees of institutionalization of the labor market.

C. Difficulties of Strategic Behavior-Driven Flexibility

Strategic behavior-driven flexibility is not without its own problems and difficulties. The benefits of high productivity and quick adaptation to new technologies can be expected when functional flexibility is achieved by commitment. However, it must be noted that inducing commitment is possible only at the expense of some numerical flexibility and allocative efficiency. This may not be a serious problem in an environment of stable growth. When markets become turbulent and macroeconomic conditions deteriorate, strategic behavior-driven flexibility may prove inadequate means of making speedy adjustments. Globalization, in this sense, is posing difficult challenges to the economies that rely on strategic behavior-driven flexibility. Recent economic difficulties in Sweden and Japan may be considered examples of such challenges.

It must also be kept in mind that the institutional requirements for strategic coordination are quite stringent. A substantial degree of unionization and mutual respect and trust between unions and management are minimum requirements. In addition, there has to be formal or informal institutional mechanisms for coordinating wage-productivity bargaining at various levels. These institutional requirements cannot be met by a legal change overnight. It takes persistent efforts at institution-building and social consensus to meet those requirements. Perhaps, a blessing of history may also be a necessary ingredient.

IV. Enhancing Flexibility in the Korean Labor Market

A. How Rigid is the Korean Labor Market?

It is ironic that labor market rigidity became such a prominent issue in Korea. At least until 1987 when the 'democratization' process began, the conventional wisdom on Korea had it that one of its many merits was its free competitive labor market (Fields 1984; Fields and Wan 1989). It was argued that the consequent labor market flexibility contributed to lowering unemployment and reducing poverty. As I have criticized elsewhere, such a view is fraught with many conceptual and factual problems (You and Chang 1993; You 1994). In particular, it neglects of the fact that the 'free' labor market was a product of interventions by the pro-active state on many fronts, including labor repression. It remains true, however, that the Korean labor market was numerically flexible on the whole. There is a wide consensus, for instance, that wage determination was influenced overwhelmingly by the balance between the demand and the supply of labor and little by the weak and fragmented unions.

It is not surprising therefore that real wage flexibility was quite high in Korea before 1987 (You 1990). Some econometric studies that compare real wage flexibility in Korea with that in other countries find that the Korean flexibility greater than both the US and the Japanese one (Ito and Kang 1989; Kim 1994). Also, the employment adjustments to output variations are found to be faster in Korea than in Japan, though slower than in the US, and the adjustment of work hours is found to be the slowest in Korea among the three countries (Kim 1994).¹³ Recalling that relative inflexibility of hours is a part of the pattern of market-driven numerical flexibility, the above characteristics seem enough to conclude that the numerical flexibility by market competition was high in Korea before 1987.

As for functional flexibility, the prevailing view is that it was low in Korea due to the underdevelopment of skill formation system (Park 1992). Supporting this view are such facts as the disproportionate dependence on simple and repetitive unskilled labor,

¹³The adjustment of hours tends to be slower, the faster the employment adjustment is. In the Korean case, moreover, long overtime work used to be the normal practice, leaving little room for hours adjustments.

firms' reluctance to invest in training and their preference for poaching, and, above all, extremely high quit rates. It also seems that the underdevelopment of skill formation system is not unrelated to the fact that the labor productivity increase lagged behind the rapid rise in the capital-labor ratio and that, consequently, the capital-output ratio rose substantially to the detriment of profitability (Jang 1997).¹⁴ However, what the above suggest is low functional flexibility by commitment and not necessarily low functional flexibility by domination.

In fact, the high degree of numerical flexibility left wide open possibilities for high functional flexibility by domination. Such a possibility was fully taken advantage of by many Korean firms in new industries. As they faced the massive challenge of learning to develop new industries in a hurry, their managers tried to enlist production workers in the learning efforts by promoting QC activities and keeping engineers in close contact with them.¹⁵ Amsden (1989: 209) makes an apt remark that "managers could never hope to manage on a tight, "Taylorist", top-down fashion, at least not initially, because no one at the top knew enough about the process to do so" (emphasis original). Further contributing to the less-than-Tayloristic approaches of the Korean managers were such factors as the absence of craft union traditions and the Japanese influences. Apart from the emphasis on industrial learning, the absence of craft union tradition and the Japanese influences seem to have helped promote flexible uses of labor (see You 1995, for a fuller discussion).

It is then possible to conclude that the Korean labor market before 1987 was quite flexible in the direction of market-driven flexibility. It is important, however, to note that the labor market was segmented in important ways. Particularly, it is possible to discern a segmentation between a relatively capital intensive sector

¹⁴The neoclassical growth accounting shows similar results. For example, Young (1994) estimates that only 11.6 percent of the Korean growth during 1966-90 can be attributed to TFP growth, with the remaining 88.4 percent accounted for by factor accumulation. Noting that this productivity performance compares very poorly with the advanced countries and makes the Korean economy susceptible to 'diminishing returns', Krugman (1994) puts forward a pessimistic view on Korea's future growth.

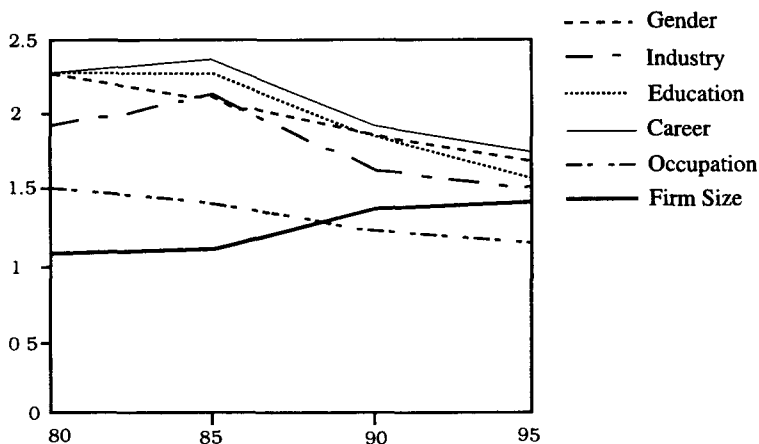
¹⁵The need for learning was all the more great, since the Korean technology import depended least on foreign direct investment and licensing and most on turnkey plants and capital equipment importation.

and a relatively labor intensive sector: the former with higher pays, lower turnover, and lower proportion of female workers than the latter. In terms of the typical models of labor market identified in Figure 2 the former had the characteristics of the paternalistic co-optation model, and the latter the sweatshop model (You 1995). This was because the capital intensive sector tended to be the newer industries with greater challenges of industrial learning. Even in this sector, it must be noted, the numerical flexibility by market competition was substantial and skill formation was limited as indicated by, for instance, very high quit rates.¹⁶

The change in the political climate after the June 29th Declaration in which the military-dominated government capitulated to the popular demands for democratic reforms brought about a fundamental change in the labor relations in Korea. The Declaration was immediately followed by a nation-wide wave of more than three thousand labor disputes within two months and a rapid expansion of union organization. The new unions were independent and militant in contrast to most of the old unions that were either company-dominated or very moderate. Collective bargaining now took the center stage in wage determination. Faced with this new situation, the government changed its labor policy from repression to disengagement. The unionization rate and the strike activity peaked around 1989-90, but subsequently they decreased as the firms and the unions learned to live under the new order and as the government returned to intervention against militant unions (see You 1995, and Lee and Kim 1997, for more details).

It is only natural that these changes in the labor relations affected the flexibility characteristics of the Korean labor market. There is indeed some evidence that numerical flexibility has decreased since 1987. First, the steep rises in real wages during 1987-92 led many to believe that wages have become more rigid. However, this may be simply reflecting the macroeconomic conditions—the economic boom and the consequent tightening of the labor market during this period. An indirect evidence for increasing wage rigidity is the role of the labor unions in wage formation,

¹⁶For example, during 1970-71 the average monthly turnover rate of the capital-intensive industries was as high as 4.1 percent, while that of the labor-intensive industries was 6.4 percent (You 1995). Over ninety percent of the turnovers in Korea have been quits rather than layoffs.



Notes: Gender wage difference = male average/female average
 Industry wage difference = highest industry/lowest industry
 Education wage difference = college graduates/high school graduates
 Career wage difference = 10 or more years/1-2 years
 Occupation wage difference = white collar/blue collar
 Firm size wage difference = 500 or more/10-29 employees

FIGURE 4
 TRENDS IN WAGE DIFFERENCES (1980-1995)

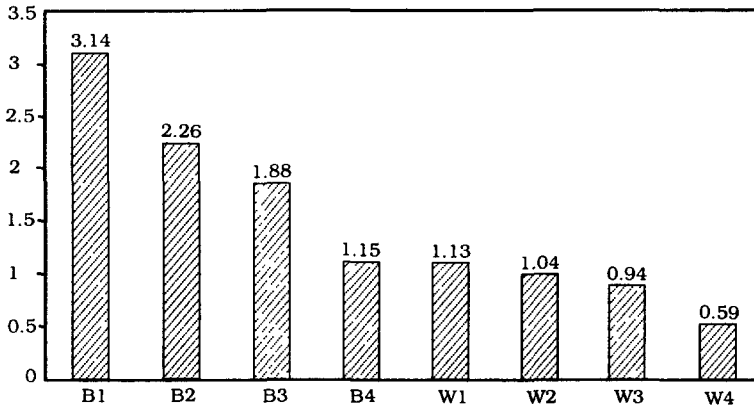
which was greatly strengthened since 1987. Without going into an exercise of econometric estimation of union wage premium, we may infer the union influence from the trend in the wage differences across firm size using the fact that larger firms are much more likely to be unionized than smaller ones in Korea. Figure 4 depicts the time trends of various wage differences, which normally contract when the labor market tightens. As expected, the wage differences across gender, industry, education, experience and occupation all have been steadily decreasing since the mid-1980s. The wage difference across firm size, however, increased during the same period, suggesting the unions' capture of rents in larger firms.¹⁷

¹⁷Lee and Kim (1997) make similar observations. In the case of Japan, the wage difference across firm size used to be very large in the sixties, giving rise to the dual economy hypothesis. It decreased since the 1970s in step with the tightening of the labor market, before rising again in the 1990s as a result of the prolonged recession (Tachibanaki 1996).

A much more significant phenomenon is perhaps the reduction in the quit rate, since it was the high quit rate as well as the large flow of entrants that made employment adjustments easy in the past. The monthly separation rate, which differs little from the quit rate as there are very few layoffs in Korea, decreased from around 4 percent in the early 1980s, and to around 3 percent after 1988. To some extent this may be due to the changing composition of the labor force, i.e. the decline in the share of young and inexperienced workers. It is also likely that the rapid wage increases and the spread of independent unionism induced a behavioral change. Either way, the decline in the quit rates not only made employment adjustments more difficult but produced an added burden of wage costs under the system of seniority wage.

It must also be noted that there are large differences in the quit rates across groups. For instance, the monthly separation rate of the male blue-collar workers in firms with 10-99 employees was more than five times greater than that of the male white-collar workers in firms with 500 or more employees in 1990 (see Figure 5). The latter in fact approaches the separation rate of the life-time employees of Japan. It is thus reasonable to suppose that the male white-collar workers in large firms have expectations of life-time employment, and this why they were the ones who got most upset with the proposal of redundancy layoffs during the negotiations for labor law reform. Another observation to be made about Figure 5 is that, in terms of the separation rate, the male blue-collar workers of large firms are much more immobile than those of small and medium-sized firms and as immobile as the white-collar workers.

Direct evidence on growing labor market rigidity since 1987 is presented in Lee and Kim (1997). It shows that the estimated short-run (one to six months) output elasticity of employment in manufacturing decreased dramatically between the period January 1978 to June 1987 and the period July 1987 to December 1994, but that the long-run (one year) elasticity showed no significant decline. The decline in the short-run elasticity was common to both larger and smaller firms, but the long-run elasticity exhibited a slight increase among firms with 100 or more employees and declined only among smaller firms with 10-99 employees. The latter fact reflects a decline in the elasticity of labor supply to the manufacturing sector and is related to the well-publicized phenomenon of smaller manufacturing firms' difficulty in hiring new workers.



Notes: B = Blue collar, W = White collar

Size 1 = 10-99, 2 = 100-299, 3 = 300-499, 4 = 500-

FIGURE 5
MONTHLY SEPARATION RATES ACROSS OCCUPATION
AND FIRM SIZE (1990)

However, how do we explain the absence of a fall in the long-run elasticity among larger firms, especially since the quit rates are lower in larger firms? The answer to this question probably has to do with the responses of the firms to the growing numerical rigidities: i.e. larger firms are making more effective responses than smaller ones. Larger firms have been developing their own flexibility strategies, including increased utilization of temporary workers, contract workers and other irregular employment (Kang 1997). While the unions and the institution of collective bargaining have been strengthened since 1987, the unionization rate at about 10 percent of the labor force is too low and the coordination structure among the unions is too weak to be able to impart numerical flexibility by strategic coordination. In this context larger firms are, with some success, pursuing a strategy of creating marginal work force to make up for the growing rigidity of the core workers.¹⁸

¹⁸I have eschewed discussion of the changes since 1987 in terms of functional flexibility because of the paucity of evidence. There is however anecdotal evidence suggesting dramatic declines in functional flexibility by domination. To what extent Korean firms are trying to nurture functional flexibility by commitment is an open question, but it seems quite clear that

B. The Saga of the Labor Law Reform

The discussion on reforming the labor laws got started in the spring of 1996 at the initiation of the President, who called for the transition from an era of 'suspicion and confrontation' to one of 'participation and cooperation' in labor-management relations. The initial position taken by the government put emphasis on strategic behavior-driven flexibility, giving only a minor attention to market-driven flexibility. In his speech, President Kim suggested five principles for labor reform – (i) maximization of mutual gains, (ii) participation and cooperation, (iii) autonomy and responsibility, (iv) focus on education and human resources, and (v) global standards for institutions and mentality (Ministry of Labor 1996). The first four of these are related to strategic behavior-driven flexibility, and market flexibility was mentioned as a minor note on the last principle. Writings of the scholars who provided the theoretical underpinnings to the government reform initiative are even clearer on where the emphasis lies. Both Bai (1996) and Shin (1996) stress the need for a change of management styles toward human resource-centered competitiveness strategies as well as the need for the unions to get involved in them. Cho (1996) also argues that the aim of the reform should be the creation of high performance work system based on functional flexibility by commitment.

Commission on Reform of Labor Management Relations, consisting in representatives of the labor, the business and the public interest, was formed as the venue for discussion and negotiation to reach a consensus on labor law reform. As the negotiation got started, however, the business side focused singularly on measures to weaken social protection of workers and restrictions on employment contract in the name of enhancing flexibility. This was an expected response, given the already noted trends of business strategies to seek numerical flexibility by market competition. What was not expected was the extent to which they dominated the public discourse on labor reform. There seem to be three important reasons for this development.

First, as the economy went into a recession from the summer of 1996, the need for business restructuring became acute and, rightly or wrongly, labor market rigidity was identified as one of the

their flexibility strategy emphasizes restoring numerical flexibility by competition.

central structural defects of the Korean economy that was obstructing speedy restructuring. Taking advantage of this situation, the big business mobilized their influence on the mainstream media to run a relentless campaign to put labor market flexibility on top of the reform agenda. Its central message was that since other countries are gaining competitive advantage through labor market deregulation, we must follow suit or risk falling behind forever.

Second, the government did not show any commitment to support the initial agenda of promoting 'participation and cooperation' based on strategic behavior-driven flexibility. It would have required committing a significant amount of resources for job training and skill development as well as engineering institutional changes that would facilitate union involvement in management decisions and various aspects of economic policy making. Not only did the government lack the will to do so, it soon changed its mind, seeing political advantages in aligning itself with the interests of the big business.

Third, in the confrontation surrounding the labor law reform, the labor unions took a basically defensive position. Instead of engaging in a full-fledged debate over the desirability of and the desirable ways to achieve labor market, they simply opposed various proposals by the employer-side on the grounds that they would threaten workers' livelihoods.¹⁹ This made the labor unions look rather intransigent and lacking in the vision for future labor relations that can support a competitive economy as well as worker interests. As a result, they won some important battles aided by the sympathy of the public who were outraged by the mean tactics of the government and concerned about job insecurity in the midst of the recession, but they lost the war over the idea of labor market flexibility.

After a great political turmoil, the new labor laws were passed and took effect in March of this year (see endnote 2). According to Ministry of Labor (1997), the new labor laws focused on "strengthening the freedom of association and autonomy of the labor unions, striking a proper balance in the bargaining powers of the labor and the management, and labor market deregulation and flexibility." This shows that the government itself is admitting a

¹⁹See Commission on Reform of Labor Management Relations (1996) for the union positions and Kang (1997) for a theoretical articulation of them.

failure to promote 'participation and cooperation' that was the primary objective of the reform in the beginning. Moreover, if we take a closer look at the major changes, it is hard to agree with the characterization of the new labor laws given by the government.

First, the changes that relate to "strengthening the freedom of association and autonomy of the labor unions" include allowing multiple unions immediately at the industry and association level but five years later, starting in 2002, at the company level, allowing political activities by a trade union that has only nominal effect because of the regulations in the election laws, and lifting of the ban on third party intervention in labor disputes. There was also a clause banning the management from paying wages to full-time union leaders from the year 2000. This may be in the long run a necessary measure for union autonomy, but it will entail financial problems for unions, particularly at small-and-medium-scaled firms. Moreover, the ban on union formation by the teachers and government employees remained. Also remaining was the ban on acts of disputes by unions in social overhead services and other key industries like petroleum refinery, medical services and broadcasting and communications.

Next, as for "striking a proper balance in the bargaining powers of the labor and the management", important changes include codification of the no-work-no-pay principle, reduction in the period during which a dismissed union member will be allowed to retain his or her status as a union member, a ban on occupying production facilities during acts of disputes, and allowing employers to replace strikers with non-union members and non-striking union members of the same company. These changes are all clearly in the direction of weakening the bargaining power of the unions rather than striking a proper balance between the labor and the management.

Finally, the "labor market deregulation and flexibility" measures include allowing redundancy layoffs from 1999, introduction of a flexible work hour system, allowing more flexible management of the severance payment system, and codification of the principle of protection for part-time workers in proportion to work hours. The controversial proposal for legalizing temporary work services was put off for later discussion, but it is now being proposed by the government again. Given that the requirements for redundancy layoffs are strictly stipulated, following a Supreme Court precedent,

allowing redundancy layoffs is not so much a substantial change as a symbolical one.

To sum up, the new labor laws ended up as incoherent patchwork compromise between union demands for basic labor rights and the management demands for flexibility-enhancing measures. In both respects, the new laws are full of half-measures. Even so, if we look at the individual changes one by one, many of them seem to be at least improvements over the past. The real problem lies in the big picture. No systematic strategy to improve flexibility emerged to put the many pieces together, and the possibilities for strategic behavior-driven flexibility was completely ignored. Furthermore, the mean tactics of the government and the short sightedness of the businesses conspired to kill the idea of 'participation and cooperation'.

C. Future Directions for Labor Market Flexibility in Korea

Let us now take stock of the discussions so far and consider future directions for labor market flexibility in Korea. To begin with, we have to keep in mind that labor market flexibility has multiple dimensions and multiple ways to achieve them. It is unfortunate that the Korean debate has essentially been focused only on 'the right to hire and fire' of the employers.

From a normative point of view, the benefits and costs of strategic behavior-driven flexibility must be carefully weighed against those of market-driven flexibility. And it is clear that there cannot be a set of optimal flexibility characteristics that could be applied to all industries under all situations. For example, strategic behavior-driven flexibility would be more desirable, the more knowledge and skill intensive the production technology is. In contrast, if the production technology requires only simple and repetitive work, market-driven flexibility may be a better option. This raises a difficult problem of whether a society should aim for universal standards at the expense of economic optimality or allow sectoral differentiation at the expense of equality and solidarity.

In any case, there is a case for designing labor market institutions such that strategic behavior-driven flexibility would be favored in as great a portion of the labor market as possible. Since there are multiple technological options and any technology is malleable to some extent, institutions can induce firms to choose

technological strategies that are better suited to those institutions. Such institutional engineering is justified, because, from the business point of view that does not take workers' welfare into full account, market-driven flexibility may be preferred even when it is not socially desirable.

These normative considerations must, of course, be mediated by an analysis of actual conditions before we draw policy conclusions. Several issues arise in this connection.²⁰ One is that the institutional conditions in Korea are inhospitable to strategic behavior-driven flexibility: The unionization rate is too low, and both parties of labor-management relations do not show any interest in heavy human capital investment. Another is that the proportion of highly skilled workers, who are the natural basis of strategic behavior-driven flexibility, is rather low in Korea. Yet another is that there exist a large number of hidden surplus workers and pent-up needs for restructuring in Korean industries that can only be addressed by making it easy to fire workers. While these observations raise legitimate concerns about the feasibility of strategic behavior-driven flexibility in Korea, they do not, to my judgment, constitute insurmountable obstacles.

The unionization rate, at about 10 percent, is indeed too low and the labor-management relations are too confrontational for securing numerical flexibility by strategic coordination. This is, however, not an immutable condition but a reflection of the past history of labor repression and still remaining legal restrictions on union organizing. If the unions are truly accepted as partners in running industries and the economy, unions will grow numerically and mature into responsible economic agents. As for the low proportion of highly skilled workers, it must be pointed out that one of the best ways to correct it is precisely to promote functional flexibility by commitment. Also, the fact that the Korean industries need restructuring that involves laying-off surplus workers does not necessarily preclude possibilities for promoting strategic behavior-driven flexibility. Retraining and redeployment of redundant workers within the firm and/or outside the firm through active labor market policies could be used to deal with the problem. At any rate, focusing on 'right to fire' seems beside the point. Despite the post-

²⁰These are issues raised by Woo Hyun Cho in his critical comment on an earlier version of this paper.

ponement in allowing redundancy layoffs until 1999, recent reports show that they are carried out in substantial numbers (more than ten thousand workers from the beginning of 1997 to the end of September) in practice and on the increase (*Chosun-Ilbo* 11/7/97). It is widely recognized that the main obstacles to speedy restructuring are the chaebol system, government regulations and the defects in the financial system rather than difficulties in layingoff surplus workers.²¹

In many ways, in fact, the employment system in Korea resembles that of Japan. At least on the surface, Korea has all of what are called the 'three pillars of the Japanese system'—company unions, seniority wage, and life-time employment. This condition may be fruitfully exploited to promote strategic behavior-driven flexibility in Korea. It is true that the current system is not functioning well, but it does not mean that it has to be completely dismantled as the free market advocates argue. A major reason for the malfunctioning of the current system is the unfairness in promotion decisions in higher level positions both in the public and the private sector.²² Promotion provides the only powerful incentive for the workers to excel in their jobs and to invest in skill development in the Japanese-style system. Therefore, it is critically important to ensure that promotion decisions are based on objective evaluation of individuals' capabilities and contributions.

Instead of trying to fix here and there in order to reduce labor cost in the short run, what is sorely needed is a systematic effort to move toward an employment system that can provide the basis of high productivity and social cohesion. This is why we must consider strategic behavior-driven flexibility more seriously.

²¹Ironically, the two sectors where laying-off surplus workers really is a central issue are the government and the financial sector.

²²It is widely believed that 'to be well connected' becomes a more and more decisive factor as one goes up the promotion ladder. This is a complex social phenomenon, but it is clear that it has to do with restrictions in competition in both politics and business. Therefore, enhancing labor market flexibility requires not just labor market measures but reforming the corrupt relationship between the political power and the big business that forms the linchpin of the competition-restraining system.

V. Conclusion

This paper has presented a new conceptual framework for labor market flexibility, in which we distinguish not only between numerical and functional flexibility but between different ways in which each of them may be attained. Market-driven flexibility strategy enhances numerical flexibility by increasing labor market competition and deregulation and functional flexibility by employer domination on workers. Strategic behavior-driven flexibility, in contrast, enhances numerical flexibility by strategic coordination in collective bargaining and functional flexibility by inducing commitment of workers. Although different kinds of flexibility may be optimal for different kinds of industries and jobs, strategic behavior-driven flexibility is in general socially more desirable than market-driven flexibility.

With this framework, we have analyzed the implications of globalization on labor market flexibility. Globalization is seen to create a pressure toward market-driven flexibility for a number of reasons, but the response of individual countries is varied. The ideological dominance of the free market liberalism notwithstanding, the actual course of developments in the labor institutions depends on national histories and formations of class power. Furthermore, the strategy of market-driven flexibility, practiced most fully in the US, the UK and New Zealand, has not been unambiguously successful in terms of unemployment and productivity performances. It has been however consistent in producing rising income disparities and insecurities.

The Korean labor market is undergoing serious changes. It used to have high degrees of market-driven flexibility under a regime of labor repression. Since 1987, however, rigidities have accumulated as a result of institutional changes and market developments. Faced with growing rigidity, the labor unions do not have the capacity to develop effective strategic coordination, and the firms are not inclined to pursuing functional flexibility by commitment. Larger firms are instead trying to restore lost flexibility by increasingly relying on irregular workers.

The employer strategy of increasing numerical flexibility by competition came into conflict with the initial emphasis on developing strategic behavior-driven flexibility in the government proposal for labor reform. The government retreated quickly, and the labor

firmly rejected the employer strategy without being able to engage in a comprehensive discussion on the flexibility issue. Predictably, the outcome of the negotiations (rather, confrontations) was a set of new labor laws that are full of half-measures and lacking in any systematic labor market strategy.

It is indeed a systematic strategy to structure the labor market that is most needed. The current policy direction toward market-driven flexibility will only endorse the business strategy of reducing labor costs that emphasizes greater utilization of marginal workers and weakening the unions rather than accelerating productivity growth on the basis of a committed work force. There is no reason to expect that the skill formation system and the organization of the labor market will be optimal if left to the market. On the contrary, the past experience shows that deregulation results in a tendency of polarization, with an unnecessarily large proportion of marginal and low skilled workers, as well as problems of productivity growth. In order to meet the challenges of globalization, the government, the business and the unions must make persistent efforts to create an institutional basis for more desirable forms of flexibility, and they must get involved in the skill formation system so as to maximize the share of highly skilled occupations.

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