UNIT LABOR COST TRENDS IN THE IMF ERA

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The unit labor costs[1] for all Korean industries increased by an average 3.9% per year between 1995 and 1997. In 1998, though, the unit labor costs fell as a result of the cutback in nominal wages and the drop in employment. With this decrease in unit labor costs, the price competitiveness of Korean products improved to a certain degree. However, this improvement in competitiveness is likely to be temporary since it was not accompanied by a substantial increase in the value-added.

Changes in unit labor costs in 1998

In 1998, the unit labor costs for all industry decreased by 4.3% as compared with the previous year. The decrease in unit labor costs reflected a drop in nominal wages and a rise in labor productivity. Average nominal wages posted a 2.5% decrease in 1998, the first decline in twenty years. In addition, since the drop in labor input (-7.1%) was bigger than the drop in output (-5.3%), labor productivity also increased by 1.9% over the previous year.

In the manufacturing sector, the unit labor costs decreased by 12.7% in 1998, as nominal wages fell 3.1% and labor productivity rose 10.9%. The 10.9% increase in labor productivity in manufacturing was the result of a 16.4% decline in labor input, largely a 13.2% decrease in employees.

Due to the great variation in labor productivity among each industry caused by fluctuations in output, there are severe differences in how much unit labor costs changed for each industry. These changes in unit labor costs

Table 1. Changes in Unit Labor Costs

(unit: annual rate, %)

	1996	1997	1998		1996	1997	1998
All Industries	5.9	1.2	-4.3	Manufacturing	1.2	-6.7	-12.7
Food Products & Beverages	-1.9	-2.7	-8.2	Other Non-Metallic Mineral Products	-3.2	-2.9	-10.2
Textiles	3.3	-0.8	-2.9	Basic Metals	-4.9	-14.0	-2.8
Clothing & Furs	-3.4	13.6	3.4	Fabricated Metal Products	-3.0	-1.3	-10.9
Leather, Bags, Footwear	3.2	13.7	3.9	Audio, Video & Commmunication Equipment	-2.3	-18.5	-33.0
Wood & Wood Products & Cork	13.9	-7.3	-5.7	Medical, Precision & Optical Instruments	-5.0	7.7	10.5
Publishing, Printing	16.1	9.2	-12.8	Automobiles & Trailers	7.5	-10.7	6.5
Chemicals & Chemical Products	-0.9	-7.6	-6.5	Other Transportation Equipment	1.5	-15.0	-28.1
Rubber & Plastic Products	1.8	-5.6	4.6	Furniture, Manufacturing N.E.C	3.8	7.3	-11.1

1) Unit labor cost is computed as the ratio of "labor costs" in nominal terms divided by real "output". It can also be expressed as the ratio of "hourly compensation to labor productivity".

among the various industries can be broken down into three categories. First, in food products & beverages (-8.2%), textiles (-2.9%), wood products & coke (-5.7%), chemicals & chemical products (-6.5%), and basic metals (-2.8%), the unit labor costs decreased by 3~8% since the decrease in nominal wages outweighed the changes in labor productivity.

Second, in the audio, video and communications equipment (-33.0%), and other transportation equipment industries (-28.1%), the unit labor costs fell sharply as labor productivity rose over 40% thanks to the 29.3% and 37.0% increases in output.

Third, in automobiles & trailers (6.5%), medical, precision & optical instruments (10.5%), rubber & plastics products (4.6%), leather, bags and footwear (3.9%), and clothing and furs (3.4%), the unit labor costs actually increased by 4~10%. Labor productivity dropped significantly because the decrease in labor input was outweighed by the decrease in output.

Implications and Suggestions

The most important reason for the decrease in unit labor costs for industries overall was the huge decline in nominal wages while the rate of increase in labor productivity was moderating. However, such a reduction trend in unit labor costs without an substantive improvement in labor productivity—or in other words, a reduction resulting solely from the cutback in nominal wages—cannot be continuously maintained nor is it desirable.

In addition, any improvement in labor productivity was largely the result of a decrease in labor input because of the huge drop in the number of employed, rather than an increase in value-added created. The gains were made not through an improvement in manufacturing processes, a transition to higher value-added industries, or a more efficient distribution of human resources, but rather a simple quantitative reduction in employment.

What is more, the unit labor costs in low value-added industries has increased and labor productivity declined over the past year with the total number of employed in these industries staying the same or even increasing, while the total number of employed in high value-added industries decreased. In other words, the distribution trend or the movement of workers across industries was not made in an efficient manner.

In the long run, Korean industries must pursue a "high wages, low personnel expense" structure by trying to improve its manufacturing processes, creating greater value-added, and being more efficient in the utilization of human resources.

Particularly manufacturing industries subject to large swings in output according to the business cycle suffered weakened labor productivity caused by an insufficient reduction of surplus employment. Namely, in most industries whose output declined by over 20% in 1998, the decrease in labor input was 5~10%p less than the decrease output. Accordingly, it is clear that greater labor flexibility is needed.

In the long run, Korean industries must pursue a "high wages, low personnel expense" structure by trying to improve its manufacturing processes, creating greater value-added, and being more efficient in the utilization of human resources. In addition, improving competitiveness in a fundamental and lasting manner will be dependent on enhancing areas of non-price competitiveness such as quality and design, strategic differentiation in products and in geographical markets, increasing R&D and making rational investment decisions. VIP