

Addressing Unemployment and Low Productivity in SMEs in the Republic of Korea, 1995-2003

Introduction

As the Republic of Korea industrialized beginning in the 1960s, the Korean government introduced policies to ensure a qualified, skilled workforce to its rapidly growing economy. By the 1990s, however, structural changes were reshaping the economy. Then the 1997–98 Asian financial crisis caused a severe economic downturn in Korea. Gross domestic product growth fell from 5.8 percent in 1997 to –6.7 percent in 1998, the unemployment rate rose from 2 percent in 1996 to 8.6 percent in 1999, and the demand for skilled workers decreased. Along with the increasing unemployment rate, Korean small and medium enterprises (SMEs) faced another challenge at this juncture. While in 1993 these businesses employed 70.7 percent of workers and contributed 49 percent of total industrial production (Korea Federation of Small Business Administration 2002), “SMEs ... were less competitive in terms of productivity, scale, and finance in comparison to large enterprise counterparts” (Lee and Sahu 2017). The productivity per worker of SMEs was 34 percent of that of large enterprises, while the average wage for SME workers was only 55 percent of the average for large enterprises (Lee 2006). Furthermore, SMEs did not participate actively in training their workers under the auspices of the government-led skills development policy.

Development Challenge

The challenge for Korea was to reform its skills development policy in order to increase employment rates, while also tackling the low productivity of SMEs, the group of businesses most severely affected by the Asian financial crisis.

Intervention

To create a more skilled workforce that could contribute to industrialization, the Korean government enacted, in 1967, the Vocational Training Act, thereby establishing the employer-directed training policy (direct training subsidy) for large enterprises. Korea’s vocational training policy subsequently underwent a number of reforms. In 1974, the government introduced a compulsory in-plant training system, because enterprises voluntarily training their employees could not keep up with the demand for skilled workers. This measure met strong resistance from enterprises, which deemed the in-plant training requirement inflexible and impracticable. The system was subsequently replaced by an optional training-or-levy system introduced 1976. The new system gave large enterprises (with more than 300 workers) the choice between fulfilling the in-plant training requirement and paying a training levy. The government also established the Vocational Training Promotion Fund Act (1976), which created a mechanism to use the training levies collected from enterprises to strengthen the public training institutions.



Korea Program FOR
Operational Knowledge



기획재정부
Ministry of Economy
and Finance

PROJECT DATA

SECTOR:

Small and Medium Enterprise Development

DEVELOPMENT CHALLENGE:

Tackling Increasing Unemployment Rate

DELIVERY CHALLENGES:

Stakeholder Engagement; Opposition or Lack of Consensus

COUNTRY:

Republic of Korea

REGION:

East Asia

PROJECT DURATION:

1995–2003

This delivery note was adapted with permission by Yongjin Lee from an original case study by Kye Woo Lee and Dipan Kumar Sahu; the original case study was prepared for the Ministry of Economy and Finance of the Republic of Korea and the KDI School of Public Policy and Management for the Global Delivery Initiative. This adaptation represents a condensed version of the original case study. Although the analysis of this delivery note draws on that of the case study, the note does not necessarily reflect the views of the original author nor of the Ministry of Economy and Finance of the Republic of Korea.

By 1992, a number of economic factors—the second oil shock, the global recession caused by the Latin American debt crisis, and restructuring in Korea throughout the 1980s—resulted in high unemployment, so the Korean government expanded the coverage of the training-or-levy system to SMEs with 150 workers or more. The government provided no special assistance for training, and many SMEs opted to simply pay the training levy instead of providing in-plant training, because the rate of the training levy was significantly lower than actual in-plant training expenses. Consequently, the compulsory in-plant training scheme ended up merely mobilizing funds (for public vocational training institutions) rather than promoting the voluntary participation of SMEs in training their workers. Furthermore, the skills training offered by the public training institutes failed to address the skills demanded by private enterprises and was ineffective in improving the skills of workers, which meant that private enterprises did not have an incentive to participate.

However, in accordance with the philosophy that training is a public good that cannot be governed completely by market principles, the Korean government decided to intervene in the labor market. In 1993, the Korean government discarded the compulsory in-plant training policy for all enterprises but those with more than 1,000 workers. Instead, in 1995, the government introduced an employment insurance system under the Employment Insurance Law (EIL) that included a new training (vocational skills development) levy–rebate program to encourage employers to provide lifelong training services for their employees. Under this policy, all enterprises would pay training levies as part of the unemployment insurance fees for their workers without the option to provide in-plant training. Enterprises could choose training institutions, courses, and methods (in-service or preservice training) as met their needs. The government reimbursed the training expenses after the enterprises trained their workers. The newly reformed skills development system was fully implemented by the end of 1997: the training levy–rebate policy coverage was expanded to cover enterprises of all sizes (including SMEs with only one worker) and rebate incentives were provided for SMEs.

Addressing the Delivery Challenges: Stakeholder Engagement; Opposition/Lack of Consensus

The training levy–rebate incentive system under the EIL improved on the training-or-levy system. Participation by both enterprises and workers increased. This growth was in part because the EIL was rigorously enforced and in part because the rebate system provided an incentive to participate in trainings. However, SMEs did not make as much use of the training levy–rebate incentives as larger firms. Although most large firms had their levies reimbursed, few SMEs took part in training, and they forfeited their levies. In 2001, the Ministry of Labor (MOL) reported that 77.6 percent of all large enterprises trained 37.5 percent of their total workers, securing about 30 percent of their total training levies, whereas only 4.7 percent of SMEs offered training programs to 4.2 percent of their total workers, recovering only 15 percent of their total training levies (Lee 2006).

To address the delivery challenge of stakeholder engagement and opposition, the government needed to analyze the causes of the challenge. Lee (2006) identified six component issues that contributed to the engagement gap: scale, public good, finance, organization, information, and gender. Those issues meant that SMEs still faced disincentives, such as high training costs, the risk of “poaching” if the workers they trained were later recruited by other enterprises, the institutional and administrative burdens of arranging training programs and recovering levies, and the asymmetry of available information on training markets. To address these varied organizational, informational, technical, and managerial constraints, the SME Training Consortium was launched as a pilot program in 2001. This built on the experience of the Korea Chamber of Commerce and Industry (KCCI), a private industrial association that carried out a training consortium pilot program in 1999. The program was designed to organize 30 to 35 SMEs and to carry out voluntary collective training of workers, with additional financial, organizational, and technical assistance from the government. With a World Bank grant of US\$250,000, the pilot project began in Busan in June 2001.

The pilot program had four phases: (a) planning and organization of a training consortium, (b) training needs assessments for member SMEs, (c) training service provision, and (d) monitoring and outcome evaluations (Lee and Sahu 2017). In the first phase, the local chamber of commerce and industry identified 30–50 local SMEs (“from the same industries” (Lee and Sahu 2017)) and organized a training consortium (TC). An operational committee (OC),

composed of training experts and representatives from stakeholders (member SMEs, the local chamber of commerce and industry, and the MOL field office) was established to oversee and coordinate trainings. MOL supported TC management financially and paid for two training specialists to work with the consortium and to manage trainings.

In the second phase, the two training managers (TMs) assigned to each TC “played a key role in coordinating and managing its programs” (Lee and Sahu 2017). The TMs held a variety of responsibilities, including (a) carrying out training needs assessment surveys, which involved interviewing managers and workers and conducting job analysis; (b) planning and programming training activities of member SMEs; (c) contracting outside training institutions to train the workers; (d) collaborating with training institutions to develop training programs and materials; (e) monitoring the institutions’ training activities; and (f) conducting an evaluation study upon completion of major training courses.

In the third phase, the government attempted to reform existing financial incentive systems to encourage SMEs to provide training for their workers. The final phase consisted of the OCs (in addition to the KCCI and the MOL) carrying out monitoring and evaluation and ensuring accountability for each consortium.

The TC approach succeeded in raising SME workers’ productivity, promoting SME use of the training levy–rebate scheme, resolving the shortage of skilled human resources in SMEs, and addressing the unemployment rate (Lee 2005). In the project, many member SMEs actively provided training opportunities to their workers with the help of their TMs, seconded by the local chamber. The pilot program built up a network among various stakeholders and helped make the training system demand-driven. Since the pilot project was seen as achieving positive results, the MOL mainstreamed the consortium approach in 2003, making it a “flagship” program (Lee and Sahu 2017).

Lessons Learned

The Korean government’s experience with attempting to raise productivity and build skills and human resources in small and medium enterprises may hold lessons for efforts to build up human capital in this sector.

Identifying and Overcoming Constraints through a Pilot Program

It was very important for the Korean government to formulate a new policy based on accurate identification of the problems, which improved throughout the pilot program. Because the SME Training Consortium program started as a pilot, the Korean government accumulated experience and knowledge through the program’s various iterations before scaling it up to a national level. For example, the TMs of each TC worked to understand and overcome barriers to SME participation in training programs. This kind of iterative learning ultimately built up to successful scale-up and launch of what would become the government’s flagship training program.

Encouraging Ownership and Building Strong Partnerships among Stakeholders

While SMEs were the main stakeholders in the TCs, the project strengthened partnerships among all parties involved, which led to new forms of relationships between the government and private sector. Government representatives (for example, from MOL, Ministry of Industry, Small and Medium Enterprises Administration, and provincial and municipal governments) became members of the TC Operating Committee and played an advisory role on issues related to training and human resources development. The TCs convened periodic consultations, seminars, and meetings to carry out monitoring and evaluation. They also provided input on improvements and simplifications to government procedures and processes related to trainings and levy rebates. Lee and Sahu (2017) note that this “close collaboration between the private and public sectors led to some positive results. For example, the ceiling of training levy rebates was raised from 200 to 270 percent of the training levy paid, and training expenses were reimbursed at the time of the government’s approval of training courses. In addition, the lead time required for submission of a training plan for government approval was shortened substantially, and the ceiling imposed on the rebate of training expenses when an SME [conducted] in-plant training, which was significantly lower than that set for institutional training, was repealed at the request of SMEs.”

References

- Lee, Kye Woo. 2006. "Effectiveness of Government's Occupational Skills Development Strategies for Small- and Medium-Scale Enterprises: A Case Study of Korea." *International Journal of Educational Development* 26 (3): 278–94. doi:10.1016/j.ijedudev.2005.08.002.
- Lee, Kye Woo, and Dipan Kumar Sahu. 2017. "Training Levy-Rebate Incentive Scheme and SME Training Consortium Program to Address Unemployment and Low Productivity in SMEs—A Korean Policy Case. KDI School and Global Delivery Initiative." <http://www.globaldeliveryinitiative.org/library/case-studies/training-levy-rebate-incentive-scheme-and-sme-training-consortium-program>.
- Lee, Kye Woo. 2005. "How Effective were Government Strategies for the Small and Medium Scale Enterprises Training Consortium?" *Korean Small Business Review* 27 (2):175–203 (in Korean).



WORLD BANK GROUP

© 2020 International Bank for Reconstruction and Development/The World Bank. Some rights reserved. The findings, interpretations, and conclusions expressed in this work do not necessarily reflect the views of The World Bank, its Board of Executive Directors, or the governments they represent. The World Bank does not guarantee the accuracy of the data included in this work. This work is subject to a CC BY 3.0 IGO license (<https://creativecommons.org/licenses/by/3.0/igo>).