

# **Decomposition of the Unemployment Rate through Labor Flow Analysis**

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The unemployment rate in Korea, which shows weak co-movement with the business cycle and has been on a sustained upward trend since 2013, was recently at its highest level since the global financial crisis, affected by the COVID-19 pandemic. This paper examines the secular structural changes inherent in changes in the unemployment rate and the factors behind the decoupling between unemployment and the business cycle, by analyzing labor flows among different labor force states (employment, unemployment, and nonparticipation). This paper then assesses implications of the recent high unemployment rate.

After the global financial crisis, the upward trend of the unemployment rate was found to be driven primarily by the continued decline in the labor flows into employment than by the flows into unemployment. It is attributed to several factors: a) the weakening of job creation capacity due to the changes in the industrial structure including automation and decline in the number of new start-ups amid rising economic uncertainties, and b) the increased labor supply due to the younger generations' extended period of jobseeking as their education level rises and to the increase in women's participation in the labor market.

In terms of the cyclical variation in the unemployment rate, the labor flows into unemployment show a relatively clear countercyclicality which has been weakened since the global financial crisis, resulting in a far weaker correlation

between cyclical variation and the business cycle. This weakening in the correlation appears to have been driven by several factors: a) retirees, remaining in the labor market, b) automation in the manufacturing industries, c) offshoring in labor-intensive sectors, d) the strengthening of direct employment policy by the government, and e) the rigidity in the labor market.

Korea recorded an elevated level of unemployment rate in 2020, which is greatly attributable not only to the pandemic, but also to the upward trend of the unemployment rate which has continued since the global financial crisis. The cyclical component of the unemployment rate also rose sharply relative to 2019, approaching the level seen during past economic recessions.

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