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Research Report

Employment Incentives: Issues and Solutions

KDI Focus, No. 74

Provided in Cooperation with:

Korea Development Institute (KDI), Sejong

Suggested Citation: Park, Yoonsoo (2016) : Employment Incentives: Issues and Solutions, KDI Focus, No. 74, Korea Development Institute (KDI), Sejong, <https://doi.org/10.22740/kdi.focus.e.2016.74>

This Version is available at:

<https://hdl.handle.net/10419/200874>

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September 26, 2016 (No. 74, eng.)

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Employment Incentives: Issues and Solutions

Yoonsoo Park, Fellow at KDI

“As of 2016, 20 employment incentives are in operation in Korea under four ministries with a budget of 2.8 trillion won. However, instead of creating new jobs, these projects mainly aim to maintain and improve existing jobs, unlike most OECD countries. Moreover, the scope of target groups is too broad and conflicts with the core principle of providing selective support to vulnerable job seekers. Therefore, efforts must be made to enhance policy efficiency by placing stronger emphasis on new job creation and support for the vulnerable.”

I. Issues

As of 2016, 20 employment incentives are currently in operation under four ministries with a budget of 2.8 trillion won.

The Employment Promotion Subsidy, Regional Employment Promotion Subsidy, Subsidy for Senior Employment, Subsidy for the Stable Employment of Seniors, Subsidy for Stable Employment During Childbirth and Child Rearing Periods, Subsidy for Employment Maintenance, Subsidy for New Job Creation, Youth Internship at SMEs, Senior Internship ...

* This paper is written based on Korea Development Institute, “In-depth Performance Evaluation for Full-scale Reform of Job Creation Project,” 2016 (forthcoming) (*in Korean*).

<Table 1> Concept of Employment Incentives

Policy Means	Interim Goal	Final Goal
Provision of subsidy to user or individual	Induce new hiring	Increase employment within the overall economy
	Retain existing jobs	
	Encourage job rotation and sharing	

This paper discusses the effects and limitations of Korea's employment incentives and intends to suggest a direction for improvement.

These seemingly complicated but similar names are the titles of incumbent government employment incentives. As of 2016, a total of 20 incentives, including those listed above, are in operation under four ministries with a yearly budget of 2.8 trillion won. The budget size equates to the addition of over 93,000 new jobs on an annual salary of 30 million won. Considering that the annual job creation rate in Korea is 30,000, this is by no means a small number. And given such a huge budget, it is imperative that the incentives are properly monitored. As such, this paper discusses the effects and limitations in Korea's employment incentives and attempts to suggest a direction for improvement.

II . Theoretical Discussion on Employment Incentives

1. Concept and Type

Employment incentives are government- subsidized budgetary projects that aim to increase employment throughout the economy.

Employment incentives are government-subsidized budgetary projects aimed at increasing employment throughout the entire economy. According to the OECD, employment incentives are classified into three types: recruitment incentives, employment maintenance incentives and job rotation and sharing.

Recruitment incentives literally refer to policies that induce the creation of new jobs through subsidies for new hiring while employment maintenance incentives refer to policies that prevent the elimination of existing jobs, and job rotation and sharing deals with encouraging companies to split one job into several, by breaking down duties or reducing work hours. But, regardless of which type is chosen, the final goal of employment incentives is to increase overall employment. This is summarized in <Table 1>.

2. Expected Effects of Employment Incentives

Then, in what ways could employment incentives contribute to increasing employment? Company decisions on recruitment are based on a comparison of the cost and benefit of hiring. Specifically, if productivity generated (benefit) by a worker is found to be less than the wage (cost) for whatever reason, the company will not hire or will consider letting go of the employee. In cases such as this, government subsidies that compensate for the loss

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will serve as an incentive for companies to create new jobs or preserve existing ones, at least temporarily. However, subsidy provisions cannot last, thus sufficient improvement in workers' productivity during the subsidy period is vital in maintaining employment after the expiry period.¹⁾

There are two potential mechanisms through which the improvement in worker 'productivity takes place: the learning-by-doing effect and screening effect. The former describes the state where a worker's productivity is enhanced while on the job, and the latter refers to cases wherein companies directly monitor their employees' productivity via the employer-employee relationship.

Take for example a job seeker who a company is reluctant to hire as he/she is regarded as less educated and experienced despite his/her excellent work performance in past jobs. Employment incentives could serve as an opportunity for this job seeker to prove his/her capabilities. The learning-by-doing and screening effects are more likely to occur in new jobs than in existing ones. This is generally true because work ability tends to improve significantly at the early stages of one's career and then plateau gradually over time. Moreover, companies are inclined to underestimate the productivity of newly employed workers more than that of longtime employees.

Another example includes a scenario where there is a deterioration in the productivity of existing jobs due to a 'temporary' drop in market demand and companies have no choice but to adjust employment status. The government could use subsidies to maintain employment until market demand and productivity recover. The job rotation and sharing incentive, designed to maintain employment by reducing work hours per employee, could be an effective policy means in such a case. Imagine a company faced with the decision of letting its employees go in response to falling market demand. Adjusting employment status entails various lay-off costs such as severance pay, whereas little additional cost is required to reduce work hours. In light of this, there is room for the government to use subsidies to encourage companies to respond to the reduced market demand by cutting back work hours, instead of adjusting their employment status.²⁾

To sum up, although recruitment incentives—subsidies for new hiring— generally

Under normal conditions, recruitment incentives are effective, but at a time of crisis, maintenance incentives and job rotation and sharing projects could serve as effective policy measures.

1) Depending on the status of vulnerability, productivity enhancement cannot be expected from some workers. In this case, an indefinite provision of subsidies could generate jobs. An example of this is the incentive for the employment of the disabled. This paper does not discuss cases in which the vulnerability of the beneficiary is so severe that the government must intervene.

2) Meanwhile, under normal conditions, unlike in a crisis, job rotation and sharing cannot act to increase employment. The argument of more employment via fewer work hours is based on the assumption that work hours are highly substitutable with employment. Take a company for example which demands 4,000 hours (=40 hours x 100 persons) of input in order to sustain production activities. If the work hour per person is reduced to 20 hours, an additional 100 workers could be hired, according to the argument. This, however, does not hold true in reality where little substitution exists between work hour and employment. This is because the former can be adjusted quite flexibly, whereas the process of adjusting employment entails various quasi-fixed costs related to searching, recruiting and training. Also, given the fact that highly skilled workers tend to work more and for longer, the assumption of sharing jobs with less skilled workers is highly unrealistic. For this reason, a majority of studies have pointed out that the argument of job creation via job sharing looks plausible only on the surface and is not plausible theoretically with poor empirical evidence of job creation effects.

contribute to increasing employment, in special circumstances, such as an economic crisis, employment maintenance incentives and job rotation and sharing incentives could also serve as effective measures to prevent unemployment.

3. Relevance of Selective Support

Employment incentives can be a relatively more effective policy means in alleviating unemployment issues than other labor market policies only if they are properly designed and managed (Sianesi, 2008). However, they also have certain limitations and side effects that should not be taken lightly. Firstly, the biggest effect from job creation will be felt by those who are the most sensitive to subsidies, meaning small-sized businesses under heavy pressure from labor costs and minimum wage job seekers. Under the circumstances, it is difficult to expect employment incentives to create 'quality jobs.' Secondly, even if employment incentives work to provide beneficiaries with more hiring opportunities, this will also entail repercussions for society as a whole. Specifically, more opportunities for incentive beneficiaries means less opportunities for non-beneficiaries. Not only that, a distortion may occur in normal competition between companies creating jobs—that were naturally generated by the market—or those receiving subsidies and those that are not.

Given these restrictions, employment incentives should be used prudently and only when they are desperately needed. Above all, recruitment incentives must target vulnerable job seekers who are unable to acquire employment by themselves. Providing the vulnerable population with the necessary support is the government's due responsibility, and at the same time, this is needed to maximize the policy effect of employment incentives. More simply, if subsidies go to companies or individuals that do not necessarily need them, for example to hire, this would render the subsidy ineffectual in terms of the policy effect.

As for employment maintenance incentives or job rotation and sharing incentives, subsidies should only be provided after the underlying causes of poor business conditions are identified, for example whether the problems are chronic or temporary. This is because, giving a subsidy to a company suffering from persistent difficulties would neither be meaningful or helpful. In fact, it would be like putting an incompetent business or industry on life support. Economic growth demands that input factors be allocated to highly productive industries or businesses, and this process naturally entails unemployment. If employment incentives are misused to suppress the normal creation of unemployment, this could undermine the economic dynamics and eventually hinder the creation of quality jobs.

The abuse of employment incentives would lead to several side effects, and thus should be used selectively for the vulnerable who are in desperate need of government support.

<Table 2> OECD Employment Incentives (2013)

(Unit: %)

Country	Employment Incentive (Share of GDP)	Incentive Type (Share of Employment Incentive)		
		Recruitment	Employment Maintenance	Job Rotation & Sharing
Sweden	0.64	100	-	-
Denmark	0.4	82.5	-	17.5
Luxembourg	0.4	17.9	38.3	no data available
Spain	0.21	54.3	40.2	5.5
Finland	0.16	63.8	-	36.2
Italy	0.16	98.6	0.2	1.2
Belgium	0.15	99.8	0.2	-
Hungary	0.12	89.3	10.7	-
OECD Average	0.11	81.8	9.1	9.1
Poland	0.1	100	-	-
Norway	0.09	100	-	-
Portugal	0.09	94.2	-	0.1
Slovakia	0.08	100	-	-
Ireland	0.07	100	-	-
Slovenia	0.06	100	-	-
Switzerland	0.06	100	-	-
Israel	0.05	100	-	-
Japan	0.05	51.6	48.4	-
Austria	0.04	86.8	12.2	1
Czech	0.04	100	-	-
Korea	0.04	9.6	90.4	-
France	0.03	100	-	-
Netherlands	0.03	100	-	-
Estonia	0.02	100	-	-
Germany	0.02	100	-	-
Australia	0.01	86.8	12.7	-
New Zealand	0.01	98.3	1.7	-
UK	0.01	100	-	-
US	0.01	100	-	-
Canada	0.005 below	100	-	-
Chile	0.005 below	100	-	-
Mexico	0.005 below	100	-	-

Note: Data for Korea, France, New Zealand, Poland and Spain are as of 2012.

Data for Australia, Chile, Israel and UK are as of 2011. Other Countries are as of 2013.

Source: Partially revised version of Table V-2 (p.117) in Cheon *et al.* (2015) using OECD database.

III. Problems in Korea's Employment Incentives

1. Prioritizing Employment Maintenance over Creation

<Table 2> introduces an international comparison of employment incentives in OECD countries using the latest data available for 2013. It was found that countries spent an average 0.11% of GDP on employment incentives; Korea recorded 0.04%, lower than the OECD average but higher than advanced western economies including the US, UK, Germany and France.

What is notable in <Table 2> is that most countries use employment incentives as a complementary tool to subsidize new hiring. A large share of OECD countries were found to spend 81.8% of their budget on recruitment incentives that are, in several countries, a type of employment incentive. This finding is consistent with the discussion above; supporting new recruitment will most likely contribute to increasing employment, except

Korea's budget for employment incentives relative to GDP is lower than the OECD average but higher than advanced economies in the West, such as the US, the UK, Germany and France.

<Table 3> Employment Incentives (2016)

Authority	Title	2016 Budget (100 mil. won)	Type
Ministry of Employment and Labor	Maternity protection and child care support	9,296	Employment maintenance incentives
Ministry of Employment and Labor	Elimination of blind spots in social insurance	5,202	Employment maintenance incentives
Small and Medium Business Administration	New growth fund (loan)	2,800	Employment maintenance incentives
Ministry of Employment and Labor	Youth internship at SMEs	1,941	Recruitment incentives
Ministry of Employment and Labor	Incentives for the employment of the disabled	1,518	Employment maintenance incentives, Recruitment incentives
Ministry of Employment and Labor	Support to on-site child care centers	1,059	Employment maintenance incentives
Ministry of Employment and Labor	Employment promotion subsidy	1,013	Recruitment incentives
Ministry of Employment and Labor	Livelihood settlement loan	1,000	Employment maintenance incentives
Ministry of Employment and Labor	Subsidy for the stable employment of seniors	826	Employment maintenance incentives
Ministry of Employment and Labor	Subsidy for job creation	708	Employment maintenance incentives, Job rotation and sharing
Ministry of Employment and Labor	Subsidy for stable employment during childbirth and child rearing periods	623	Employment maintenance incentives
Ministry of Employment and Labor	Support for employment for intergenerational coexistence	515	Employment maintenance incentives, Recruitment incentives
Ministry of Employment and Labor	Support to time-selective jobs	463	Employment maintenance incentives, Recruitment incentives
Ministry of Employment and Labor	Subsidy for employment maintenance	314	Employment maintenance incentives
Ministry of Trade, Industry and Energy	Research manpower support for technology-innovative SMEs	302	Recruitment incentives
Ministry of Employment and Labor	Subsidy for senior employment (senior internship)	282	Recruitment incentives
Small and Medium Business Administration	Strengthening SMEs' export capacity	250	Employment maintenance incentives
Ministry of Employment and Labor	Support for employment management of the disabled	149	Employment maintenance incentives
Ministry of Unification	Subsidy for employment of North Korean defectors	119	Recruitment incentives
Ministry of Employment and Labor	Regional employment promotion subsidy	4	Recruitment incentives
Total (20 projects)		28,385	

Note: Type of incentive is classified at author's discretion. Multiple types are applied to incentives that run different types of programs.

OECD countries have
operate employment
incentives to complement
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in special circumstances, such as economic crises. Unlike OECD countries, however, Korea spends only 9.6% of its employment incentive budget on new job creation projects while the rest is spent on maintaining existing jobs.

The reason for the large support to existing jobs in Korea seemingly lies in the fact that a high number of employment incentives that have no relevance have been classified as such. <Table 3> shows the Korean employment incentives that are under operation as of 2016. Indeed, of the total 20 incentives, elimination of blind spots in social insurance (520.2 billion won) and new growth funds (280.0 billion won)—the second and third largest in budget size, respectively— aim to increase the subscription rate of social insurance and support SMEs, hence can hardly be considered an employment incentive. Others, such as the livelihood settlement loan (100.0 billion won), research manpower support for technology-innovative SMEs (30.2 billion won) and strengthening SME's export capacity (25.0 billion won), intend mainly to improve workers' welfare or subsidize SMEs so are also irrelevant.

Even after excluding these random jobs, Korea's employment incentives still provide a large share of the support to existing jobs, and instead of creating new jobs, the majority

<Table 4> Main Beneficiaries Recognized by Incentive Managers (Multiple Choice)

	No. of Responses		No. of Responses
No particular target	10	Elderly	-
Youth	3	Long-term unemployed	-
Middle-aged and seniors	3	Married immigrants	-
Disabled	2	Female heads of households	-
Women	1	Adolescents in crisis	-
Low-income class	1	Homeless	-
North Korean defectors	1	No response	1

Source: Korea Development Institute and National Economic Advisory Council (2013. 6).

pay more attention to maintaining or improving existing jobs: subsidy for employment maintenance (31.4 billion won) to prevent unemployment on temporary business setbacks; maternity protection and child care support (929.7 billion won), support to on-site child care centers (105.5 billion won) and subsidy for stable employment during childbirth and child rearing periods (62.3 billion won) to support workers with children; subsidy for the stable employment of seniors (82.6 billion won) to support employment security for senior workers; and support for employment for intergenerational coexistence (51.5 billion won) and subsidy for job creation (70.8 billion won), both of which, on the surface aim at creating jobs but actually focus on wage system reform and working environment improvement.

2. Shortage of Selective Support

<Table 4> lists the responses from ministry officials in charge of the incumbent 20 employment incentives in 2016 to questions about the main beneficiaries of respective projects. According to the multiple choice survey, the answers were mainly age-based with 'no particular target' being the most common at 10 followed by the youth, middle-aged and senior populations, at three each, respectively. In the meantime, there was no reference to the long-term unemployed, female heads of households, the elderly, married immigrants, adolescents in crisis and the homeless, all of whom may be classified as vulnerable job seekers. Such a result implies that current employment incentives may not be providing selective support to the vulnerable population.

<Table 4> is simply a reflection of the subjective awareness of incentive operators, meaning again that the vulnerable population may have been selectively supported. To examine this further and more objectively, this study reviews the process that incentives use to select target groups. For instance, eligible applicants for youth internships at SMEs (194.1 billion won) and senior internship (28.2 billion won) are those aged 15-34 yrs and 50 yrs or over, respectively, at the time of application. Given their proportion within the

According to a multiple choice survey conducted on operators of employment incentives regarding the main beneficiaries, 'no particular target' was the most common answer.

Analysing the target selection process used in major employment incentives reveals a lack of selective support for the vulnerable.

total population, which is 64% as of 2015, the scope of eligible applicants is quite broad.

The opposite is true for research manpower support for technology-innovative SMEs (30.2 billion won), which targets only the highly educated, with a master's or doctorate degree. Currently, when a company hires highly educated employees, it is given subsidy, creating a win-win situation for the company. However, it is often the case that in reality, companies hire competent talent voluntarily without the encouragement of a subsidy, meaning that the subsidy is limited in its policy effects. To put it another way, although the incentive may hold certain importance as a R&D support policy, as an employment incentive, it is constructed in reverse format.

Then, what about the employment promotion subsidy (101.3 billion won), a key incentive designed to support the vulnerable? The goal is to promote the employment of those who suffer from difficulty in getting a job under normal labor market conditions. Thus, subsidies are offered to employers who hire them (p.3, Ministry of Employment and Labor, 2015). As its goal suggests, the incentive will more likely focus on the vulnerable population than other incentives. Eligible applicants are the unemployed who have completed a certain number of employment support programs stipulated by the Minister of Employment and Labor,³⁾ who selectively provide support to those who are experiencing difficulties in acquiring a job that are so serious they have to voluntarily participate in employment support programs. The problem, however, is that qualification certificates for programs can be obtained without much difficulty. Serving as a prime example is a well-known employment service package. Attendants can become qualified once they complete the 1st stage, which simply consists of counselling and planning. In particular, youths are accepted to attend Package II with no extra conditions attached, meaning that anyone can be eligible for the employment promotion subsidy with only the slightest effort.

IV . Conclusion and Policy Suggestions

The final goal of employment incentives, must be clarified further, and more support should be given to new jobs.

This section offers policy suggestions based on the above discussions. First, the final goal of employment incentives is to increase employment, which needs further clarification. Incentives that do not fit the goal should be removed or reassigned to other areas. And, the differing goals of respective incentives make it difficult to compare performance and to allocate budgets systematically based on performance. So, it is necessary to ensure that the goal of the employment incentive is to increase employment while building a systemic management process that can increase or reduce the budget according to the results of

3) Those who are exempt from the program are severely disabled persons, female heads of households and island residents with little access to employment support programs.

performance evaluations that are based on common indicators.

Second, more support for new jobs is needed. Maintaining and improving existing jobs is important, but under normal conditions, supporting new jobs may be more effective in increasing employment. This possibility is also backed by the fact that employment incentives in most OECD countries are used to subsidize the creation of new jobs. As such, more support for new hiring should be provided so that job seekers can find suitable jobs as quickly as possible.

Third, stronger selective support should be offered to the vulnerable population. Employment incentives are government policy tools that provide subsidies to companies in return for their employment of the disadvantaged, meaning those who are unable to find employment on their own. But, if the subsidy is provided to companies for the hiring of able-bodied job seekers whom the company would hire voluntarily, this negates the positive effects on employment enhancement and will become a mere a subsidy for labor costs. As such, targeting procedures must be reinforced so that government subsidies are not wasted.

To that end, this paper suggests the supplementary use of employment incentives in connection with other labor market policies, such as employment services and vocational training. For instance, extra subsidies can be granted to only those who continue to experience difficulties in acquiring a job despite continuous job seeking activities. This can be in the form of employment services or vocational training programs for a certain period of time. And to make this possible, a system that can integrate and manage the currently fragmented labor market policies must be first established.

One suggestion for selective support is to grant a subsidy to only for those who have engaged in job seeking activities via employment support programs for a certain period of time but have failed to find employment.

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