Strengthening Social Cohesion in Korea

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Foreword

Korea has made tremendous economic progress over the past decades on the back of rapid growth and a well educated and skilled population. Nevertheless, income inequality has widened more recently, calling attention to the policies that can be put in place to strengthen social cohesion in pursuit of stronger, more inclusive growth in the years to come.

In 2011, the OECD addressed these important policy challenges in a report called *A Framework for Growth and Social Cohesion Policies in Korea*. The *2012 OECD Economic Survey of Korea* delved further into this area. This work showed that to preserve Korea's remarkable economic and social achievements, more should be done to promote equitable social and economic outcomes.

Strengthening Social Cohesion in Korea follows up on the policy analysis and recommendations presented in these two publications. It provides an in-depth analysis of the obstacles to stronger social inclusiveness and discusses the most promising policies to counter them. The report identifies cost-effective policy options to tackle poverty and inequality through the tax and transfer system. It also proposes viable policy strategies for reducing labour market duality, while at the same time promoting employment and employability among under-represented groups, such as women and older workers, which is a key priority for a rapidly ageing society.

The latest report acknowledges that strengthening social cohesion goes beyond addressing poverty and inequality challenges. It is also about expanding access to social services, such as education and health care and it takes a closer look at specific areas. First, it assesses the quality of early childhood education and care, an issue of critical importance for ensuring equality of opportunities among children and helping parents' decisions about how best to reconcile family and work commitments. Second, it reviews policies to improve primary health care, with particular focus on those services that allow moving away from the still dominant role of hospitals in the health system.

Strengthening Social Cohesion in Korea provides timely analysis, evidence-based recommendations and a policy toolkit from which the new administration can draw useful insights. It also builds on numerous experiences and good practices from other OECD countries.

The OECD is ready to continue supporting Korea's reform agenda, by delivering "Better Policies for Better Lives".

Angel Gurría,
OECD Secretary-General

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This report is the outcome of a collective effort and reflects the contribution of a team of policy analysts, from various OECD directorates co-ordinated by the OECD Directorate for Employment, Labour and Social Affairs. The overview and summary of policy recommendations was prepared by Alessandro Goglio; the chapter in which Korea's key social cohesion issues are put in context was prepared by Randall Jones (Economics Department); the thematic chapter on income distribution and poverty among the working-age population by Michael Förster and Linda Richardson; the chapter on labour market duality by Alessandro Goglio and Paul Swaim; the chapter on early childhood education and care by Miho Taguma (Directorate for Education); and the final chapter on moving from hospital to primary care by Michael Borowitz and Ankit Kumar.

To prepare the report, a team from the OECD Secretariat visited Korea in July 2012 and engaged in wide-ranging discussions with ministries, members of parliament, senior officials, experts and social partners. The report also benefitted from two workshops jointly organised by the OECD and the Korean Development Institute (KDI), which were held in Paris (May 2012, at the OECD's headquarters) and in Seoul (July 2012, at KDI's headquarters). Analysts from the OECD and KDI, as well as several leading Korean experts, provided many useful insights at the workshops. The OECD gratefully acknowledges the financial contribution of KDI and the Korean government, particularly Korea's Permanent Delegation to the OECD, to the realisation of the report, as well as their strong support throughout the process.

Alessandro Goglio led the team and co-ordinated the project. Stefano Scarpetta, Deputy Director of Employment, Labour and Social Affairs at the OECD supervised the preparation of this report and provided extensive comments on various versions of the report. Randall Jones provided continuous support in the elaboration of the policy recommendations of the report. Sylvie Cimper provided statistical assistance in the preparation of tables and figures, and prepared the manuscript for publication. Statistical support was also provided by Lutécia Daniel. The team is particularly grateful to John Martin, Director of Employment, Labour and Social Affairs at the OECD, for his guidance and extensive comments on various versions of the report.

Table of contents

Figures

Tables

Acronyms and abbreviations

AETR(s)	Average effective tax rate(s)
ALMP(s)	Active labour market programme(s)
AMI	Acute myocardial infarction
APW	Average production worker
AW	Average worker
BLSP	National Basic Livelihood Security Programme
CCL	Canadian Council on Learning
CHD	Coronary heart disease
COPD	Chronic obstructive pulmonary disease
CVD	Cerebrovascular diseases
DB	Defined benefits
DC	Defined contribution
DRG(s)	Diagnosis-related group(s)
EAPS	Economically Active Population Survey
ECEC	Early childhood education and care
EI	Employment Insurance
EITC	Earned Income Tax Credit
EPL	Employment Protection Legislation
ESC	Employment Security Centre
EU	European Union
EU15	Fifteen European Union member countries prior to the accession of ten candidate countries in May 2004: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden and the United Kingdom
GDP	Gross Domestic Product
HIRA	Health Insurance Review and Assessment Service
IACI	Industrial Accident Compensation Insurance
IQ	Intelligence Quotient
ISCED	International Standard Classification of Education
KDI	Korea Development Institute
KEF	Korea Employers Federation
KEIS	Korea Employment Information System
KHA	Korean Hospital Association
KICCE	Korea Institute of Child Care and Education
KLF	Korea Labor Foundation
KLI	Korea Labor Institute
KLIPS	Korean Labor and Income Panel Study
KMA	Korean Medical Association
KRW	Korean won
LPP	Livelihood Protection Programme
MAP	Medical Aid Programme

MCL	Minimum cost of living
MEST	Ministry of Education, Science and Technology
MHW	Ministry of Health and Welfare
MOEL	Ministry of Employment and Labor
MOHW	Ministry of Health and Welfare
NEET	Neither in employment, nor in education or training
NHI	National Health Insurance
NHIC	National Health Insurance Corporation
NHS	National Health Service (United Kingdom)
NICHD	National Institute of Child Health and Human Development
NIEER	National Institute for Early Education Research
NP	National Pension
NPS	National Pension Scheme
NRR	Net replacement rate
P4P	Pay-for-performance
p.a.	Per annum
PES	Public Employment Service
PISA	Programme for International Student Assessment
PPP	Purchasing power parity
QOF	Quality and Outcome Framework
RACs	Re-employment Assistance Centres
RTW	Early Re-employment Allowance
SEP	Successful Employment Package
SME(s)	Small- and medium-sized enterprise(s)
TULRAA	Trade Union and Labor Relations Adjustment Act
TWA	Temporary Work Agency
UB	Unemployment benefit
UKCES	UK Commission for Employment and Skills
USD	United States dollars
VET	Vocational Education and Training
WHO	World Health Organization
WPS	Workplace Panel Survey

Executive summary

Korea faces the challenge of strengthening social cohesion in the context of a severe demographic transition

Korea's population, one of the youngest in the OECD at present, will be the second oldest by 2050. During this transition, public social spending will need to increase significantly while economic growth slows.

While Korea's "social record" is mixed, further erosion of social cohesion is a risk in the absence of decisive action now

Korea's economic progress over the past decades has been outstanding. Nonetheless, income inequality has increased over the past years, along with relative poverty. Indicators of well-being confirm that all is not well. Because of the challenges of combining family life with work aspirations, Koreans cannot have the number of children that they would like, resulting in the lowest birth rate in the OECD. Working very long hours hinders women's participation in the labour market as does the wide gender pay gap, implying a huge waste of human capital. Looking ahead, Korea will face the same pressures that contribute to rising inequality in many other OECD countries. In addition, it will have to cope with pressures which are specific to Korea:

- First, labour market dualism between regular and non-regular workers is relatively strong, a key factor behind the growing inequality in pay and working conditions.
- Second, the redistributive impact of its tax and transfer systems is among the weakest from an international perspective.
- Third, the level of public social spending is among the lowest in the OECD area.

OECD scenario analysis suggests that acting quickly in a wide range of areas will pay off

One scenario embeds the assumption of more effective family-friendly policies to boost female participation to the labour market – including a mix between early childhood education and care, parental leave, and so on – and an overall reduction in working hours down to 40 hours per week by 2030. The ensuing potential gains are enormous, given the large scope for raising female participation in the labour market: by 2030, potential output would exceed the baseline level by about 15%. The benefits accruing to Korean families would also be sizeable, in terms of improved living standards and possibly their subjective perception of well-being and life satisfaction.

The first requirement to foster social cohesion is growth

It boosts employment while generating the public revenues necessary to finance social programmes. The key to sustaining output growth in Korea is to raise labour productivity, while limiting the trend decline in labour inputs through higher participation. Given that productivity is relatively high in the manufacturing sector, the priority should be to lift productivity in the service sector. Competition in both goods and service markets must be strengthened through vigorous regulatory reform.

Strengthening social cohesion requires scaling up public social spending

One challenge is to improve access to the three main pillars of the social safety net – the National Basic Livelihood Security Programme, Employment Insurance and the Earned Income Tax Credit (EITC) – for those at risk of poverty, while at the same time strengthening work incentives. The efficiency of social spending can be improved by ensuring that all programmes work together. Increases in social spending also require higher taxes, unless they are fully matched by cuts in other areas of public spending. Recent OECD work concludes that the most efficient way to boost revenue is through consumption taxes, which impose fewer distortions than direct taxes. Korea still has considerable scope to hike its value-added tax (VAT) rate of 10%, which is well below the OECD average of 19%. A significant VAT rise should be accompanied by appropriate offsetting policies, notably an expanded EITC and effective social spending.

Cutting the relatively large share of non-regular workers is also important for social cohesion

It will both support growth prospects, by giving rise to a better trained and more motivated workforce, and improve equity, thanks to reduced wage disparities. A comprehensive approach is required involving several pillars. One priority is to further relax employment protection for permanent workers; this would reduce the incentive for firms to hire non-regular workers as a means to enhance employment flexibility. Recent labour market reforms have provided greater employment protection for non-regular workers, enhancing job security for non-regular workers whilst reducing the incentives for employers to rely on precarious forms of employment. However, there remains ample room to better harmonise employment protection across different types of non-regular work. Replacing the retirement allowance with corporate pensions can also help to reduce duality, given that many non-regular workers are not covered by the retirement allowance. Despite recent improvements, the corporate pension scheme is still not attractive enough to many employers and employees to convince them to switch. Discontinuing tax preferences for retirement allowances would be a step in the right direction. Another way to reduce non-regular employment would be to increase their coverage by social insurance by reinforcing labour inspection activities, including through improved co-operation between labour, social security and tax inspectorates.

Women, youth and older workers need greater access to highly productive employment

Korea has recently taken promising measures to improve the labour market situation of these groups. It will be important to monitor closely their effectiveness. Additional measures may be needed to change strongly engrained labour market practices – such as long working hours for regular workers and forcing them to retire from their career job well before the age of pension entitlement – as well as cultural values, such as the high value Koreans place on academic study *vis-à-vis* vocational education. Promoting women's labour force participation while boosting fertility rates requires increasing the availability of child care, more family-friendly policies, reducing the gender pay gap, and promoting the take-up of paid parental leave, for fathers as well as mothers. With respect to older workers, the key priority is to reduce the incidence of early retirement from career jobs: firms should not be allowed to impose mandatory retirement below the age of 60, while greater flexibility in wages should be promoted.

Education reforms are also needed to promote inclusive growth

These include: *i)* improving the access of low-income children to high-quality early childhood education and care (ECEC); *ii)* reducing reliance on private tutoring, notably at *hagwons*, by improving university admission procedures, expanding the quality and diversity of schools and upgrading vocational education; and *iii)* expanding loans to university students with repayment contingent on income after graduation. The planned extension of public support for ECEC to all 3- and 4-year-olds needs to be implemented. One option is to increase the capacity of public kindergartens. At the same time, service quality could be improved *via* greater competition among the different providers. The information and accreditation system should be strengthened, and only formally accredited providers should be eligible for public subsidies. This would also allow parents to make better-informed decisions about their choice of ECEC provider. These measures need to be complemented by the effective implementation of the common curriculum for 5-year-olds in child care and kindergarten (as planned in 2012), while at the same time continuing the harmonisation for 3- and 4-year-olds. Additionally, upgrading programmes for younger children in line with the common curriculum would support continuous child development from birth to compulsory schooling. Finally, kindergartens and child care (for children aged 3-5) should be subject to common regulations and standards (e.g. staff qualifications, staff-child ratio).

Primary health care needs to be strengthened to improve social cohesion

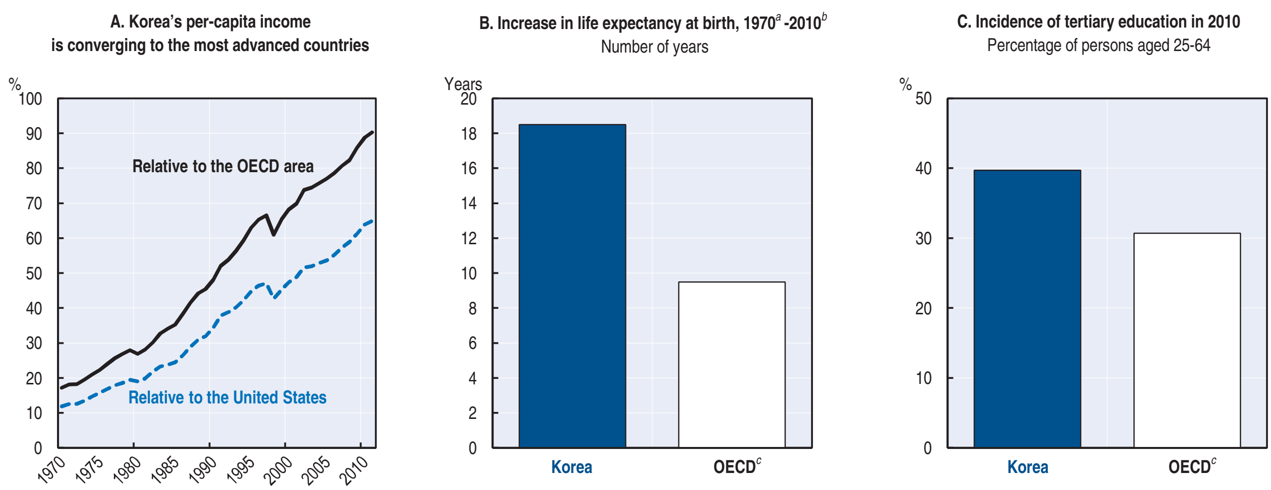
Moving away from a hospital-centred health system to one where primary care plays a greater role is a priority to improve health outcomes for low-income households who are discouraged from seeking such care by high co-payment rates. It will also help restrain the rapid growth of health spending. The development of a strong primary care system will require good working models of community-oriented multi-specialty group practices. Medical universities should be given grants to create such centres and use them as a training base for future primary care specialists. Strong primary care will also need central government support, particularly to pay the capital costs for building new centres. This could be followed by competitive tenders to the private sector to manage and staff these centres. The insurance fee schedule should increase payments for preventive and cognitive services (and lower fees for procedures and diagnostics). This change could be complemented by a pay-for-performance (P4P) scheme similar to the current Korean hospital P4P scheme, which would reward primary care practices with high rates of coverage for key primary care interventions. Primary care must further be supported by a strong programme of clinical guidelines based on available clinical evidence using a standard international methodology. Last but not least, a new type of workforce will be needed, with medical professionals trained in primary care as well as other specialists such as psychologists and social worker teams.

A policy toolkit for growth and social cohesion in Korea

Korea's economic record is outstanding, but income inequality and relative poverty have risen markedly since the mid-1990s, along with a deterioration of other well-being indicators

The economic progress achieved by Korea over the past four decades has been among the most rapid and sustained ever seen, both in terms of the pace of convergence of per-capita income towards the OECD average and the extent and depth of the societal transformations that economic change has entailed (Figure 0.1).

Figure 0.1. **The economic development of Korea over the past 40 years has been impressive**



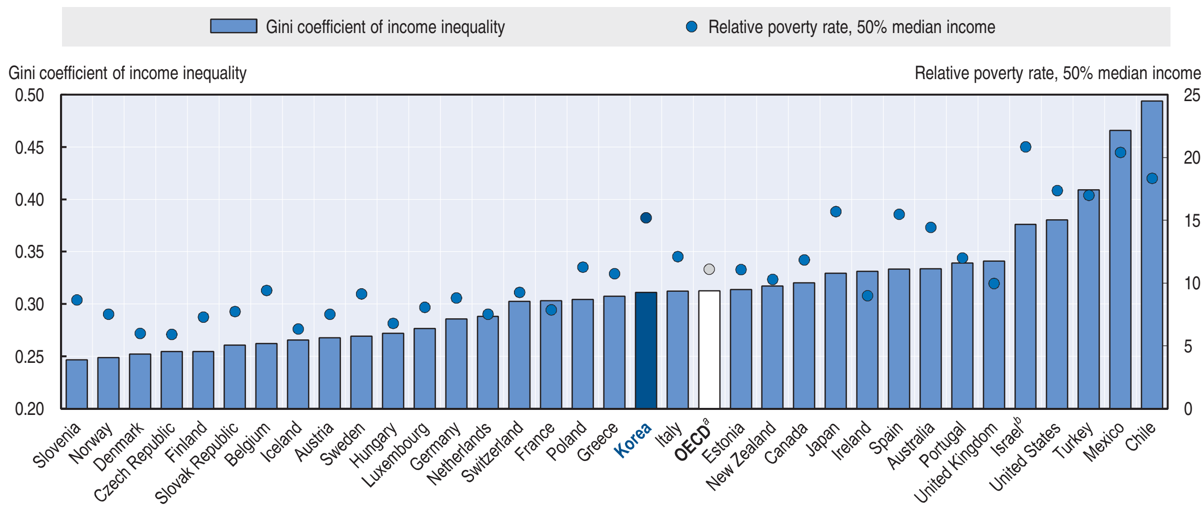
a) Or first year available; 1971 for Canada and Israel; and 1990 for Chile.
b) Or latest year available; 2008 for Canada; 2009 for Italy; and 2011 for France, Iceland, Mexico and Sweden.
c) Unweighted average of the 34 OECD countries.

Source: OECD calculations based on the *OECD Annual National Accounts Database* for Panel A; *OECD Health Database* for Panel B; and OECD (2012), *Education at a Glance 2012: OECD Indicators*, OECD Publishing, *http://dx.doi.org/10.1787/eag-2012-en*, Table A1.3a, for Panel C.

Notwithstanding this impressive economic performance, Korea has experienced over the past 15 years a marked rise in income inequality and relative poverty. The Gini coefficient, a standard measure of income inequality that ranges from 0 (when everybody has identical incomes) to 1 (when all income goes to only one person), has been on an upward trend and by 2009 it reached the OECD average (Figure 0.2). Meanwhile, relative poverty – conventionally measured as the share of the population living on less than half of the median income – has also been on an increasing trajectory, reaching 15% in 2009, the eighth highest in the OECD.

Unlike the path observed in several other OECD countries, the latest indicators suggest that income inequality has declined – albeit slightly – during Korea's strong recovery from the Great Recession of 2008-09. It also appears that the relative poverty rate has remained fairly stable in the recent past. Although these are positive developments, there is no room to be complacent.

Figure 0.2. **Income inequality has increased significantly in Korea and is now close to the OECD average, while relative poverty is one of the highest**



Note: Levels of income inequality and poverty in OECD countries, 2010 (or closest). Countries are ranked in ascending order of the Gini coefficient of income inequality which ranges from 0 (perfect equality) to 1 (perfect inequality). Relative poverty rates are defined as the share of individuals with income less than 50% of the median for the entire population. Data refer to the distribution of household disposable income in cash across people.

a) Unweighted average of the 34 OECD countries.

b) Information on data for Israel is available at: *http://dx.doi.org/10.1787/888932315602*.

Source: Calculations based on the *OECD Database on Income Distribution and Poverty*, *www.oecd.org/els/social/inequality*, Preliminary data.

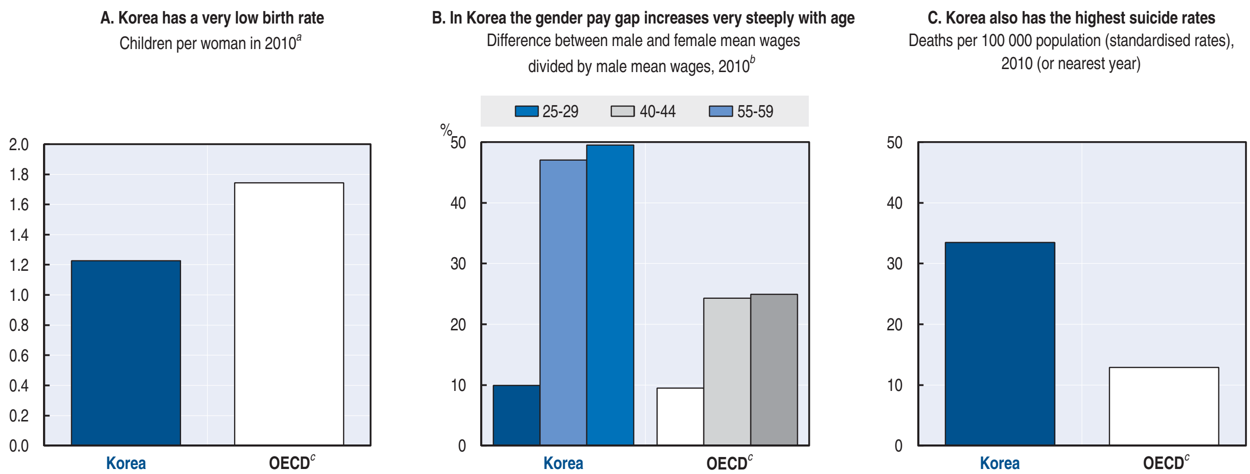
Other well-being indicators also point to tensions in the Korean economy and society. In particular, Korea has the lowest birth rate in the OECD, with two parents replacing themselves in the next generation by little more than one child (Figure 0.3). This is more than just evidence that the country is facing a tough demographic transition. It also points to a difficult social context, in which individuals cannot easily combine their family life with their work aspirations and as a result cannot have the number of children that they would like.

At the same time, there are strong signs that the considerable educational progress that Korea has achieved so far has not translated fully into better labour market outcomes. In part, this reflects the inheritance of Korea's economic model of working very long hours, which makes it difficult to combine employment with family responsibilities, thus limiting the access of many women to mainstream jobs. Female labour force participation rates are about the same now as 20 years ago (55% compared with an OECD average of 65%), with only 10% of all managerial positions being held by women compared with about one-third across the OECD. The overall gender pay gap among full-time workers (39%) is the highest among OECD countries.[1] Given the seniority-based wage system and labour market dualism, the loss in wages and career prospects for those who temporarily leave the labour force results in a very large "motherhood penalty".

Moreover, Korea is the OECD country with the highest income poverty rate among older people. Partly related, death rates from suicides have more than doubled in Korea over the recent past and now are the highest among OECD countries, at 39 per 100 000 and 20 per 100 000 for men and women respectively.

Taken together, these factors are evidence that the "social record" of Korea's economic achievements is a mixed picture. This is surprising for a country with a legacy of "egalitarian growth" and where economic growth was a key factor in promoting social mobility until the mid-1990s.

Figure 0.3. **The challenge of strengthening social cohesion in Korea cannot be reduced to tackling inequality and poverty**



a) 2009 for Canada.

b) Data refer to 2008 for Australia, Austria, Denmark, Finland, Germany, Korea, Norway and the Slovak Republic; to 2007 for Belgium, the Czech Republic and Ireland. For Austria, 25-29 refers to 20-29, 40-44 refers to 40-49, and 55-59 refers to 50-59.

c) Unweighted average of the 34 OECD countries.

Source: OECD calculations based on the *OECD Family Database* for Panel A; *OECD Database on Average Earnings by Gender and Age* for Panel B; and *OECD Health Database 2012* for Panel C.

The drivers of inequality and declining social cohesion are likely to persist and have to be counteracted by policy intervention

Looking further ahead, the fact that Korea is now increasingly integrated in the global economy implies that it is facing the same pressures that contribute to rising inequality in many other OECD countries (OECD, 2011a). In particular, in Korea, as in most OECD countries, technological progress tends to be skill biased: high-skilled workers benefit much more than low-skilled workers. Meanwhile, further regulatory reforms and institutional changes intended to enhance competition, while increasing the growth potential of the Korean economy, can be expected to widen inequality by reducing employment opportunities for the low-skilled, or reducing the already low returns of some forms of self-employment.

Yet, the influence of common factors is compounded by specific features of the Korean economy, which make it particularly vulnerable to further inequality pressures and have to be addressed by adequate policy interventions (Figure 0.4):

- First, the Korean labour market is characterised by its relatively *strong dualism* between regular and non-regular workers. Dualism is a key factor behind the growing inequality in pay and working conditions that feed into household income inequality and relative poverty making it one of the principle challenges to address.
- Second, the redistributive *impact of its tax and transfer systems is among the weakest* from an international perspective.
- Third, *the level of public social spending is among the lowest* in the OECD area.

Strengthening social cohesion is key for equity but also for sustaining strong economic growth

The evidence presented in the new report on *Strengthening Social Cohesion in Korea* suggests that while Korea needs to pursue structural reforms to sustain its strong record of economic growth, it also has to address its pressing social challenges. Indeed, growth is essential to make further progress in living standards, but growth on its own will not solve all the problems. The observed rise in income inequality can have corrosive effects on social mobility, depleting a key source of economic vitality. International experience suggests that intergenerational earnings mobility tends to be low in countries with high income inequality – such as Italy, the United Kingdom and the United States, for example – and higher in the Nordic countries, where income is distributed more evenly. Inequality can also fuel protectionist sentiments. People will no longer support open trade and free markets if they feel that they are losing out, while a small group of winners is getting richer and richer.

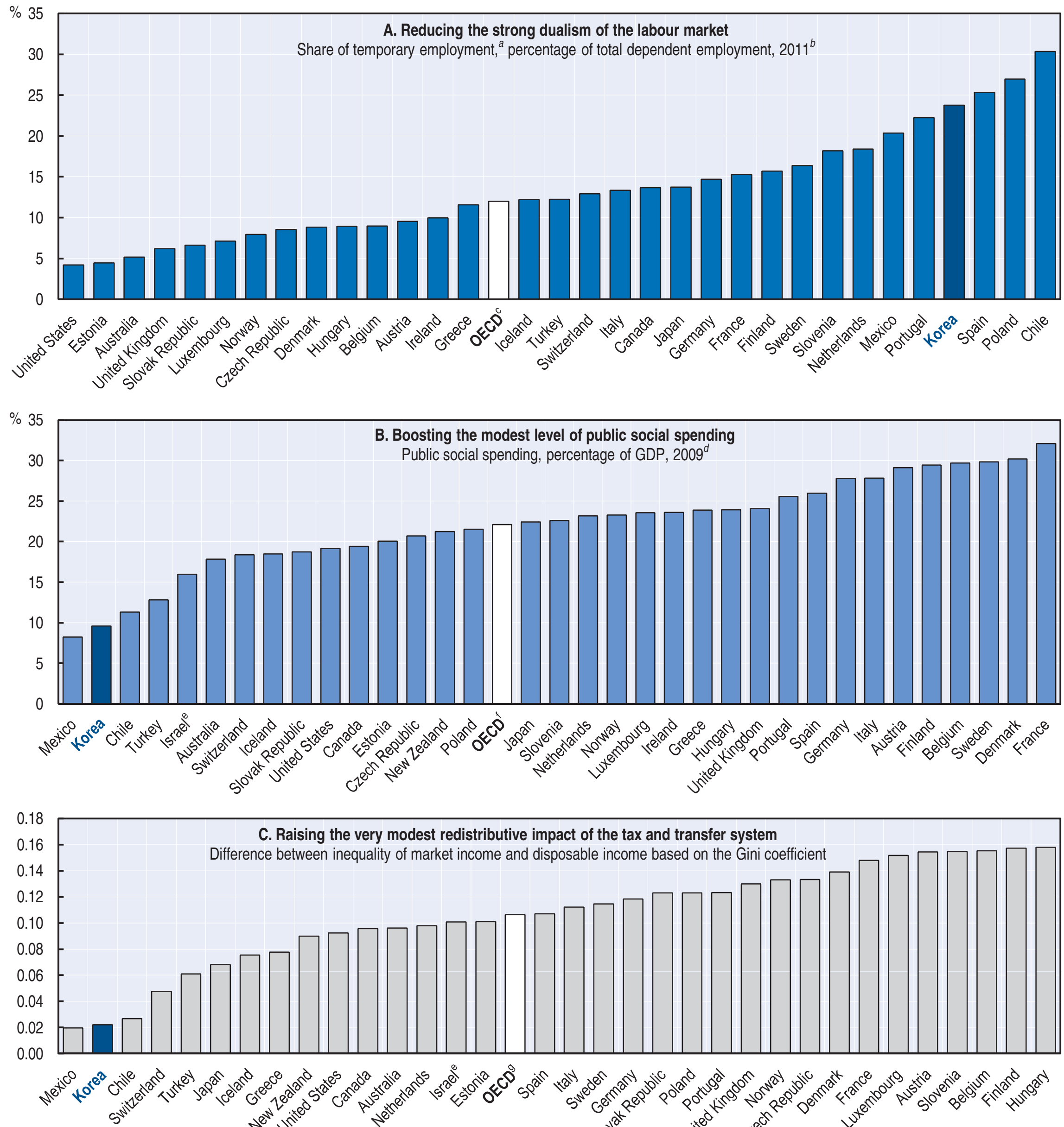
Rising social cohesion has become a source of concern for many Koreans. Koreans increasingly question the quality of health care and education services. The health system is dominated by private providers which are poorly organised to deliver co-ordinated care for the growing elderly population with multiple morbidities. They also question the opportunities opened by education and training and the actual returns attached to their investment in human capital. Likewise, they are concerned about the quality of jobs and whether they are stable enough to provide adequate career prospects as well as a decent pension. These concerns motivate the fundamental "go social" objective that policy makers must pursue, according to *Strengthening Social Cohesion in Korea*. However, it is also essential to respond to these legitimate concerns with cost-effective solutions that do not imperil the fiscal sustainability of the Korean social protection model in the long run.

Rapid population ageing makes addressing these concerns even more urgent. This requires acting quickly on a wide range of policy areas.

Strong growth makes it easier to strengthen social cohesion

Strong and sustained economic growth is obviously a first requirement to foster social cohesion. It serves to create jobs, while at the same time generating the public revenues necessary to finance social programmes. Indeed, increasing social spending from its current level of 9.6% of GDP in Korea toward the OECD average of 22.1% would certainly be more difficult to achieve in a low-growth economy, as it would seriously impact private-sector spending. Yet, pursuing output growth requires good policies.

Figure 0.4. **Three challenges that Korea policy makers need to meet in order to reverse the rise in income inequality**



a) Temporary employees are defined as wage and salary workers whose job has a pre-determined termination date. For Korea, it includes only employees with a fixed-term contract, temporary agency workers and on-call workers (excluding double-counting).
b) 2004 for Mexico, 2005 for the United States and 2006 for Australia.
c) Weighted average of OECD countries whose data are available in 2011.
d) Data for Mexico have been estimated. Data for Switzerland refer to 2008.
e) Information on data for Israel is available at: *http://dx.doi.org/10.1787/888932315602*.
f) Unweighted average of the 34 OECD countries.
g) Unweighted average of the 33 OECD countries shown in Panel C.

Source: OECD Online Employment Database (*www.oecd.org/employment/database*) for Panel A; *OECD Social Expenditure Database* (*www.oecd.org/els/social/expenditure*) for Panel B; and *OECD Database on Income Distribution and Poverty*, *www.oecd.org/els/social/inequality*, Preliminary data for Panel C.

To set out the framework for such policies, it is useful to start with a review of the key drivers of economic growth from an international perspective (Figure 0.5). In 2011, the gap in GDP per capita of Korea with respect to the top half of OECD countries was about 30%. Decomposing this gap into the effect of labour utilisation as distinguished from the effect of labour productivity suggests that output growth in Korea is by and large fuelled by strong growth of labour inputs, reflecting exceptionally long working hours. Indeed, working time per capita was more than 30% above the top half of OECD countries. This suggests that there is little scope to raise further labour utilisation, which is likely to decline as the working-age population begins shrinking in 2017. Priority should be given, instead, to adjusting its composition by reducing the very high working hours while at the same time raising participation rates among the groups in the labour market that are currently under-represented.

In contrast to labour inputs, labour productivity per hour worked is 55% below the average of the top half of OECD countries (Figure 0.5, Panel C), explaining the 30% per capita income gap between Korea and the high-income countries. The key to sustaining output growth in Korea, therefore, will be to increase labour productivity, while limiting the decline in labour inputs through higher participation. Given that productivity is relatively high in the manufacturing sector, the priority should be on increasing productivity in the service sector, which accounts for two-thirds of total employment. Indeed, labour productivity in Korea's service sector is about 54% of that in its manufacturing sector and 44% of the US service sector average in 2010.

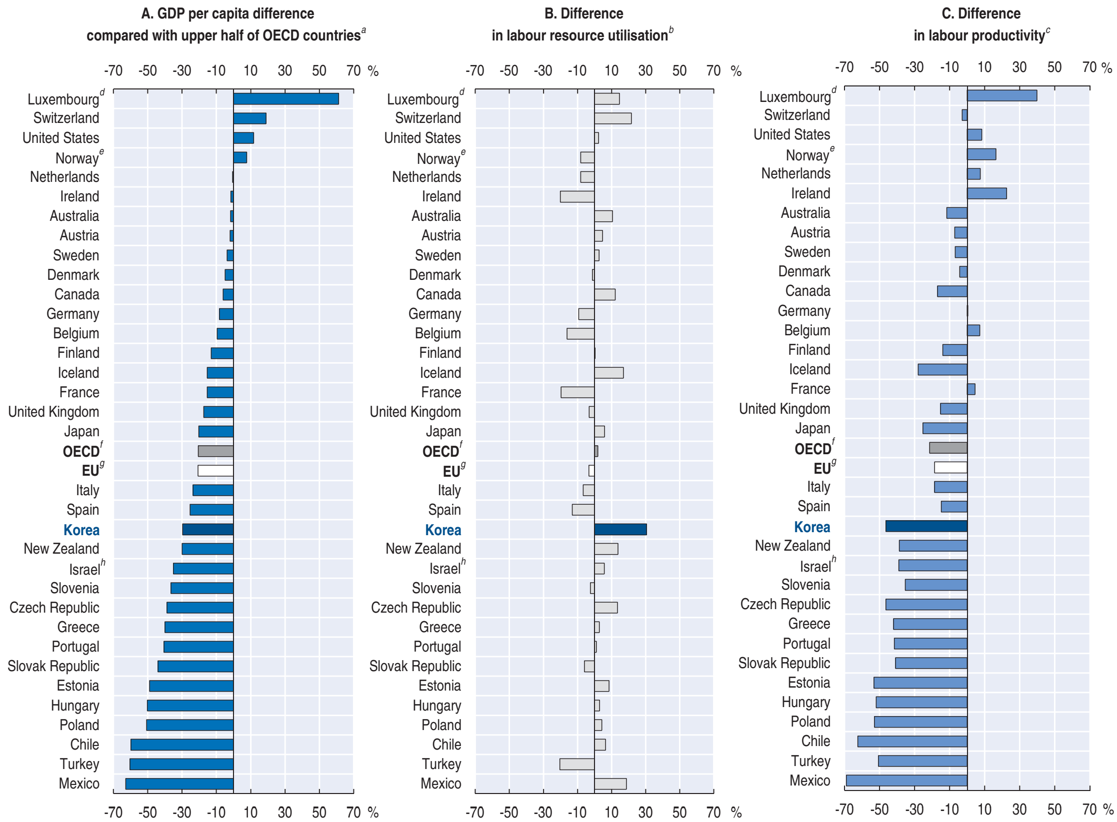
Competition-friendly reform will help to support productivity growth

Fostering labour productivity growth in services requires a coherent set of policy interventions. First, competition in markets for goods and services must be strengthened through regulatory reform. Despite progress during the past decade, around a third of business lines in the service sector remain subject to entry barriers. In addition, competition policy should be further strengthened by raising financial penalties significantly on firms violating the Anti-monopoly and Fair Trade Act – to increase the deterrent effect – and scaling back the number of exemptions from competition law, including for SMEs.

Greater openness to the world economy is another priority to boost productivity, particularly in services. The stock of foreign direct investment (FDI) as a share of GDP in Korea was the third lowest in the OECD area at 12% of GDP in 2011. Moreover, FDI in the service sector was only 6% of GDP compared with the OECD average of 25%. Strengthening international competition requires reducing barriers to FDI, including foreign ownership ceilings in key services, and liberalising product market regulations. In addition, it is important to foster a foreign investment-friendly climate by enhancing the transparency of tax and regulatory policies and reforming the labour market. Through the years, various editions of the *OECD Economic Survey of Korea* have put the accent on the importance of these policy priorities (see for example, OECD, 2008).

Labour productivity could also be improved by recognising and treating workers with stress-induced mental illness as this leads to decreased productivity through disability and "presenteeism" where workers are not achieving their full potential while at work. Remedying stress-induced loss in productivity requires greater access to mental health services, particularly psychological services which are currently not reimbursed by health insurance. Workplace initiatives have been disappointing because of the high level of stigma. It is more important to improve access to mental health services with no gatekeeping to ensure confidential consultations with mental health professionals.

Figure 0.5. **Korea's future output growth will need to be strongly driven by gains in labour productivity, which remains very poor by international standards**



a) Compared to the average of the 17 OECD countries with highest GDP per capita in 2011, based on 2011 purchasing power parities (PPPs). The sum of the percentage differences in labour resource utilisation and labour productivity does not add up exactly to the GDP per capita difference since the decomposition is multiplicative.

b) Labour resource utilisation is measured as the total number of hours worked per capita.

c) Labour productivity is measured as GDP per hour worked.

d) In the case of Luxembourg, the population is augmented by the number of cross-border workers in order to take into account their contribution to GDP.

e) Data refer to GDP for mainland Norway which excludes petroleum production and shipping. While total GDP overestimates the sustainable income potential, mainland GDP slightly underestimates it since returns on the financial assets held by the petroleum fund abroad are not included.

f) Unweighted average for the 34 OECD countries.

g) The EU category brings together countries that are members of both the European Union and the OECD. Data refer to an unweighted average of the EU15 countries plus the Czech Republic, Estonia, Hungary, Poland, the Slovak Republic and Slovenia.

h) Information on data for Israel is available at: *http://dx.doi.org/10.1787/888932315602*.

Source: OECD (2013), *Economic Policy Reforms 2013: Going for Growth*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/growth-2013-en*.

Fostering social cohesion requires a holistic approach

Although structural reforms are indispensable to maintain strong growth, they should be complemented by measures to address Korea's key social policy challenges if growth is to become more inclusive and sustainable. In particular, *Strengthening Social Cohesion in Korea* stresses that achieving this objective requires a holistic approach:

- First, it identifies effective options to improve social policies to counteract more effectively market-based inequality;
- Second, it suggests viable policy strategies for reducing labour market duality, while at the same time promoting employment and employability among under-represented groups – such as women and older workers – which is a key priority given rapid population ageing; and
- Finally, the report stresses that promoting social cohesion in Korea also requires assuring access to essential public social services, such as education and health care. In particular, the report provides a detailed assessment of the quality of early childhood education and care, an issue of critical importance in ensuring equality of opportunities among children and helping parents reconcile family and work commitments. Moreover, the report looks at policies to improve primary health care services in Korea, paying particular attention to those that carry a stronger potential for encouraging a move away from the still dominant role of hospitals in the health system.

The potential pay-offs of such an approach are large

The report provides ample evidence to gauge the potentially large long-term pay-offs of such a holistic approach. In the labour market, promoting a transition towards regular employment would both support the growth prospects, by giving rise to a better trained and more motivated workforce, and improve equity, thanks to reduced wage disparities. To a large extent, this dualism takes the form of temporary employment which accounted for 24% of all employees in 2011, almost double the OECD average. However, relatively poor employment conditions for both regular and non-regular workers in SMEs also play a major role.

In education, greater efforts to promote high quality, affordable early childhood education and care can act as a catalyst for promoting sustained growth and equality, by supporting stronger inter-generational mobility. But there are also more immediate beneficial effects, namely those stemming from the possibility of freeing up more time for mothers to work and realise their career aspirations. In turn, this could have positive spillovers to fertility.

In health care, moving away from a hospital-centred health system to one where primary care plays a more important role is a priority to improve health outcomes for low-income households who are discouraged from seeking such care, due to high co-payment rates. Furthermore, it is a priority to limit the rapid growth of health spending. At present, the weakness in primary health-care is evidenced in high rates of avoidable hospital admissions for chronic conditions – such as asthma and diabetes.

Following her win in the December 2012 Presidential elections, President-elect Park has announced ambitious plans for addressing these policy concerns. This report *Strengthening Social Cohesion in Korea* is designed to serve as a contribution to the new administration's reform agenda as it draws on international benchmarks and best practices.

The specific policy reforms that *Strengthening Social Cohesion in Korea* identifies as essential requirements to tackle social challenges are reviewed below. Success will depend crucially upon the quality of design and delivery but also in ensuring sound funding of widening public social spending programmes over the long-term.

Increasing social spending can go a long way towards strengthening social cohesion but is also crucial to ensure efficiency in this spending

As Korea became an industrialised and urbanised society, part of the responsibility for social welfare has shifted from families and firms to the public purse, with the implementation of insurance programmes for medical care (1977), pensions (1988), unemployment (1995) and long-term care (2008). Nevertheless, as highlighted above, public social spending remains well below the OECD average of 22% of GDP. Figure 0.6 shows that in all areas of public social spending, Korea's expenditure is well below the OECD average. This difference reflects a combination of factors: Korea's relatively young population, the limited coverage of health and long-term care insurance and the relatively recent introduction of the pension system.

What makes Korea unique is that all of these factors that contributed to keep social spending low are set to reverse in the coming years. Under current policy settings and entitlements, total public social spending will reach the current OECD average of around 22% of GDP by 2050, according to estimates by the Korea Institute for Health and Social Affairs (KIHASA; Won et al., 2011). Pressure on social spending has already begun to materialise in the past two decades as public social spending increased at an annual rate of about 12% (between 1990 and 2009), the fastest in the OECD area. This upward trend in social welfare spending, however, has not reversed the rising trends in income inequality or relative poverty. Thus more needs to be done to tackle increasing inequality and high levels of poverty through social policies.

More efforts to ensure integration of social programmes must be undertaken

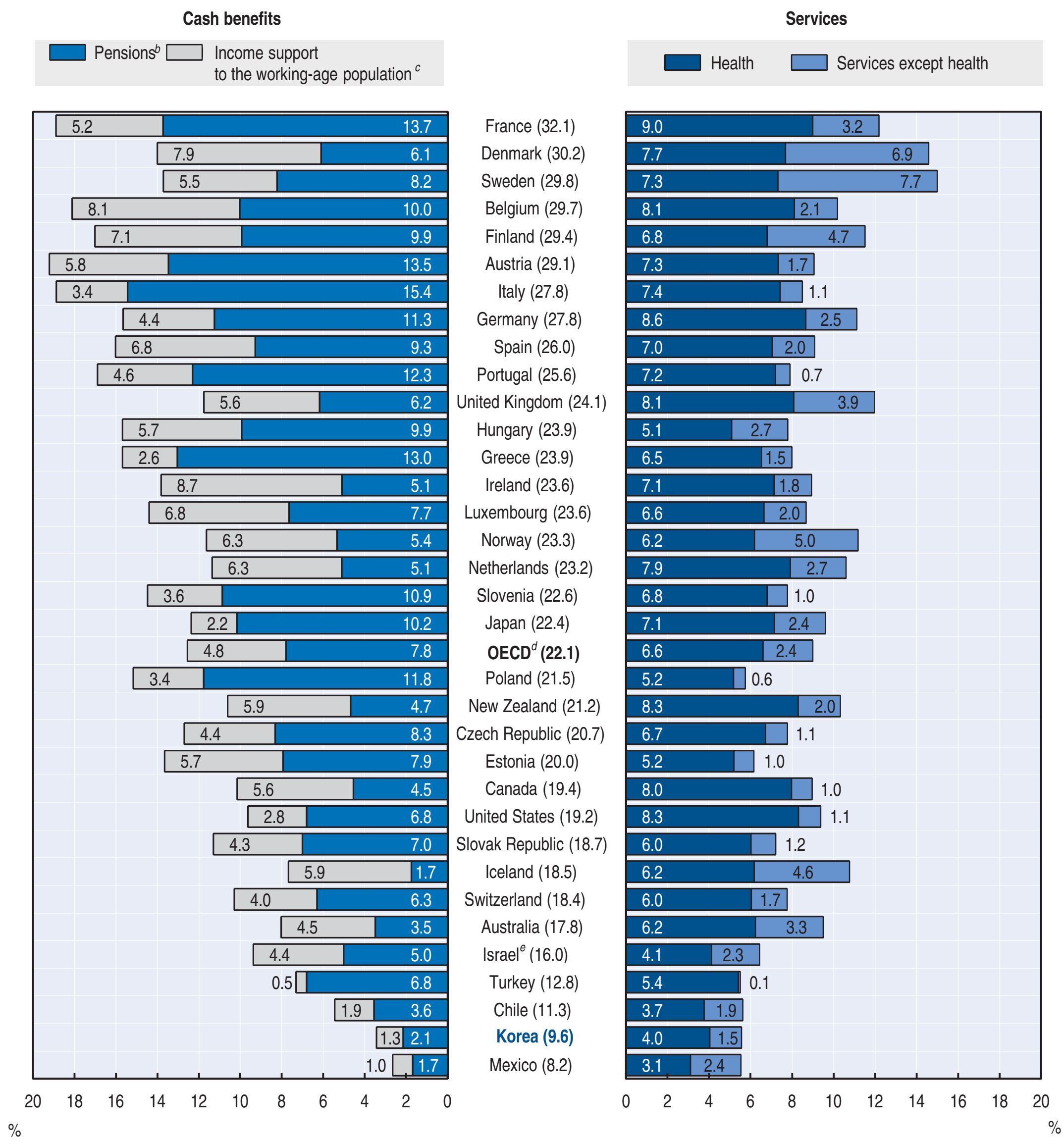
While higher social spending is a necessary requirement, it is also crucial to ensure efficiency in spending. Efficiency can be improved by ensuring that all programmes work together in pursuit of stated policy objectives. To achieve this, it is important to upgrade the collection of premium payments. The introduction of the integrated computerised database for social security administration in 2010 has brought about substantial improvements but more efforts are needed and a more unified approach to policy is required, both within and across levels of government. Undertaking systematic and regular monitoring and evaluation of social spending programmes – including by checking how they interact and work together – will also help identify ineffective or unnecessary programmes that can be scaled back or eliminated. This is essential to avoid wasteful spending and negative externalities. In the case of the National Basic Livelihood Security Programme, attention should be given to minimising the risk of long-term benefit dependency.

How to finance higher social spending without hurting output growth?

Increases in social spending require higher taxes, unless they are accompanied by cuts in other areas of public spending. The negative macroeconomic consequences of a rising tax burden can be significant due to a potential weakening of work incentives and a loss of external competitiveness, which in turn can lead to slower economic growth.

Figure 0.6. **Korea's public social expenditure is low in all main social policy areas**

Percentage of GDP, 2009[a]



Note: Countries are ranked by decreasing order of public social expenditure as a percentage of GDP. Spending on active labour market programmes (ALMPs) cannot be split by cash/services breakdown; they are however included in the total public spending (shown in brackets).

a) Data for Mexico have been estimated. Data for Switzerland refer to 2008.

b) Data refer to spending relating to "Old-age" and "Survivors" pensions.

c) Data refer to spending relating to "Incapacity benefits", "Family cash benefits", "Unemployment and other social policy areas".

d) Unweighted average of the 34 OECD countries.

e) Information on data for Israel is available at: *http://dx.doi.org/10.1787/888932315602*.

Source: OECD (2012), "Social Spending after the Crisis, Social Expenditure (SOCX) Data Update 2012", available at *www.oecd.org/els/social/expenditure*.

At present, the overall "tax wedge" on labour income, including social security contributions, remains comparatively low in Korea. At around 20% in 2011, it is the fifth lowest among OECD countries. In fact, the low tax burden has been a factor in supporting the external competitiveness of Korean goods and services and enhancing entrepreneurship, while at the same time strengthening incentives for foreign direct investment and investment in education.

How to finance higher social spending to foster social cohesion and address pressures stemming from population ageing while minimising, if not removing, the negative impacts on economic growth and competitiveness? The experience of other OECD countries that have undertaken pro-active tax reform strategies helps shed light on a suitable reform path for Korea.

Recent OECD work exploring the tax-and-growth nexus has concluded that the most efficient way to boost revenue is through consumption taxes, which impose fewer distortions than direct taxes (Arnold et al., 2011). One key conclusion of this work is that Korea still has considerable scope to hike its value-added tax (VAT) rate of 10%, which is well below the OECD average of 19% in 2012. Other relatively non-distortionary taxes include environmental taxes, which address negative externalities of climate change and pollution, and property taxes. Indeed, the above cited OECD study strongly corroborates the view that taxes on property are also more favourable for growth than other taxes as they have less impact on decisions to supply labour, produce, invest and innovate. At present, Korea's tax on property-holding is relatively low compared with other OECD countries. Korea also has considerable margins of manoeuvre to broaden its tax base.

With regard to indirect taxation, one major shortcoming is that its increase typically entails adverse effects on income distribution, which, in the Korean context, would mean undermining the main reasons for increasing social spending in the first place. For this reason, it is essential to accompany higher indirect taxes with offsetting policies, notably an expanded Earned Income Tax Credit (EITC) and effective social spending (see below).

As for direct taxes on personal and corporate income, the objective should be to broaden the bases and keep marginal rates low. For personal income taxes, this requires increasing the compliance of self-employed workers. To this end, the tax authorities need to enhance transparency about the income of the self-employed, as only 40% is captured by the tax system at present. This would also promote compliance with social security contributions, which are also based on income. Recent efforts to achieve more effective social security coverage of non-regular workers have involved the introduction of a new computerised database. While this is a welcome step, insofar as it will allow integrating the collection of premiums by the different social insurance pillars, more efforts are needed and a more unified approach to policy is required, both within and across levels of government.

Well-targeted tax and benefit programmes are also needed

Korea has an institutional framework capable of providing a more effective safety net for the working-age population but given its limited effectiveness and major gaps in coverage, reforms are urgently needed. The challenge for policy reform is to extend the reach of the three main pillars of the safety net – National Basic Livelihood Security Programme (BLSP), Employment Insurance (EI) system and EITC. Measures need to be taken to improve the accessibility for those whose circumstances result in family income below the poverty threshold while at the same time strengthening the employment orientation of the support provided to those who have work capacity.

One priority is to expand the role of the EITC that was introduced in 2008. In 2009, only 3.6% of households received the EITC, with total payments of 0.1% of total government spending. The EITC was extended in 2012 to childless households and some self-employed workers. The impact of an EITC in terms of increasing total labour supply and decreasing unemployment is greater in countries with a wide earnings distribution, low tax rates on labour and low benefits for the non-employed, indicating that it could be an effective instrument in Korea. However, at present the capacity of the EITC in Korea to deliver these benefits is limited by low benefit levels and tight targeting compared to similar programmes in other OECD countries, particularly in the case of families with children. In addition, constraints on the eligibility of current and former recipients of the BLSP further limit the potential of the EITC to make work pay. For the EITC to have a stronger impact in Korea, it must be made accessible to more low-earning households and its generosity increased.

The long-term impact of increases in public social spending and female participation are sizeable

Long-term scenario analysis can be helpful for assessing the macroeconomic challenges that Korea faces due to the expansion of social programmes and on-going demographic shifts, even though projections made over several decades are inherently subject to considerable uncertainty. For illustration, Table 0.1 presents several macroeconomic scenarios drawing from a new model used to extend the short-term projections for Korea as presented in the latest edition of the *OECD Economic Outlook* (OECD, 2012c).

In the *baseline scenario*, it is assumed that public social spending as a percentage of GDP increases only as a response to the mechanical impact of ageing on the demand of public social services, at current entitlement conditions. While this provides a useful benchmark, this assumption is too limited given the extra-pressure on public social spending stemming from the push on the government to more effectively address social concerns. Hence, the *first illustrative scenario* assumes that public social spending increases by 7 percentage points of GDP between 2014 and 2030 *in addition to* the impact of ageing on the cost of existing programmes (equivalent to 5 percentage points of GDP). The resulting combined increase implies that public social spending reaches the current OECD average of about 20% of GDP by 2030. In the calibration of the scenario, roughly one-quarter of the overall increase in public social spending (i.e. 3 percentage points of GDP) is financed by higher taxes and the remaining part by government borrowing. The main macroeconomic impact of strongly ramping up public social spending, under the assumption that this is mainly financed through government borrowing, is to induce a strong deterioration of the debt of the general government. Specifically, compared with the baseline scenario, the increase of the gross debt of the general government by 2030 is about 37%, as a percentage of GDP.

Whilst this long-term outcome clearly implies the transfer of a very large financial liability on future generations, the *second scenario* changes the baseline by embedding the assumption of a smaller increase of public social spending, i.e. 3 percentage points of GDP by 2030 instead of 7 percentage points (again on top of the ageing effect). The overall macroeconomic effect of assuming a more moderate increase of public social spending keeping the same funding assumptions is that in 2030 the gross debt of the general government exceeds the baseline by a smaller amount than observed under the first scenario (10.6%).

Table 0.1. **Scenario analysis of the macroeconomic impact of increases in public social spending and changes in labour supply**[a]

Percentage of GDP
(unless otherwise specified)

	2015	2020	2025	2030
Baseline scenario				
Private saving ratio	22.5	21.3	20.0	18.7
Government saving ratio	8.2	6.9	4.7	2.1
Current account balance	2.3	1.1	-0.7	-2.9
Gross debt of the general government	37.1	41.1	51.8	70.6
***First scenario:* Strong rise in public social spending to reach the OECD average by 2030**				
Public social spending increases by 7 percentage points of GDP on top of the impact of ageing on the cost of existing programmes (5 percentage points of GDP between 2014 and 2030)				
Resulting deviation from the baseline in:				
Private saving ratio	-0.2	-1.0	-1.7	-2.3
Government saving ratio	-0.3	-1.8	-3.7	-6.2
Current account balance	-0.4	-2.8	-5.4	-7.6
Gross debt of the general government	0.3	5.5	17.5	37.4
***Second scenario:* Moderate rise in public social spending**				
Public social spending increases by 3 percentage points of GDP on top of the impact of ageing on the cost of existing programmes (5 percentage points of GDP between 2014 and 2030)				
Resulting deviation from the baseline in:				
Private saving ratio	-0.1	-0.6	-1.0	-1.4
Government saving ratio	-0.1	-0.5	-1.1	-1.7
Current account balance	-0.2	-1.1	-2.1	-3.1
Gross debt of the general government	0.1	1.6	5.0	10.6
***Third scenario:* Gradual increase in female participation to achieve the same participation rate of male by 2030**				
Resulting deviation from the baseline in:				
Potential output of the total economy (percentage deviation from the level of the baseline)	0.1	1.6	7.0	19.0
***Fourth scenario:* Same as third scenario but in concomitance with a gradual reduction in the number of working hours to 40 hours per week by 2030**				
Resulting deviation from the baseline in:				
Potential output of the total economy (percentage deviation from the level of the baseline)	0.1	1.4	6.0	15.4

a) The simulations are based on the long-term projections model described in Johansson et al. (2013). The model is used here to extend the November 2012 *OECD Economic Outlook* short-term projections to 2030. The technical details retained for these simulations are the same as described in the aforementioned paper except for the social protection scenarios where there are two modifications to the Korea sub-model. *First modification:* In the original model, a fiscal rule is used to keep the public debt ratio stable. In the modified version of the Korea model used here, the evolution of both public spending and revenue is set by assumption. In the baseline and the two social protection scenarios, public spending is assumed to increase *via* the impact of ageing on the cost of existing programmes (by 5 percentage points of GDP between 2014 and 2030). Then, in one scenario, the expansion of social protection is assumed to increase public spending by an additional 7 percentage points of GDP between 2014 and 2030, for a total increase in public spending of 12 percentage points of GDP, of which 3 percentage points is assumed to be financed by higher revenue and the rest by borrowing. In the other scenario, the expansion of social protection is assumed to increase public spending by an additional 3 percentage points of GDP between 2014 and 2030, for a total increase in spending of 8 percentage points of GDP, of which 2 percentage points is assumed to be financed by higher revenue and the rest by borrowing. *Second modification:* In the original version of the model for Korea, more generous social protection (i.e. excluding the ageing effect) does not affect the private saving rate. In the modified version of the model, an expansion of social protection reduces the private saving rate on account of lower precautionary saving by households. However, to the extent that the expansion of social protection by government is financed by borrowing as opposed to higher revenue, the 40% *Ricardian-equivalence effect* built in the original model offsets some of the decline in precautionary saving.

Source: OECD estimates.

Importantly, the decline in the private saving rate is relatively contained under both scenarios, implying a small difference (only 0.9% in 2030). This is because the scenarios include a *Ricardian-equivalence effect*, whereby households anticipate the fact that a debt-financed increase in public spending will lead to higher taxes at some point in the future and therefore do not adjust their propensity to save accordingly. This effect is economically sound and supported by OECD empirical evidence. Indeed, one could argue that, if government expands social safety nets but does not take appropriate measures to finance the expansion private agents will not "be fooled" and will not modify their saving behaviours so much.

The policy message is clear. Any decision to increase public social spending beyond the mechanical impact of ageing will necessarily require to be supported by a well-defined funding strategy. This, in turn, will necessitate a careful policy balancing act between different funding options. The most appropriate strategy would be to finance higher public social spending by recurring, instead to higher public debt, to higher tax revenues as a percentage of GDP, or a combination between higher tax-financing and lower public spending in areas other than social spending. The outcome can be expected to entail some sacrifice in terms of a somewhat higher current account deficit, reflecting the fact that private households will reduce their precautionary savings in this case. However, this will be easy to accept given that it will be a direct consequence of an improved trust of Korean families in the future and their stronger subjective feeling of well-being. At the same time, what matters the most is that the long-term course of public fiscal balances will be set on a strongly sustainable pattern.

The *third scenario* assumes deeper structural reforms to promote higher female labour force participation to reach the same level projected for Korean men in 2030. This would require more effective family-friendly policies, including a mix between early childhood education and care, parental leave, and so on. The combined potential gains of such policies are very sizeable in Korea, given the large scope for raising the female participation rate in the labour market. Not surprisingly, the potential gains of such policies are very sizeable: potential output would exceed the baseline level by almost 20% in 2030.

Yet, the outcome of the third scenario is likely to be unrealistic insofar as it does not take into account the fact that working hours are very high in Korea, at present. Therefore, the *fourth alternative scenario* illustrated in Table 0.1 combines the convergence of female participation rates to the male rates with an overall reduction in working hours to reach the level of 40-hours per week by 2030. Under this scenario, the level of potential output in 2030 would exceed the baseline level by about 15%. Thus, under this scenario not only would the economy growth rapidly, but the benefits accruing to Korean families would also be sizeable, in terms of improved living standards and possibly their subjective perception of well-being and life satisfaction.

Tackling entrenched dualism in the labour market

A significant portion of the Korean labour force that works in precarious jobs does so at relatively low wages and receives less protection from social insurance. Lower wage costs represent a strong incentive for firms to hire non-regular workers. These workers earn only about two-thirds as much as regular workers, and productivity differences only account for a part of the pay gap. Such a cost advantage is magnified by the lower coverage of non-regular workers by the social insurance system. Firms also hire non-regular workers to achieve greater employment flexibility, given the strict rules governing the dismissal of regular workers. While extensive recourse to non-standard employment benefits employers, it imposes costs on the overall economy. For example, temporary workers receive less firm-based training than permanent workers, thus slowing human capital formation and productivity growth for the country as a whole. The use of non-regular workers often blurs the demarcation line between formal and informal jobs.

Several reforms have been recently undertaken by the Korean government to address labour market duality. These reforms have the potential to reduce firms' incentives to hire non-regular workers and thus the number of workers at risk of becoming trapped in low-quality jobs. However, it will be important to monitor closely the effects of these reforms with a view to improving their effectiveness and ensuring that they are coherent and mutually reinforcing. It should also be stressed that the recent reforms leave strong employment protections in place for regular workers and progress in reducing dualism is likely to be disappointing until these protections are relaxed.

As a practical guidance for better identifying possible areas where further progress is needed going forward, *Strengthening Social Cohesion in Korea* puts forward a multi-pronged approach for reducing labour market duality. Such a comprehensive approach involves several pillars:

- One key priority is to further relax Korean employment protection for permanent workers. In particular, the procedures for unfair dismissal should be simplified and accelerated, since the current procedure often involves an excessively long delay before the final court decision is reached. Relaxing employment protection for regular workers would reduce the incentive for firms to hire non-regular workers as a means to enhance employment flexibility.
- Recent labour market reforms have provided greater employment protection for non-regular workers, enhancing their job security whilst reducing the incentives for employers to overuse precarious forms of employment. While the increase in protection has gone about as far as is desirable on average, there is considerable scope to better harmonise employment protection legislation across different types of non-regular work. In particular, the rules limiting the use of temporary agency workers (dispatched workers) appear to be too strict by comparison with those applying to workers hired on fixed-term contracts and part-time workers. Aligning the Korean regulation with that of the other OECD countries would require replacing the "positive-list system", which limits such workers to certain authorised occupations and industries, with a "negative-list system", which allows them in general, except in certain specified cases.
- Replacing the retirement allowance with corporate pensions has the potential to make an important contribution to reducing duality, given that many non-regular workers are not covered by the retirement allowance. Despite recent improvements, the corporate pension scheme still is not attractive enough to many employers and employees to convince them to switch. Discontinuing tax preferences for retirement allowances would be a step in the right direction.
- Additional measures to enforce the minimum wage have been introduced recently which is welcome given evidence of significant non-compliance. Another welcome change was allowing fixed-term trainees, who are under contract for less than one year, to be covered by the minimum wage law. While this should help to contain the phenomenon of low pay among temporary employees, thus supporting the effort against labour market duality, it might also act as a disincentive to employ certain groups of workers, such as low-skilled youth. To counter this risk, the Korean authorities could envisage the introduction of lower sub-minimum wages for low-skilled youth engaged in jobs requiring investment in training. The experience of

other countries suggests that this could encourage firms to invest more in hiring and training less-educated youth, while enabling them to share the related cost burden with these young workers.

- One effective way to discourage informal employment would be to reinforce labour inspection activities, including by improving co-operation between labour, social security and tax inspectorates. The decision to unify the collection of social security contributions under the National Health Insurance Corporation is an important step forward, although much remains to be done to achieve a high degree of integration between the main social insurance schemes. Doing so is expected to narrow the gap in labour costs between regular and non-regular workers, while also making the social protection system more effective by reducing the size of the informal sector. It would also impact on equity directly, insofar as non-coverage is one of the reasons the Korean tax-transfer system does little in comparison with other OECD countries to reduce income inequality. The incorporation of more non-regular workers into the Employment Insurance System would also increase their access to public training and enhance their employability and their chances to move into better jobs.
- Another priority is to ensure that activation policies reach out more effectively to non-regular workers. At present, these workers miss out on activation policy more often than their regular counterparts. The new *Successful Employment Package* is a promising step, but in order to tackle the labour market duality problem, the package should also be used as a tool to boost the longer-run career prospects of non-regular workers, by combining subsidised work experience with training.

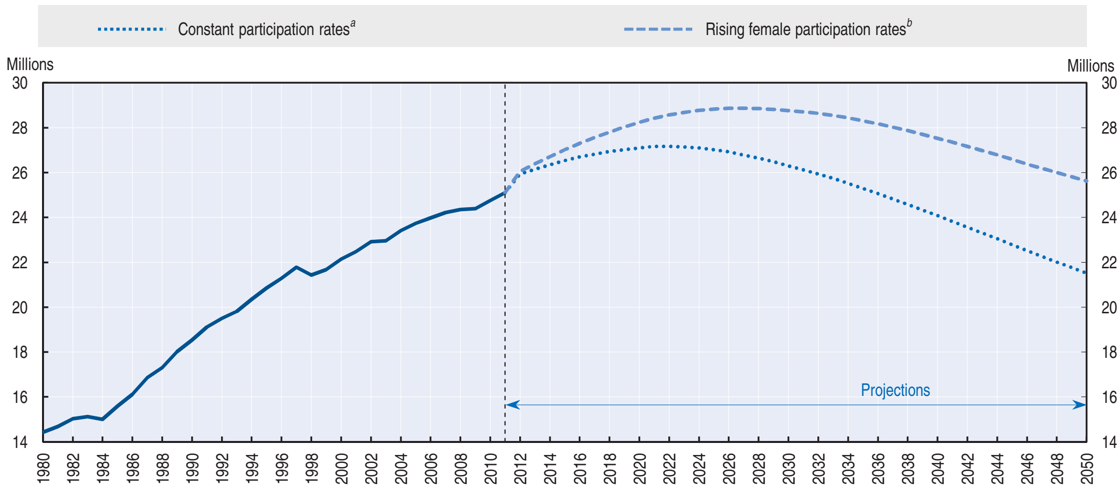
Complementary measures are required to tackle the labour market outcomes for specific groups: youth, women and older workers

Rapid population ageing implies that increased policy attention needs to be devoted to making the best use of all human resources (Figure 0.7). This is a powerful reason why the labour-market policies to reduce overall duality discussed above need to be complemented by measures to provide women, youth and older workers with greater access to high productivity employment.

The Korean government has recently taken a number of promising measures to improve the labour market situation of these three groups. It will be important to monitor closely the effectiveness of these initiatives, since many of them may need to be reinforced in order to change strongly engrained labour market practices – such as the requirements that regular workers work long hours and retire from their career job well before the age of pension entitlement – as well as cultural values, such as the high value Koreans place on academic study *vis-à-vis* vocational education.

Tackling the dual challenge of promoting women's labour force participation while boosting fertility rates requires reforms to increase the availability of child care, encouraging family-friendly policies, down breaking dualism and promoting the take-up of paid parental leave, for fathers as well as mothers (OECD, 2012e). One key to helping more women to successfully combine good careers with family life is to offer regular workers – especially women – greater flexibility in working time and work schedules, while remaining in good career jobs. Another priority is to expand access to high quality and affordable child care (see below).

Figure 0.7. **Korea's strong demographic transition will significantly reduce its labour force over the long-term projections of the labour force**



a) The participation rates for men and women are assumed to remain at their current levels for each age group.
b) Female participation rates are assumed to reach current male rates in each age group by 2050.

Source: OECD (2012), *OECD Economic Surveys: Korea 2012*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/eco_surveys-kor-2012-en*.

With respect to older workers, the key priority is to reduce the incidence of early retirement from career jobs. In this context, one essential step is that firms should not be allowed to impose mandatory retirement below the age of 60, so as to promote greater income from labour for the elderly, who face the highest rate of poverty among OECD countries. However, additional measures will be required to loosen the strong linkage between seniority and compensation, while also improving the access of older workers to training. Relaxing employment protection for regular workers could also contribute to reducing the incidence of early retirement by providing large employers with alternatives to early retirement when reducing workforce levels.

At the same time, educational choices need to become more responsive to labour market requirements if the skill mismatch among youth resulting from an over-emphasis on higher education is to be reduced. Further efforts to strengthen vocational education and career guidance are required, although some progress has already been achieved in this area. Policies to improve the dynamism and productivity of the service sector could also help to expand the demand for highly educated workers and reduce the number of non-working or underemployed university graduates.

Improving social cohesion through better education: the thorny issues of widespread private tutoring and high tertiary-level tuition fees

In 1945, Korea's literacy rate was 22% and less than 20% of children attended secondary school. Thanks to large public investment in schools, enrolment rates reached 90% for primary school in 1964, for middle school in 1979 and high school in 1993. In addition to boosting economic growth, the emphasis on universal access to primary and secondary schools promoted social mobility and income equality. Nevertheless, recent OECD work has underscored that some aspects of the current education system should be improved (OECD, 2012d). This is particularly important to enhance social cohesion, given that policies that promote equal access to education help reduce inequality.

One particular focus of recent OECD work on education in Korea has been the key equity concerns associated with the important role of *hagwon* – private institutes for after-school instruction – which increase inequality in educational results and place a heavy financial burden on families. To reduce the role of private tutoring, the government has been trying to improve the quality of schools, expand the diversity in secondary schools and de-emphasise the role of the standardised exam in the university admission process. Such reforms should be continued, while improving vocational education, to provide attractive alternatives to university. Even with such reforms, *hagwons* are likely to continue playing a major role, making it important to improve opportunities for low-cost after-school lessons for low-income students. In particular, further expanding after-school programmes in schools, which enrol 63% of students, would help.

At the tertiary level, tuition fees are the third highest in the OECD area. Unhappiness with high tuition fees has been rising recently, including by coalescing – notably during the campaign for the Presidential elections – around the slogan "half-price tuition". While politically attractive, this initiative has potentially serious efficiency and equity consequences, which were highlighted in (OECD, 2012d). First, universally subsidising tuition fees would encourage even more students to go to university, thereby exacerbating the problems of overemphasis on tertiary education and skill mismatches. Second, half-price tuition raises questions of value for money, as it would subsidise low-quality institutions that should instead be restructured or closed. Third, subsidising the tuition fees for all students is less efficient and equitable than targeting support on low-income students. Fourth, it would be expensive, costing about 0.6% of GDP annually.

Experience in other countries suggests caution as it is very difficult to move away from universal subsidisation of tuition once it is introduced. In 2012, Korea launched a plan to reduce tuition payments through additional grants to students from low-income households and aid to universities that provide more grants to such disadvantaged students. This seems a more appropriate approach. In addition, the government should expand the availability of student loans, with loan repayment contingent on after-graduation income. Such loans were introduced in 2010 but were received by only about 9% of tertiary students, given the strict eligibility criteria, which should be relaxed.

Early childhood education and care (ECEC) can play an important role in fostering social cohesion

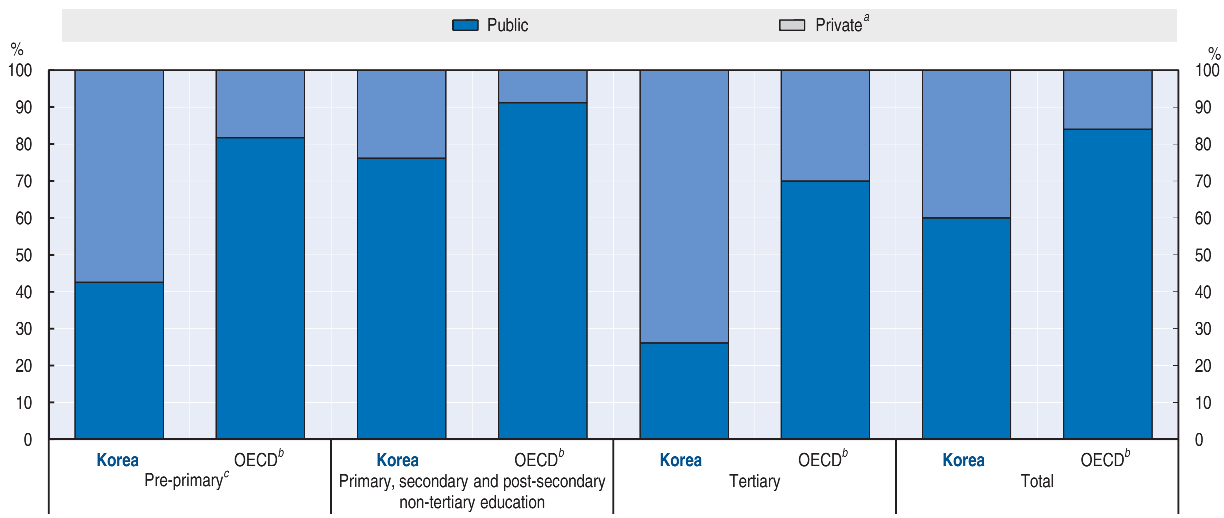
In recent years, governments in many countries have recognised the importance of investment in early childhood education and care (ECEC) for developing human capital and promoting social cohesion. A large body of empirical work has shown that fundamental cognitive and non-cognitive abilities are developed well before the age of 5. ECEC thus generates a higher rate of return on public spending than that at later stages of education and training, and even more so for disadvantaged children who receive much less cognitive and emotional stimulation at home. ECEC also leads to better outcomes at subsequent stages in life, such as better student performance, less poverty, a more equitable distribution of opportunities (as discussed above, this is important for supporting social mobility across generations), fewer school dropouts and greater labour market success.

From a labour market perspective, access to affordable, high-quality ECEC services is an important element for mothers to take an equal place in the workforce, boosting household income and giving some families a vital leg up from poverty. Moreover, increasing female workforce participation will expand the tax base. Furthermore, in OECD countries experiencing very low fertility, like Korea and Japan, surveys show that the substantial costs of raising children and ensuring high-quality learning opportunities negatively affect women's decision on whether to give birth to a child, or not.

Total spending on pre-primary education in Korea is among the lowest in the OECD area, with the public sector accounting for less than half, well below the OECD average of 82% (Figure 0.8).

Figure 0.8. **International comparison of private spending on education in 2009**

Percentage of total expenditure



a) For primary, secondary and tertiary education based on full-time equivalents. The figures do not include spending on private after-school institutions, such as *hagwons*.
b) Unweighted average of the 34 OECD countries' data when available.
c) For children aged 3 years and older.

Source: OECD (2012), *Education at a Glance: OECD Indicators*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/eag-2012-en*, Tables B3.1, B3.2a and B3.2b.

Moreover, public spending on child care amounted to 0.4% of GDP in 2009, below the OECD average of 0.6%. Private institutions play the dominant role in ECEC, accounting for 89% and 77%, respectively, of child care and kindergarten enrolments. The exceptionally low level of public spending on ECEC and the high share of private outlays make the quality of ECEC dependent on a household's income level, thus limiting the opportunities for low-income children. In addition, many children attend *hagwons*, which are focused on academic subjects, particularly foreign languages and mathematics, reflecting intense competition beginning at a young age.

Which policy measures are most suited to promote ECEC?

Strengthening Social Cohesion in Korea identifies policy measures that can reduce the specific barriers to the expansion of ECEC services and to raise its quality and equity. One priority is to implement the planned extension of public support for ECEC to all 3- and 4-year-olds starting in 2013. To this end, one option is to ensure the implementation of the plans to facilitate the expansion of the capacity of public kindergartens. This could be either half-day or full-day.

At the same time, promoting the provision of quality services could be achieved through facilitating more competition among the different providers. To achieve this, it would be important to relax the price ceilings and eliminate regulatory barriers to access the child-care provision system. Such a relaxation of the price ceilings should be accompanied by the introduction of means-tested subsidies, which will be required to ensure that higher-quality ECEC remains affordable to children from more disadvantaged families. Alongside this, an information and accreditation system should be introduced whereby only formally accredited providers would be eligible for public subsidies. Such an information system would also allow parents to make informed decisions about their choice for an ECEC provider. The system should be common to both child care and kindergartens to ensure transparency for users and streamline administrative procedures.

These measures need to be complemented by effective implementation of the common curriculum for 5-year-olds in child care and kindergarten (as planned in 2012) and continue the harmonisation for 3- and 4-year-olds. Additionally, upgrading programmes for younger children in alignment with the common curriculum would support continuous child development from birth to compulsory schooling. In doing so, attention should also be paid to "play-based learning" under the highly academic-oriented context in Korea.

Finally, common regulations and standards (e.g. staff qualifications, staff-child ratio) for all children aged 3-5 also need to be set out, regardless of whether they attend kindergarten or child care. One option is to consider a gradual integration of the administration of kindergarten and child care, at least for children aged 3-5. This could contribute to a more even service delivery, by raising qualifications of child care staff and enhancing pedagogy by providing common teacher education and professional development for child care and kindergarten staff. It could also help reduce costs through streamlining administration as well as establish a coherent financing system that is fair.

Strengthening primary care to improve social cohesion and to increase value for money of public spending on health

Within less than 30 years, Korea has made remarkable strides in health, controlling communicable diseases, and rapid improvement in life expectancy. Korea has also expanded rapidly its insurance system to achieve universal access to health insurance coverage by 1989. The pace of reform has continued with pharmaceuticals, one of the most critical and difficult reform areas in the OECD. Korea separated the functions of prescribing and dispending of pharmaceuticals (the former to doctors and the latter to pharmacists), which significantly improved the efficiency of the health system by discouraging the over-prescription of expensive medicines.

Although Korea has made great progress in health reform, there is still an unfinished agenda for reform based on the rapidly ageing population. Korea is already experiencing rapid growth in health spending per capita, which is amongst the fastest in the OECD, and is double the average of OECD countries over the past decade. Looking forward, the Korean health system will have to cope with a growing burden of elderly people with multiple morbidities such as diabetes, cardiovascular disease, and depression. The current hospital-based system is ill-suited for the new health challenges related to chronic diseases and multiple morbidities. Chronic diseases require continuous and co-ordinated care (primary care) to cope with the on-going daily complexities, where patients play a key role in managing their own conditions. Primary care, free at point of access, is a key policy to improve health equity not only amongst the elderly but across the whole population. Countries with good primary care have the least health inequity, making it a key policy to improve social cohesion.

Countries with good primary care have a more equitable access to health services (OECD, 2011b), making it a key policy to improve social cohesion. Moreover, in the countries with more equitable access to health care between rich and poor, everyone in the country is entitled to a (virtually) free benefits package of services. Evidence suggests that a cost-effective package includes preventative services as well as important public health interventions like vaccinations, but also counselling for obesity, smoking cessation, and mild-to-moderate mental disorders. As poor people suffer from more illness, reducing financial barriers to access of primary care through co-payments reduces health inequalities.

The Korean health system needs to shift its focus from an ever continuing expansion of acute services towards a system based on community-oriented primary care. WHO defines primary care as "providing the basis for person-centeredness, continuity, comprehensiveness, and integration". Primary care is the provision of first-contact, person-focused, ongoing care over time. Its main objectives are to help people meet their health-oriented needs, referring only those too uncommon to maintain competence, and co-ordinate care when people receive services at other levels of care. A primary care team would do such things as offer health promotion and disease prevention; deliver public health services such as vaccinations; diagnose common health problems like hypertension and depression; refer and co-ordinate health care for patients, thus helping to manage their journey through the health system.

Recent OECD work on health care in Korea underscores that more spending does not necessarily lead to higher quality (OECD, 2012f). It also points to a serious problem in primary care in Korea. In particular, Korea has some of the worst indicators in the OECD for ambulatory-sensitive conditions – hospitalisation rates for diseases that could be treated better and more cheaply in primary care. Korean policy makers need to redirect health spending into primary care. This could be accomplished by increasing fees for cognitive services, such as talking to a health professional rather than doing a procedure. However, primary care remains structurally weak and financial incentives are likely to be insufficient. Government spending is needed for significant capital infrastructure to build larger primary care group practices. These practices could be contracted to private physicians to manage a new form of multi-specialty group practices that would be oriented towards health promotion and prevention; treating common conditions like diabetes and depression; and co-ordinating patients' care especially after hospitalisation. This would improve quality indicators for primary care sensitive conditions, combat widening health inequalities and also save money by not hospitalising patients unnecessarily.

Moving from hospitals to improve primary health care

The key policy priority for improving value for money in the Korean health spending is the development of a strong primary care system. First, this will require good working models of community-oriented multi-specialty group practices. Medical universities should be given grants to create these centres and use them as a training base for future primary care specialists. Strong primary care will also need central government support particularly to pay the capital costs for building new centres throughout the country. This could be followed by competitive tenders to the private sector to manage and staff these centres. There will also need to be changes in the insurance fee schedule to increase payments for preventive and cognitive services (and lower fees for procedures and diagnostics). The change in the fee schedule could be complemented by a pay-for-performance (P4P) scheme similar to the current hospital P4P scheme, which would reward primary care practices with high rates of coverage for key primary care interventions.

Strengthening primary care will also require strong leadership from the Ministry of Health and Welfare. A strong system of primary care should be undergirded by a strong programme of clinical guidelines. Clinical guidelines (and clinical pathways and clinical standards) elaborate what is the correct treatment: cost-effective treatments which should be performed in primary care; treatments which primary care should refer to hospitals; and cost-effective treatments which should be done in hospital. The guidelines should be based on available clinical evidence using a standard international methodology which reviews the clinical literature. In most countries, this is done by a national public institute like the UK National Institute for Health and Clinical Excellence (NICE). The clinical guidelines can be reduced to a smaller set of clinical standards that can then be used by the Korean Health Insurance Corporation on what services should be covered.

A stronger primary care sector will also require a new type of workforce with medical professionals trained in primary care as well as other specialist such as psychologists and social workers, working in teams. Multi-specialty teams are necessary to deal with patients with multiple morbidities. Mental health services should be integrated into primary care to improve access and also to decrease stigma.

Only by building a strong primary care system will the Korean health system be fit-for-purpose for the future challenges. Currently, the health system is unsustainable; it cannot continue to increase spending faster than the economy. It will face the challenge of a growing burden of disease with an ageing population, and only a strong system of primary care will enable it to cope with the dual challenge of fiscal sustainability and chronic diseases.

By pursuing a holistic policy reform targeted to address particular shortfalls there is considerable scope to improve social cohesion in Korea

The main message of this report is that strengthening social cohesion should gain centre stage in Korea’s policy agenda. Otherwise Korea risks that ever growing segments of its population are left behind, thus undermining the country’s long-term economic growth potential. These groups include many youth, women and older workers. In the context of an ageing population, Korea simply cannot afford the large economic and social costs that such an outcome would entail. This report contains the OECD’s recommendations to support Korea to meet this challenge.

Box 0.1. **Summary of recommendations for strengthening social cohesion in Korea**

Tackle income inequality and poverty

Extend the reach of the three main pillars of the safety net: The Basic Livelihood Security Programme (BLSP); the Employment Insurance (EI); and the Earned Income Tax Credit (EITC)

- Further relax eligibility conditions for access to BLSP so as to cover all those living below the absolute poverty line, in part by further relaxing the "legal supporter criterion".
- Ensure that all those eligible for the BLSP actually receive it.
- With more people reliant on EI benefits also becoming eligible for BLSP benefits, ensure access to "top-up" benefits from the BLSP.
- Raise the EITC benefit to strengthen work incentives.
- Ease the eligibility conditions for the EITC by eliminating the requirement to have a child or spouse and raising the ceiling on assets.
- Reassess the treatment of homeownership in both the BLSP and the EITC eligibility criteria to allow more homeowners to participate in the programmes and consider relaxing the additional assets tests.
- Continue extending EITC eligibility to the self-employed as transparency about their income increases.
- Foster compliance with the EI system, particularly for employees in smaller firms where it is weak.

Enhance the employment orientation of the support provided to those who have work capacity

- Strengthen activation requirements for both EI and BLSP recipients with work capacity.
- Improve the financial gains from low-paid employment by reducing the rate at which BLSP benefits are withdrawn as earned income increases and/or permit simultaneous receipt of the BLSP and the EITC.
- Strengthen work incentives for families with low earnings capacities by modestly increasing the phase-out range of EITC payments.
- Examine the impact of the homecare allowance for children under three on parents' work incentives.

Ensure that all programmes work together consistently in pursuit of policy objectives

- Critically review the entire suite of social welfare and labour support programmes to: *i)* streamline programmes and reduce administrative burdens; *ii)* increase take-up; and *iii)* ensure that the interactions between programmes are consistent with broader social policy objectives.
- Undertake systematic and regular monitoring and evaluation to ensure that programmes meet their objectives, including *i)* the newly introduced subsidy for EI premiums for low-paid workers in small firms to see if it improves coverage; and *ii)* the Early Re-Employment Allowance paid to the unemployed who find a job before their benefits end.

Break down labour market dualism

Implement measures to reduce the share of non-regular workers in the labour force

- Relax employment protection for regular workers, in particular by simplifying and accelerating the remedy procedure for unfair dismissal, which involves an excessively long delay before the final decision.
- Further increase the share of non-regular workers that are covered by the social insurance system, thereby narrowing the gap in labour costs between regular and non-regular workers and reducing firms' incentives to hire non-regular workers, while improving the functioning of the social insurance system.

Box 0.1. **Summary of recommendations for strengthening social cohesion in Korea** *(cont.)*

- Closely monitor and evaluate the impact of the numerous steps that the government has recently undertaken to address labour market duality to ensure that they are coherent and mutually reinforcing.
- Promote the take-up of the corporate pension scheme, in part by discontinuing tax preferences for retirement allowances.

Improve the welfare and opportunities of non-regular workers

- Better harmonise employment protection legislation across different types of non-regular work, in particular by relaxing rules limiting the use of temporary agency workers by replacing the "positive-list system" with a negative-list system, which allows them in general, except in certain cases.
- Introduce a lower sub-minimum wage for young workers so that the additional measures to enforce the minimum wage that have been introduced recently do not limit the employment opportunities for low-skilled youth.
- Improve the access of non-regular workers to active labour market policies, particularly those that would boost their long-run career prospects by combining subsidised work experience with training.

Enhance employment opportunities of groups most affected by non-regular employment, namely women, youth and older workers

- Monitor the measures recently taken to improve the labour market situation of all three groups, as many may need to be reinforced to change strongly engrained labour market practices.
- Enhance the employment prospects of women by allowing greater flexibility in working time and work schedules and improving access to high quality and affordable child care.
- Reduce the incidence of early retirement from career jobs through additional measures to restrict mandatory retirement, loosen the strong linkage between seniority and compensation, improve the access of older workers to training and relax employment protection for regular workers.
- Address the skill mismatch in the youth labour market by making educational choices more responsive to labour market requirements and further strengthening vocational education and career guidance.

Foster early childhood education and care (ECEC)

Expand public support for ECEC

- Prioritise extending public support for ECEC to all 3- and 4-year-olds starting in 2013, as planned.

Promote the quality of ECEC

- Improve quality of child care services such as by relaxing the price ceilings and entry barriers for child care to promote quality through competition. At the same time, the relaxation of the price ceilings should be accompanied by the introduction of means-tested subsidies, which will be required to ensure that higher-quality ECEC remains affordable to children from more disadvantaged families.
- Set up an integrated system for accreditation, monitoring and information common for both kindergartens and child care services so that parents can make an informed decision about their choice for an ECEC provider.
- Ensure effective implementation of the common curriculum for 5-year-olds in child care and kindergarten as planned in 2012 and continue the harmonisation for 3- and 4-year-olds. Additionally, upgrade the programmes for younger children in alignment with the common curriculum.
- Set out common regulations and standards (e.g. staff qualifications, staff-child ratio) for all children aged 3-5, regardless of whether they attend kindergarten or child care.

Box 0.1. **Summary of recommendations for strengthening social cohesion in Korea** *(cont.)*

Improve primary health care

Develop the foundations of a strong primary health care system

- Proactively use the National Health Insurance (NHI), making full use of its bargaining position as the single insurer, to rebalance spending growth away from hospitals and towards strengthening primary care.
- The National Health Insurance Corporation (NHIC) should increase payments for cognitive services delivered in community settings, and reduce the reliance on fee-for-service payments in primary care over time.
- Expand undergraduate and post-graduate training of doctors and nurses in primary care, in part by introducing a mandatory training rotation in a primary care facility for medical students, thereby helping to engender greater awareness of the importance of primary care in the medical profession.
- Establish a national institute to provide health technology assessment using cost-effectiveness analysis for what should be covered by the NHI. The institute could be modelled on the UK National Institute for Health and Clinical Excellence (NICE). This institute should also develop evidence-based clinical guidelines, contracting to medical specialty societies. A special focus should be on what evidence-based services should be provided in primary care.
- Improve patient self-management for chronic diseases, such as diabetes, though providing better access to information and the use of pay for performance in primary care.

Develop a new model of health care delivery with a stronger emphasis on primary care and prevention

- Use public investment to establish model multi-specialty group practices for primary care and use seed grants from the National Health Insurance Corporation for private practitioners to come together to form new multi-specialty primary care practices.
- Encourage a multi-specialty team approach in new primary care multi-specialty group practices. The team should include other allied health professionals like social workers and integrate mental health services including psychological services.
- Address the regulatory and financial barriers that public health centres face in contracting with private practitioners or allow private practitioners to use public clinics' facilities at low (or no) cost.

Note

1. However, at 10% the gender pay gap is considerably smaller for young adults and just slightly above the OECD average.

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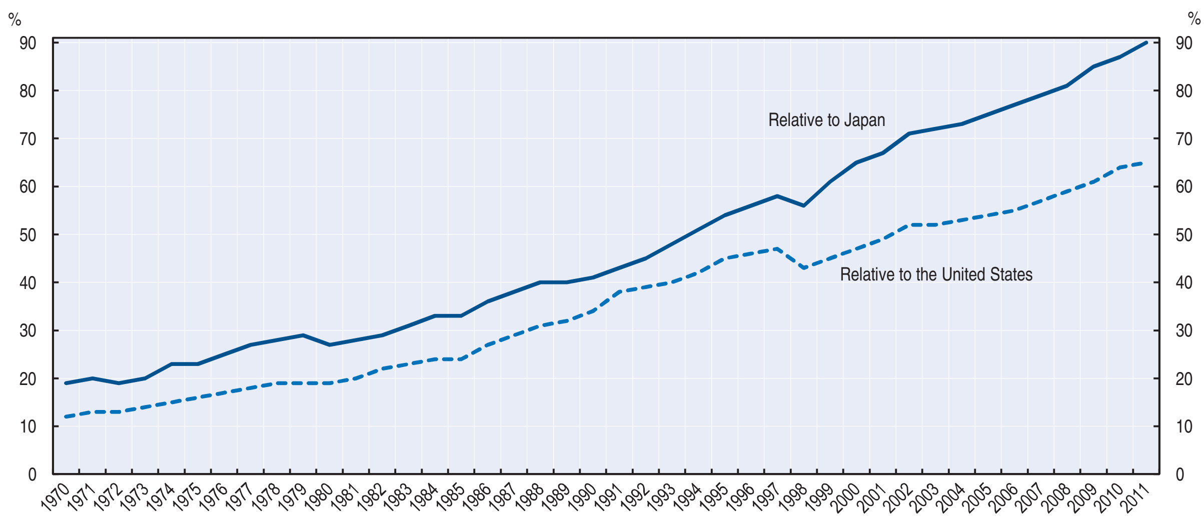
Chapter 1

Overview: Why is social cohesion an urgent issue in Korea?

This chapter examines the challenge of sustaining economic growth while encouraging social cohesion. A number of factors add to the challenge of fostering social cohesion; rapid population ageing; polarisation of the labour market between high-paid regular workers and lower-paid non-regular workers; low productivity and wages in the service sector and in small firms; and concern about the potential cost of economic rapprochement with North Korea. It is important, therefore, to advance gradually and cautiously in expanding social welfare programmes. In the face of such spending pressures, policies to sustain output growth, notably by boosting the labour force participation rate and increasing labour productivity, particularly in the service sector, are a top priority. In addition, rising public spending should be financed through tax increases designed to limit the negative impact on output growth. This suggests relying primarily on the value-added tax and environmental taxes.

Korea's economic transformation has been one of the most rapid and successful in world history. Korea overcame extreme poverty and the destruction during the Korean War to become the world's 12th largest economy in 2011 and the 6th largest exporter. Per capita income rose from 12% of the US level in 1970 to 65% in 2011 (Figure 1.1) and Korea now ranks 21st among OECD countries. The rapid economic development of Korea between the early 1960s and the 1997 Asian financial crisis was accompanied by a relatively low level of income inequality compared with other developing and emerging economies and shrinking wage dispersion. However, during the past 15 years, income inequality and relative poverty have increased significantly, as in most OECD countries, making social cohesion one of the most pressing issues in Korea today.

Figure 1.1. **Korea's per capita income is converging to the most advanced countries**[a]



a) Using 2005 purchasing power parity exchange rates.

Source: OECD (2013), *Economic Policy Reforms 2013: Going for Growth*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/growth-2013-en*.

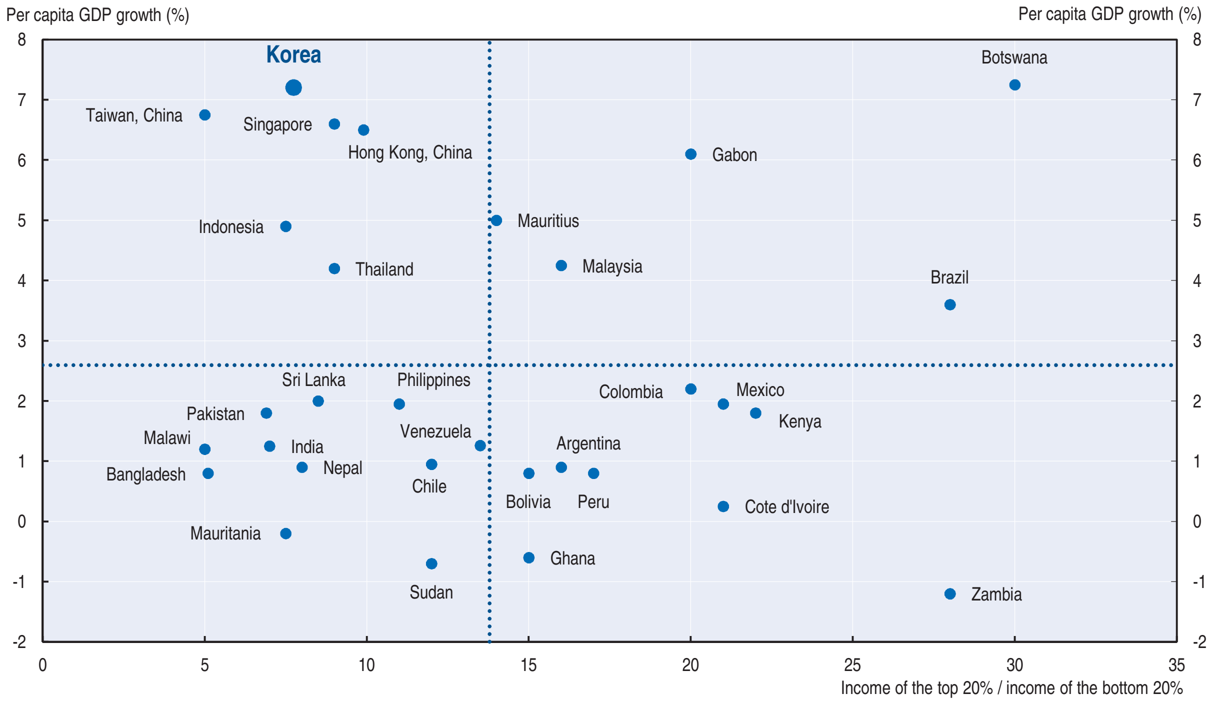
This overview chapter first discusses Korea's legacy of "egalitarian growth" and the factors that have pushed up inequality in recent years. It then outlines the main challenges to fostering social cohesion in Korea and concludes with three priorities to enable Korea to promote social cohesion.

1.1. Korea's legacy of "egalitarian growth"

During its high-growth period, Korea achieved one of fastest growth rates in the world, while its income distribution stood out as one of the most equitable among developing countries (SaKong, 1993). Over the period 1965-89, Korea's annual per capita income growth was among the highest at 7.2%, compared with an average of 2.8% for 30 developing and emerging economies, while the ratio of the income of the top 20% of the income distribution to the bottom 20% was 7.5, about one-half of the average of 14 (Figure 1.2). Indeed, wage inequality declined during the 1980s and the first half of the 1990s (Kang and Yun, 2008). The relatively equal distribution of the fruits of economic growth is illustrated by the large gains in life expectancy. Between 1960 and 2010, life expectancy rose by 28 years, the largest increase in the OECD, boosting it above the OECD average (Figure 1.3). Korea's outstanding performance was cited as support for the hypothesis of a positive relationship between growth and equity (Alesina and Rodrik, 1994).

Figure 1.2. **Output growth and income distribution in developing countries between 1965 and 1989**

Average over 1965-89

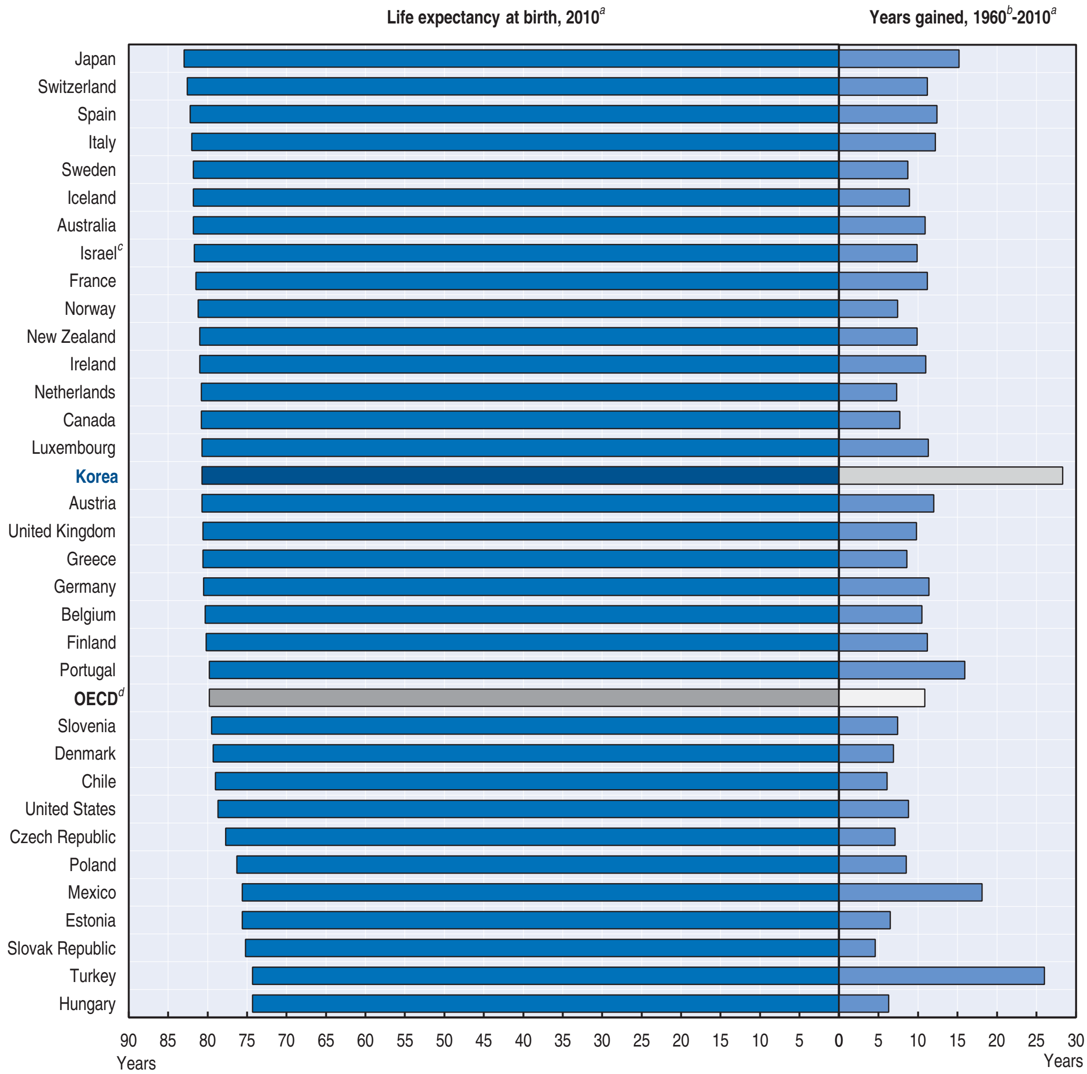


Source: World Bank (1993), *The East Asian Miracle: Economic Growth and Public Policy*, World Bank Policy Research Reports, Oxford University Press, 30 September, Washington, DC.

Shared growth was achieved, in part, thanks to the emphasis on providing universal access to primary and secondary schools, which promoted social mobility and income equality (Koh et al., 2010). In 1945, the literacy rate was 22% and less than 20% of children attended secondary school. Enrolment rates reached 90% for primary school in 1964, for middle school in 1979 and high school in 1993. Investment in education fuelled economic growth. The development of primary education following the Korean War supplied the workers for the labour-intensive industries of the 1960s. The expansion of secondary education contributed to the development of capital-intensive industries in the 1970s and 1980s. The development of tertiary education supported the development of a knowledge-based economy (OECD, 2012b).

In addition, Korea's export-led development strategy, which created job-rich growth focused on labour-intensive manufacturing, contributed to a relatively equal income distribution. The experience of Korea and some other East Asian economies contrasts with the import-substitution policies in many Latin American countries, which resulted in slower growth and higher inequality (Haggard, 1990). Korea's export-led approach provided strong incentives to employ unskilled or semi-skilled labour. At the end of the Korean War, the primary sector (agriculture, forestry and fishing) accounted for almost half of output and 70% of employment. By the mid-1990s, its share had fallen to 6% and 12%, respectively. Rapid employment growth reduced the unemployment rate from 8% in the early 1960s to 3% in the mid-1990s, while the employment rate rose from 50% to 60% of the working-age population.

Figure 1.3. **Life expectancy at birth, 2010 and the increase since 1960**



a) Or latest year available; 2008 for Canada; 2009 for Italy; and 2011 for France, Iceland, Mexico and Sweden.
b) Or first year available; 1961 for Greece, Italy and New Zealand; 1962 for Estonia; 1971 for Canada and Israel; and 1990 for Chile.
c) Information on data for Israel is available at: *http://dx.doi.org/10.1787/888932315602*.
d) Unweighted average of the 34 OECD countries whose data are shown on the chart above.

Source: OECD Health Database 2012.

Korea was able to achieve a relatively equal income distribution despite the weak impact of the social welfare system, as the government focused primarily on economic growth. Nevertheless, Korea started to develop basic social insurance programmes even while its income level was relatively low (Table 1.1). In the 1960s and 1970s, the government introduced pensions for government employees (1960), military personnel (1963) and teachers (1975), health insurance for private-sector workers in large firms (1977) and government employees and teachers (1979). In 1980, the new government made the establishment of a welfare society an objective. The coverage of health insurance was gradually expanded until it became universal in 1989 and all health insurance societies were integrated into the National Health Insurance in 1999. The

National Pension Scheme was launched in 1988 and gradually extended to all workers by 1999. In 1995, the Employment Insurance System was established and expanded to all firms three years later following the financial crisis. The last major social insurance system, Long-term Care Insurance, was created in 2008, making Korea one of only five OECD countries with such a system.

Table 1.1. **Development of the social security system**

	Social insurance	Public assistance
1960s	• Government Employees Pension (1960) • Military Personnel Pension (1963) • Industrial Accident Compensation Insurance (IACI, 1964)	• Livelihood Protection Act (1961)
1970s	• Teachers Pension (1975) • Health Insurance for Workers (1977) • Health Insurance for Government Employees and Teachers (1979)	• Health Care Protection Act (1977)
1980s	• Health Insurance for the Self-Employed (1982) • National Pension Scheme (NPS, 1988) • Universal Health Insurance (1989)	
1990s	• Employment Insurance System (EIS, 1995) • EIS extended to all types of enterprises (1998) • NPS extended to all types of workers (1999) • Integration of all health insurance societies into the National Health Insurance (1999)	
2000s	• IACI extended to all enterprises (2001) • Long-term Care Insurance (2008)	• National Basic Livelihood Security Programme (2000) • Emergency Relief Programme (2006) • Earned Income Tax Credit (2008) • Basic Old-age Pension (2008)

Source: Koh, Y., S. Kim, C. Kim, Y. Lee, J. Kim, S. Lee and Y. Kim (2010), "Social Policy", in I. SaKong and Y. Koh (eds.), *The Korean Economy: Six Decades of Growth and Development*, Korea Development Institute, Seoul.

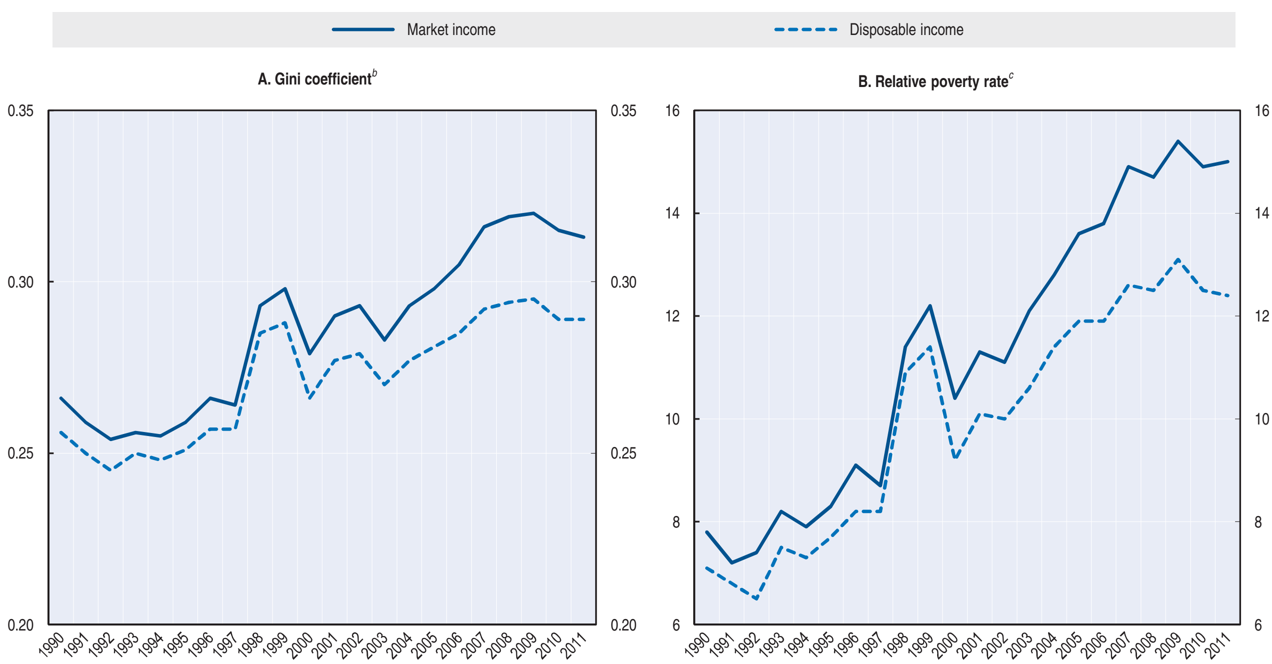
At the same time, the government introduced public assistance for low-income households, beginning with the Livelihood Protection Act (1961) and the Health Care Protection Act (1977). Following the sharp rise in unemployment during the 1997 crisis, the Livelihood Protection system was changed into the Basic Livelihood Protection System in 2000. In 2008, the Earned Income Tax Credit (EITC) was introduced on a limited scale and expanded to include childless couples and some self-employed in 2012. Finally, the Basic Old-Age Pension was established in 2008 to provide income to the elderly in the lower 70% of the income distribution.

1.2. Factors increasing inequality in Korea in recent years

Most OECD countries have experienced a marked increase in income inequality and relative poverty during the past few decades (OECD, 2011a). Korea has not been able to avoid this trend despite starting from a relatively equal income distribution and the creation of social welfare programmes. Income inequality, as measured by the Gini coefficient, trended upward from the mid-1990s until 2009 (Figure 1.4), when it reached the OECD average. Meanwhile, relative poverty – the share of the population living on less than half of the median income – rose to 15% in 2008, the eighth highest in the OECD area.

There has been considerable debate on the factors responsible for rising inequality, focusing on the roles of technological progress and globalisation. First, technological progress has tended to favour skilled labour. Korea, the OECD country with the largest increase in wage dispersion, has also experienced particularly rapid technological progress, as measured by R&D spending in the business sector. However, the link between technological progress and wage dispersion in the OECD area has been found to be weak (OECD, 2011a). Second, rapid trade and financial integration, particularly with developing countries, may have generated a relative shift in labour demand in favour of highly skilled workers. In Korea, though, the degree of wage inequality is very similar in the tradable and non-tradable industries and they have followed similar patterns in recent years (An and Bosworth, 2011). Third, changes in household structure – notably the increase in single-headed households – have increased inequality, although it was much less important than the impact of changes occurring in the labour market (OECD, 2011a). While these factors have played a role in Korea, other factors – labour market dualism, disappointing productivity trends in services and the ineffectiveness of the tax/benefit system in improving equity – have each contributed to increased inequality.

Figure 1.4. **Income inequality and poverty has been increasing in Korea**[a]



a) For urban households with at least two persons.
b) The Gini coefficient can range from 0 (perfect equality) to 1 (perfect inequality).
c) Relative poverty is defined as the share of the population that lives on less than half of the median income.

Source: Statistics Korea.

Labour market dualism

The single most important driver of rising income inequality in the OECD area has been greater inequality in wages and salaries (OECD, 2011a) and Korea is no exception. The polarisation of Korea's labour market between regular and non-regular workers has been an important factor increasing inequality. Non-regular workers account for about one-third of wage earners (Table 1.2). Firms hire non-regular workers – a category that includes those on fixed-term contracts, part-time workers and temporary agency workers – to reduce labour costs. Indeed, non-regular workers earned only 65% per hour as much as regular workers in 2011 (Panel B). Moreover, non-regular contracts allow firms increased employment flexibility, given the difficulty and costs of laying off regular workers.

The gap in labour costs is further widened by the weaker coverage of non-regular workers by the social insurance system. In 2012, less than one-half of non-regular workers were covered by the NPS, NHI and the EIS. The limited coverage by the EIS undermines the effectiveness of the unemployment benefit system, and indeed, only about one-third of the unemployed receive benefits. In sum, labour market dualism creates serious equity problems as a significant portion of the labour force works in precarious jobs at relatively low wages and with less protection from social insurance.

Table 1.2. **Non-regular employment is characterised by a substantial pay penalty**

Panel A. Employed persons by status[a] in 2011

Wage workers	Non-regular workers		*Of which*[b]: Temporary workers, with: Fixed-term contract	Temporary workers, with: Open-ended contract, expect job to continue[c]	Temporary workers, with: Open-ended contract, but could be dismissed[d]	Part-time workers	Atypical workers: Dispatched	Atypical workers: Daily	Atypical workers: Others[e]
17 510	5 995	*34.2*	*44.5*	*5.7*	*7.3*	*28.4*	*3.3*	*16.0*	*22.7*

Panel B. Hourly wages of non-regular workers relative to regular workers in 2011
Index "Regular worker" = 100

Regular workers	Non-regular workers	*Of which*: Temporary workers, with: Fixed-term contract	Temporary workers, with: Open-ended contract, expect job to continue[c]	Temporary workers, with: Open-ended contract, but could be dismissed[d]	Part-time workers	Atypical workers: Dispatched	Atypical workers: Daily	Atypical workers: Others[e]
100.0	65.3	69.0	93.7	52.4	59.3	66.5	47.4	63.7

a) Thousands of workers and percentages (shown in italics).
b) The sum of the categories of non-regular workers exceeds 100% due to double-counting.
c) Workers' whose term is not fixed and can be renewed regularly.
d) An employee could be dismissed, for example, due to seasonal factors, completion of a project or the return of an employee that they were replacing.
e) "Others" corresponds to three types of atypical employment: independent contractors, daily/on-call workers and in-house workers. The hourly wage index for "Others" in Panel B is an employment-weighted average for these three employment types.

Source: Statistics Korea, Economically Active Population Survey (EAPS), Supplementary results of the EAPS by employment type (August) for Panel A; and Korea Labor Institute (2011), "2011 KLI Labor Statistics of NRWs" for relative earnings and OECD calculations based on the MOEL Survey on Labor Conditions by Type of Employment for Panel B.

Firms' need for employment flexibility stems from the costs of laying off regular workers due to employment protection and the power of trade unions. The legal conditions attached to dismissals for "managerial reasons" – notably that firms must exhaust "all means" to avoid dismissals, discuss proposed dismissals for at least 50 days with workers and notify the government – are highly constraining. Some firms therefore rely instead on more expensive methods to reduce the number of regular employees, such as early retirement packages, and have expanded employment of workers on short-term contracts. OECD studies show that countries with stricter protection for regular workers have a higher incidence of temporary employment (Grubb et al., 2007).

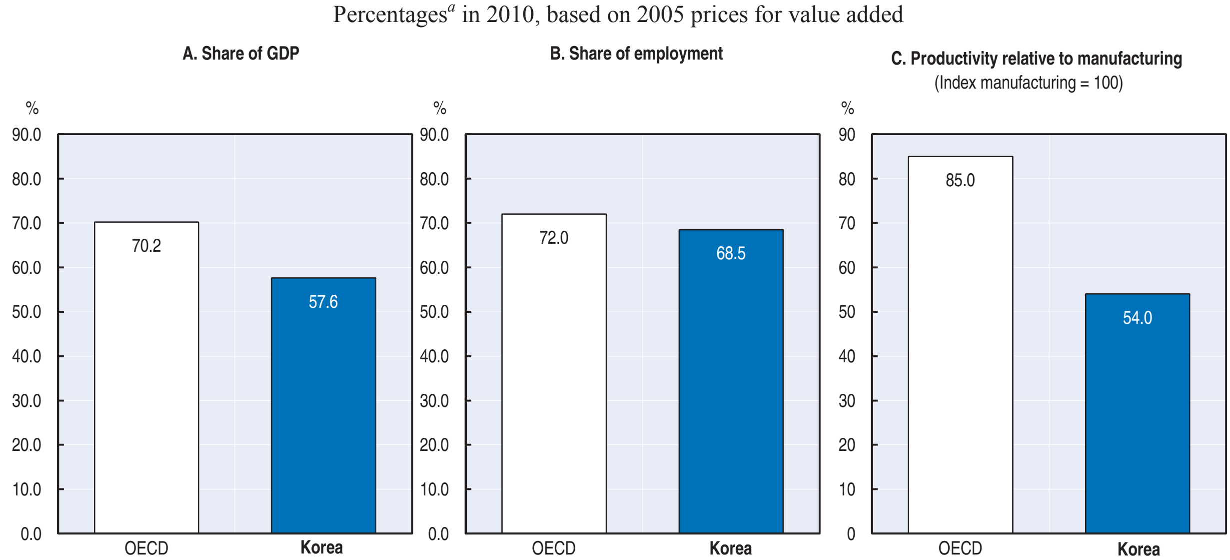
Labour market dualism also hinders productivity growth. The largest component of non-regular employment is temporary workers, who accounted for 24% of dependent employment in Korea in 2011, the fourth highest in the OECD area and double the average. The high share of temporary workers is associated with higher worker turnover, without necessarily promoting a better allocation of labour to its most productive uses. Moreover, it discourages firm-based training. Only about a quarter of firms provide systematic on-the-job training to non-regular workers, less than half the proportion for regular workers. The lack of firm-based training is compounded by low public spending on training for the unemployed, which is one of the lowest in the OECD area at 0.07% of GDP in 2009.

Low productivity in the service sector and small firms

Labour productivity growth in the service sector has consistently lagged behind that in manufacturing, slowing from an annual rate of 2.6% during the 1980s to 1.2% between 1997 and 2007, in contrast to nearly 9% growth in manufacturing (OECD, 2012b). Consequently, in 2010, service sector productivity was only about half of that in manufacturing, the largest gap in the OECD area and well below the OECD average of 85% (Figure 1.5). To some extent, low service-sector productivity is the legacy of an export-led growth strategy that attracted the most productive resources into manufacturing, which enjoyed a number of advantages, including tax breaks, government R&D support and lower electricity prices. In addition, "overly strict regulations are obstructing investment and competition" (MOSF, 2009). Although the strictness of regulations in network sectors has fallen, it remains well above the OECD average (OECD, 2012a). Weak competition is partly due to the low level of foreign direct investment (FDI) in Korea. Indeed, the stock of inward FDI in services in 2010 was only 6% of GDP compared with an OECD average of 37%.

Figure 1.5. **Korea's service sector is relatively small and has low productivity**

Percentages[a] in 2010, based on 2005 prices for value added



a) Unweighted averages for OECD of the 34 member countries with the following exceptions: for *Panel A*, Australia, Canada, Chile, Iceland, Japan, Mexico, Turkey and the United States; for *Panel B*, Canada, Iceland and Turkey; and for *Panel C*, Australia, Canada, Chile, Estonia, Greece, Iceland, Ireland, Israel, Japan, Luxembourg, Mexico, New Zealand, Portugal, Poland, the Slovak Republic, Spain, Switzerland, Turkey and the United Kingdom.

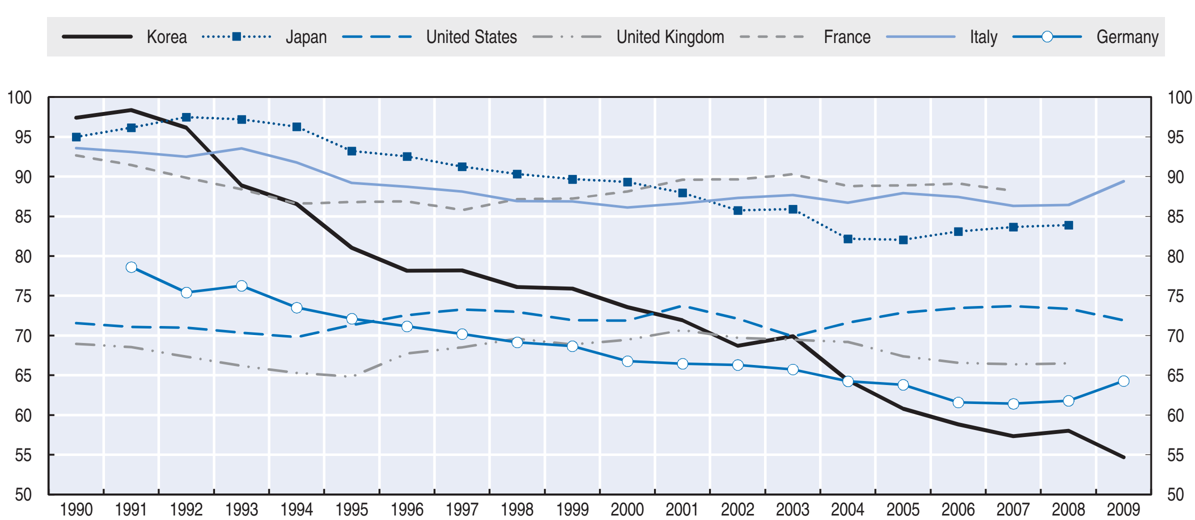
Source: OECD National Accounts Database: Quarterly National Accounts for Panel A and System of National Accounts for Panel B; *OECD STAN Indicators Database* for Panel C.

Low productivity in the service sector translates into lower wages. Indeed, the ratio of wages in services to those in manufacturing has fallen from nearly 100% in 1991 to only 54% in 2009, a larger gap than in the major OECD countries (Figure 1.6). Narrowing the productivity difference – by levelling the playing field, boosting competition and facilitating inflows of FDI – would also reduce the wage gap. The problems in services are closely linked to those of small- and medium-sized enterprises (SMEs), which account for about 90% of service-sector employment. The wages in firms with 30-99 employees have fallen from nearly 100% of those in firms with more than 300 employees in 1980 to only 65% in 2010 (OECD, 2012b), despite considerable government assistance for small firms. Indeed, the SME sector was essentially bailed out during the 1997 crisis through increased public subsidies and guarantees (Claessens and Kang, 2008). Moreover, following the 2008 crisis, small firms were supported by sharply raising guarantees by public financial institutions for lending to SMEs, advising banks to automatically roll over loans to SMEs and doubling government spending to assist SMEs.

The service sector has, to some degree, played the role of a safety net. The average mandatory retirement age set by Korean firms is 57 and many workers leave firms prior to that age. This is the result of the steep wage-seniority profile that prompts firms to force workers to retire before the mandatory age. Moreover, older workers tend to lack the skills needed in an increasingly knowledge-based economy, reflecting their low educational attainment relative to younger workers. A significant share of departing employees, many of whom receive only a lump-sum retirement payment, given that most do not qualify for the NPS or the company pension system established in 2008, end up as self-employed workers in the service sector. Reforms to boost competition and productivity in services would lower employment and boost productivity and output growth, thus reducing its role as a safety net. Developing a better safety net would thus be an important complement of competition-enhancing reforms in the service sector and actually facilitate them.

Figure 1.6. **Wages in the service sector as a share of wages in manufacturing**[a]

Index manufacturing = 100



a) Compensation per employed person in the service sector as a share of compensation per employed person in manufacturing, in percentages.

Source: OECD STAN Indicators Database.

The limited effect of the tax/benefit system on income inequality and poverty

Public social spending in Korea increased at a 12% annual rate in real terms between 1990 and 2007 – the fastest in the OECD area – boosting its share of GDP from 2.8% to 7.6%. However, the upward trend in social welfare spending has not prevented a deterioration in income distribution. Public social spending increased in the wake of the 2008 global financial crisis, as in other OECD countries (OECD, 2012c). Even in 2009, though, it was still the second lowest at 9.6% of GDP, well below the OECD average of 22%. As a result, government transfers accounted for only 2.7% of disposable income in Korea, the second lowest in the OECD area and well below the average of 12.3%, after accounting for taxes (OECD, 2011a).

Public social spending in Korea in 2009 was lower than the OECD average in each of the major areas (Figure 1.7):

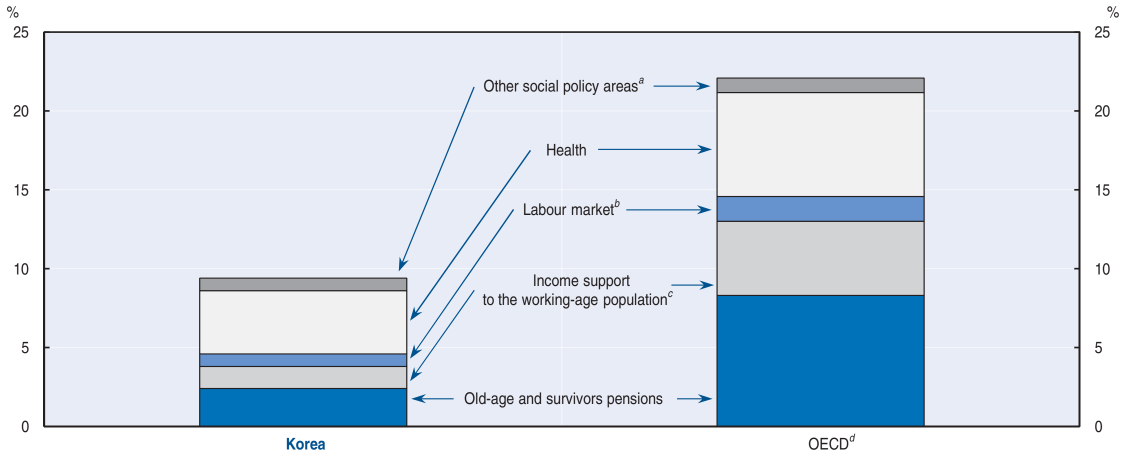
- *Pensions:* Korea's spending of 2.1% of GDP was well below the OECD average of 7.3% due to the relatively recent introduction of the NPS, gaps in its coverage and Korea's still relatively young population.
- *Income support to the working-age population:* Korea's outlays of 1.4% of GDP are far below the OECD average of 4.7%, reflecting the fact that support for families, such as child benefits and child care support, amounted to only 0.8% of GDP, the lowest in the OECD and well below the OECD average of 2.3%.
- *Health care:* Korea's low share of 4.0% of GDP reflects its relatively young population, the limited coverage of the NHI and high co-payment rates.

In addition to the relatively young population, the lower level of social spending also reflects Korea's low unemployment rate and low level of per capita income. According to one study, after taking account of these factors, the gap in social spending between Korea and the OECD average narrows from 11.7 percentage points to 3.4 (Elekdag, 2012).

Besides its low levels, social spending is not well targeted, as only a quarter of total cash benefits from the government go to the poorest 20% of the population. The problem of poor targeting is partly due to blind spots in coverage, particularly among the self-employed and non-regular workers. Meanwhile, the tax burden in Korea is low – 25% of GDP compared to an OECD average of 34% in 2010 – and has little impact on income distribution because Korea is one of only a few countries that combines a relatively low tax burden with very little progressivity (Joumard et al., 2012). Consequently, only Chile and Mexico achieve less income redistribution than Korea through their tax and benefit systems. Moreover, it achieved the smallest reduction in the relative poverty rate among the working-age population in the OECD area, reducing it by just 1.2 percentage point relative to market incomes (from 13.4% to 12.2%). In contrast, the average relative poverty rate in the OECD area is halved from 20% to 10% after taking account of the tax and benefit systems.

Figure 1.7. **The composition of public social spending in Korea compared with the OECD**

Percentage of GDP in 2009



a) Includes also spending referring to "Housing".
b) Includes spending referring to "Active labour market programmes" and "Unemployment".
c) Includes spending referring to "Incapacity related" and "Family".
d) Weighted average of the 34 OECD countries.

Source: OECD Social Expenditure Database (*www.oecd.org/els/social/expenditure*).

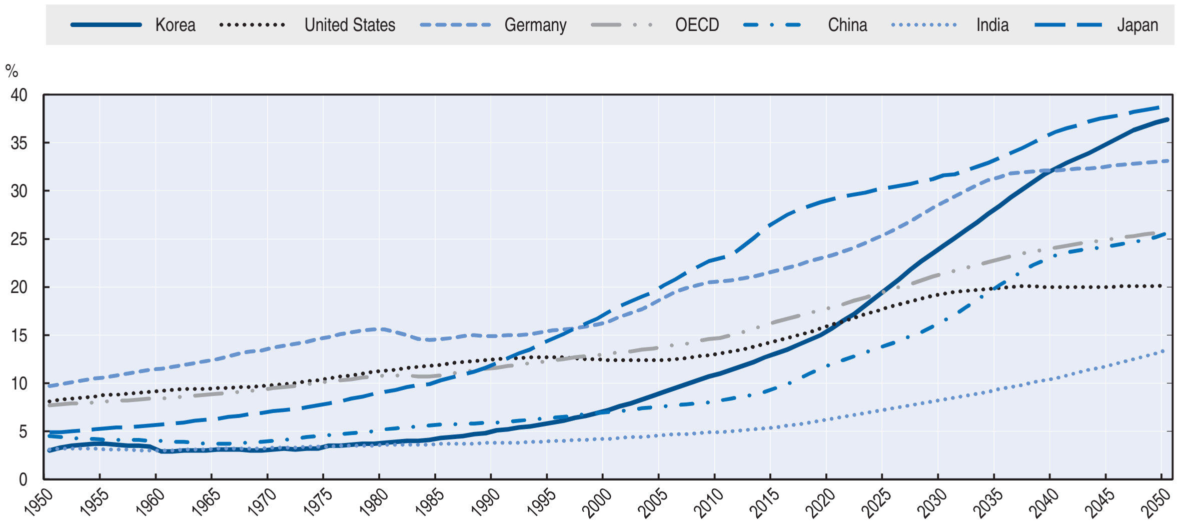
1.3. Challenges to achieving social cohesion

Population ageing in Korea, which is projected to be the most rapid in the OECD area, will make it even harder to tackle rapidly growing income inequality and poverty. The rising share of elderly in the population will drive up spending on health and long-term care, imposing a significant burden on the working-age population. In addition, Korea faces the potential cost of economic rapprochement with North Korea.

Rapid population ageing and its impact on public social spending

In 2010, the population aged 65 and over accounted for 11% of Korea's population (Figure 1.8), the fifth lowest in the OECD area. However, by 2050, the share is projected to rise to 37%, the second highest among OECD countries. Meanwhile, the share of those aged 85 and over – the age group most in need of health and long-term care – is expected to rise from 1.9% to 14.5% of the Korean population. Korea will thus experience the most rapid population ageing among OECD countries over the next 40 years, reflecting two factors. First, the fertility rate plummeted from 4.5 in 1970 to below replacement at 1.6 in 1985, reflecting government policies to reduce the birth rate. At the end of the 1990s, the rate fell further to around 1.2, one of the lowest in the world, where it has remained despite government initiatives to increase the fertility rate towards the replacement level. Second, average life expectancy has increased substantially, as noted above (Figure 1.3). One option to ease the demographic burden would be immigration, although inflows have thus far been tightly restricted. Indeed, the government reported that there were 0.7 million foreign workers in Korea in 2011, accounting for less than 3% of the labour force, well below the OECD average of 10% (OECD, 2007).

Figure 1.8. **International comparison of the share of the elderly (65 and over) in the total population**



Source: OECD Demography and Population Database.

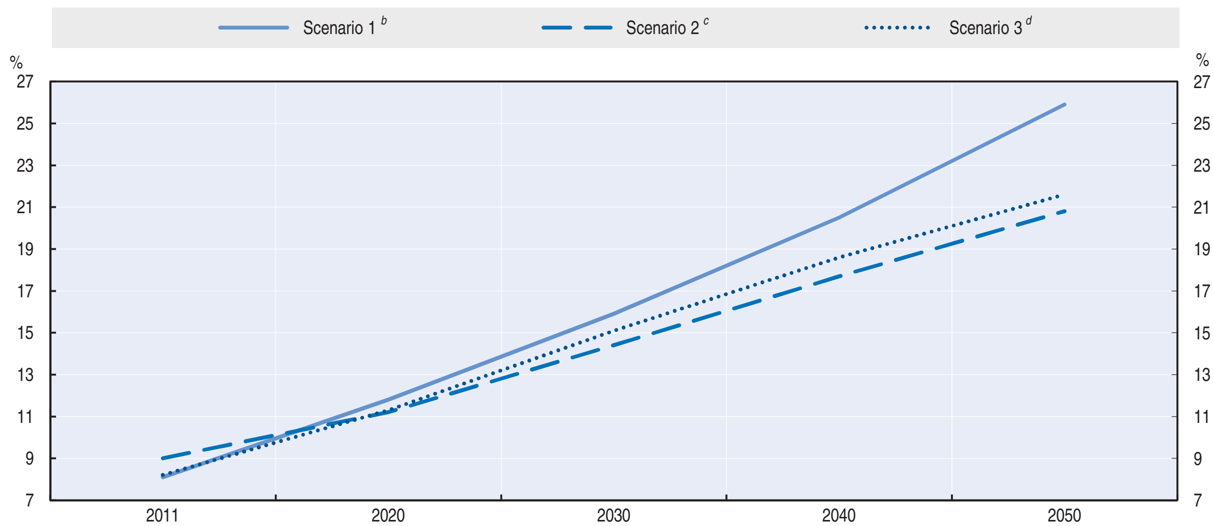
Rapid population ageing will put strong upward pressure on social spending. In addition to pensions, health outlays per capita for persons aged 65 and over are about four times higher in Korea than for those under that age (OECD, 2010). Population ageing will thus tend to accelerate health spending, which rose at an annual rate of more than 9% in real terms during the decade 1997-2007. Such rapid increases are not sustainable in an economy where potential growth has slowed to around 3.5% and is likely to fall below 2% by the 2030s. At such rates, health care would crowd out other government spending, including that needed to address income inequality and poverty. A recent study estimated that total public spending on long-term care in Korea, which was 0.4% of GDP in 2011, may rise to around 2% by 2050 (Kwon et al., 2011).

According to estimates by government-funded research institutes, total public social spending will reach the OECD average of around 22% of GDP by 2050, under Korea's current framework (Figure 1.9). These studies estimate the impact of the changing population structure on social spending by central and local governments, as well as social insurance programmes. The baseline scenario by the Korea Institute for Health and Social Affairs (KIHASA) (Won et al., 2011) projects that public social spending will reach 21.6% of GDP, assuming that real GDP growth slows from an annual rate of 4.1% in the current decade to 1.2% in the 2040s. If output grows at the slower pace assumed by the Korea Institute of Public Finance (KIPF) (Park and Chun, 2009), the share of social spending would reach nearly 26% of GDP. The baseline estimate by the KIPF also exceeds 20% of GDP.

The largest increases in social spending will be related to ageing, according to the study by KIHASA. Indeed, outlays by the National Pension Scheme (NPS) are projected to rise at double-digit rate through 2050, boosting its share of GDP from 0.6% in 2011 to 4.7% in 2050 (Figure 1.10). The rapid increase reflects the maturing of the NPS, which was only introduced in 1988. Similarly, National Health Insurance and Long-term Care Insurance, which also depend significantly on ageing, are expected to increase as a share of GDP. In contrast, the Employment Insurance System and Industrial Accident Insurance are expected to remain stable as a share of GDP.

Figure 1.9. **Long-term projections of public social expenditure**[a]

Percentage of GDP

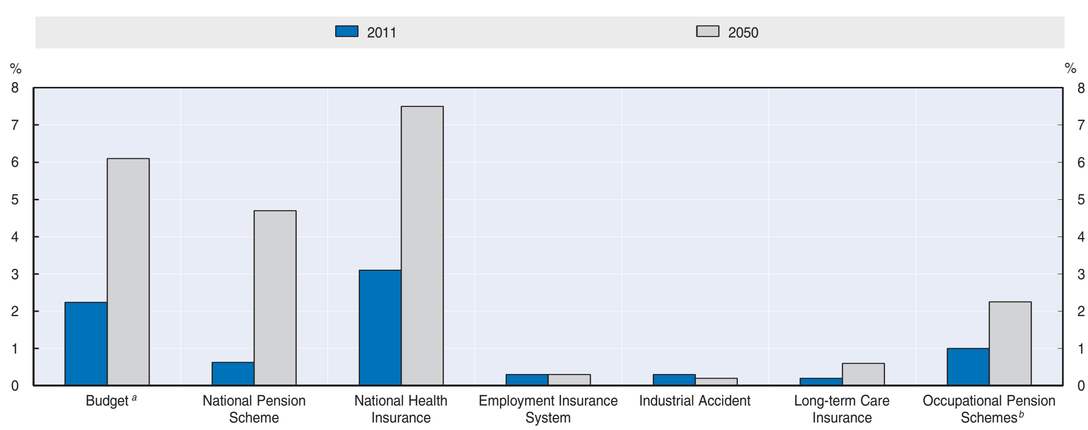


a) Includes public social expenditures by the government and the social insurance systems, using a population cohort approach.
b) Baseline estimate by Korea Institute for Health and Social Affairs (KIHASA), using the growth assumption by Korea Institute of Public Finance (KIPF).
c) Baseline estimate by KIHASA using their own growth assumption.
d) Baseline estimate by KIPF.

Source: Won, C., H. Shin, M. Yoon, M. Kim, J. Kang and K. Nam (2011), *Long-term Projections of Social Expenditure* (in Korean), Korea Institute of Health and Social Affairs, Seoul; and Park, H. and B. Chun (2009), *An Analysis of Social Spending for Research into the Development of a Medium to Long-term Spending Estimation Model* (in Korean), Korea Institute of Public Finance.

Figure 1.10. **Projection of social expenditure by category**

Percentage of GDP



a) Social spending by central and local governments.
b) Includes pensions for civil servants, private-school teachers and the military.

Source: Won, C., H. Shin, M. Yoon, M. Kim, J. Kang and K. Nam (2011), *Long-term Projections of Social Expenditure* (in Korean), Korea Institute of Health and Social Affairs, Seoul.

The question of North Korea

In 2010, the South Korean economy was 39.1 times larger than the North's and its per capita income was 20 times higher (Table 1.3). Following a 3.1% increase in 2008, North Korea's GDP fell by 0.9% and 0.5%, respectively, in 2009 and 2010. Although North Korea's total trade increased by 20% in 2010 to USD 6.1 billion, it amounted to only 0.7% of South Korea's international trade. South Korea accounted for 41% of the North's exports, second only to China, even though inter-Korea trade has stagnated since 2008. The widening gap will compound the eventual cost of economic integration, which may impose a large burden on the South (Choi et al., 2011).

Table 1.3. **Comparison of North and South Korea in 2010**

	North Korea (A)	South Korea (B)	Ratio (B/A)
Population (millions)	24.2	48.9	2.0
GNI (KRW trillion)	30.0	1 173.1	39.1
GNI per capita (KRW million)	1.2	24.0	20.0
Total trade (USD billion)	6.1	891.6	146.2
Exports	2.6	466.4	179.4
Imports	3.5	425.2	121.5
Of which: inter-Korean exports[a]	1.0	0.9	0.9
Industrial statistics (2009)			
Power generation (billion kWh)	23.5	433.6	18.6
Steel production (million tonnes)	1.3	48.6	37.4
Cement production (million tonnes)	6.1	50.1	8.2
Agricultural production (2009)			
Rice (million tonnes)	1.9	4.9	2.6
Fertiliser (million tonnes)	0.5	2.6	5.2

a) North Korean exports to the South in Panel A, and South Korean exports to the North in Panel B. The latter includes USD 23 million of non-commercial exports, primarily humanitarian aid in the form of commodities such as rice and fertiliser. Such aid peaked in 2006 at USD 421 million.

Source: Statistics Korea.

1.4. Coping with these challenges

To cope with these challenges, Korea needs to:

- Advance gradually and cautiously in expanding social welfare programmes.
- Promote economic growth.
- Finance rising social spending through tax measures that limit the impact on growth.

Advance gradually and cautiously in expanding social welfare programmes

As noted above, public social spending in Korea is projected to reach the current OECD average of 22% by 2050, under the current framework. As a result, additions and expansions of social welfare programmes would boost public social spending in Korea above the OECD average. High levels of spending create concern, particularly in light of the potentially large cost of economic rapprochement with North Korea. Korea does start from a sound position, reflecting a legacy of cautious fiscal policy that has limited gross public debt to around 35% of GDP, well below the current OECD average of about 100%. Maintaining a low debt ratio is a priority in light of the problems experienced in some high-indebted countries in the euro area and Japan. Given the fiscal constraints, Korea needs to scale back or eliminate programmes that prove to be ineffective or unnecessary, while expanding social spending prudently, particularly in the areas identified in this report; *i)* social welfare policies to reduce income inequality and poverty among the working-age population; *ii)* policies to tackle labour market duality in Korea; *iii)* early childhood education and care to promote social cohesion; and *iv)* moving beyond hospitals to better care in the community.

Promote economic growth

The top priority for social cohesion in Korea is to sustain output growth and the creation of well-paying jobs. Over the past decade, Korea has been among the top economic performers in the OECD, with output growth of 4.1% per year on average, more than double the OECD average of 1.7%. Moreover, with employment increasing at an annual rate of 1.2% since 2001, Korea has kept its unemployment rate at an average of 3.5% over the past decade. Going forward, the priority is thus to promote growth through a range of policies.

Making the service sector, where productivity is only about half of that in manufacturing (Figure 1.5), a second driver of growth is key to continuing Korea's convergence to the highest-income countries. The first priority is to level the playing field, preferably by reducing the gaps in regulation and benefits between manufacturing and services. To that end, a comprehensive quantification of the various forms of explicit and implicit support to manufacturing would be helpful. A second priority is to foster stronger competition by eliminating domestic entry barriers, accelerating regulatory reform and upgrading competition policy. Strengthening links to the world economy would also boost productivity in services. Korea's integration in the world economy is still very low in terms of import penetration in services, the share of foreign workers and the stock of inward FDI. To encourage FDI, Korea should further relax FDI restrictions, including foreign ownership ceilings in key services, and liberalise product market regulations. In addition, it is important to remove any obstacles to cross-border M&As and foster a foreign investment-friendly environment by enhancing the transparency of tax and regulatory policies and reforming the labour market.

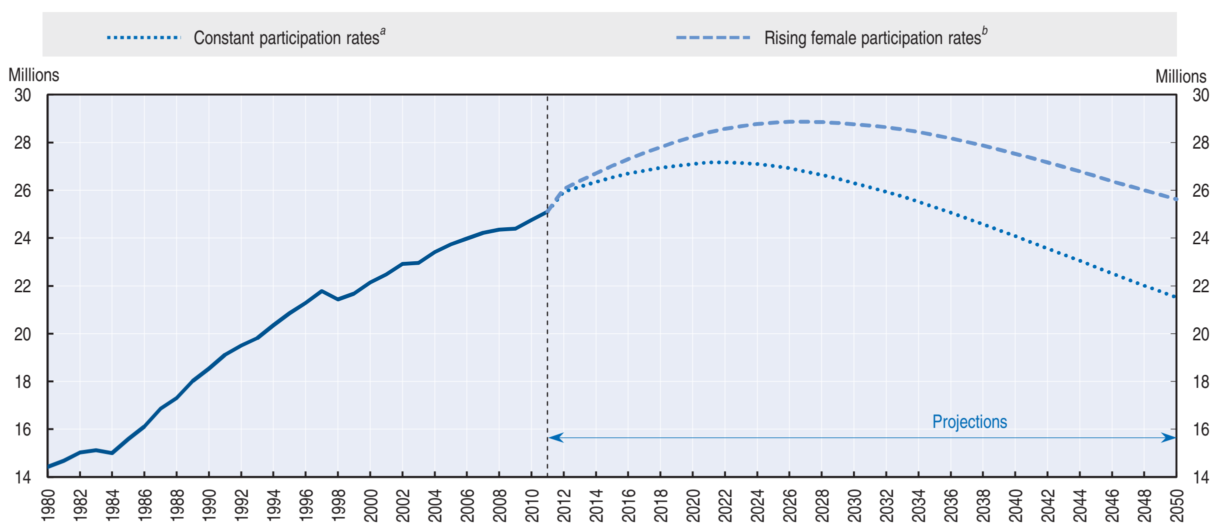
Problems in services are linked to those of SMEs, which account for about 90% of service-sector employment. It is essential to continue to streamline such support to promote the restructuring of SMEs and to remove the obstacles inhibiting their expansion. Supporting non-viable firms should be avoided as it will act as a drag on Korea's growth potential.

The development of human resources through tertiary education needs to be exploited fully to meet demographic and competitive pressures. The rapid quantitative expansion of Korea's university sector has inevitably led to some deterioration in its quality. It is important to strengthen competition by enhancing transparency about outcomes to boost quality. Moreover, Korea has few foreign tertiary institutions and foreign students account for only 2% of tertiary students in Korea. Reforms to attract foreign institutions and students to Korea would increase the quality of its tertiary education. The tertiary sector could also make a larger contribution to innovation. Korean universities accounted for only 1% of R&D funding and performed 11% of R&D in 2008, the second lowest share in the OECD, despite the fact that they account for three-quarters of PhDs.

Increasing the effectiveness of R&D requires expanding the interaction between researchers in business, government and universities. Finally, as noted in this study, investment in ECEC offers a high return by boosting the later achievement of children.

It is also important to boost labour force participation rates to mitigate the impact of rapid population ageing on the labour force. If participation rates were to remain at their current levels for each age group, the labour force would peak at 27.2 million in 2022 and then fall by 21%, to around 21.5 million, by mid-century (Figure 1.11). By that point, there would be only 1.2 persons in the labour force per elderly person, compared with 4.5 in 2010, imposing a heavy burden on workers to finance social spending. The impact could be partially mitigated by increasing the female labour force participation rate. If the female participation rate were to converge to the current level for males for each age group by 2050, the labour force would only decline to around 25.6 million, 19% higher than in the case of unchanged participation rates, resulting in a ratio of 1.4 workers per elderly person.

Figure 1.11. **Long-term projections of the labour force**



a) The participation rates for men and women are assumed to remain at their current levels for each age group.
b) Female participation rates are assumed to reach current male rates in each age group by 2050.

Source: OECD (2012), *OECD Economic Surveys: Korea 2012*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/eco_surveys-kor-2012-en*.

Raising the female participation rate requires a comprehensive approach. First, the gender wage gap, the highest in the OECD area, should be narrowed by reducing the high share of non-regular employment and making greater use of performance-based pay. Second, the availability of affordable, high-quality child care should be increased. Third, maternity leave should be lengthened from 90 days and the take-up of maternity and parental leave increased. Fourth, expanded flexibility in working time would make it easier to combine paid employment with family responsibilities, given that total working hours in Korea are the longest in the OECD area. Fifth, breaking down labour market dualism, which limits the effective contribution of non-regular workers to economic growth and their ability to accumulate much-needed human capital, would also boost female participation by making employment more attractive. It would also increase the participation rate for young people in Korea, which is one of the lowest in the OECD area. Although this also reflects the large share in tertiary education, it is also a result of the mismatch between the skills taught in school and those demanded by firms.

It is also important to make better use of older workers. Establishing a minimum age at which firms can set mandatory retirement and then gradually raising it would put pressure on firms to adjust wages in line with productivity as workers grow older. The ultimate goal should be to abolish firms' right to set a mandatory retirement age, as has been done in some other OECD countries. In addition, the retirement allowance required by firms, which also promotes the early departure of employees, should be replaced by the company pension system.

Growth prospects depend as well on the success of the Green Growth Strategy in transforming Korea's energy-intensive economy and implementing the "Low Carbon, Green Growth" vision. The priority is to promptly introduce a price on carbon, primarily through an emissions trading scheme, supplemented by a carbon tax on small emitters. This would encourage green innovation and help achieve Korea's 2020 objective of reducing its greenhouse gas emissions by 30%, relative to a business-as-usual baseline, in a cost-effective manner. The decision to launch an emissions trading scheme from 2015 is an important step in this direction.

Some of these policies to maintain economic growth would also promote social cohesion. For example, higher productivity in the service sector would narrow wage gaps, while greater public investment in education would reduce the impact of socio-economic factors on student outcomes. Moreover, breaking down labour market dualism would also help reduce wage inequality.

Finance rising social spending through tax measures that limit the impact on growth

A projected increase in public social spending from around 9% of GDP to 22% by 2050 under current policies – and even more if current programmes are expanded and new ones added – implies the need for a sharp increase in government revenue. Consequently, Korea's low tax burden – at 25.1% of GDP in 2010 (Table 1.4) – will need to rise to finance such spending. Direct taxes on households are particularly low in Korea, as only 60% of workers pay personal income tax due to generous deductions and exemptions, aimed in part at creating a level playing field with the self-employed. Social security contributions are also far below the OECD average, reflecting relatively low contribution rates and weak compliance with the social insurance schemes.

The overall "tax wedge" on labour, including income tax and social security contributions, was only 20% in 2010, the fourth lowest in the OECD area (Figure 1.12). Low taxes on labour contribute to high labour inputs in Korea, which are 37% higher relative to the population than the United States, offsetting much of the productivity gap. Cross-country studies by the OECD demonstrate that taxes on labour – in the presence of a binding minimum wage – reduce employment, saving and capital investment, thereby lowering potential growth. On the other hand, a low tax burden promotes jobs and growth by enhancing incentives for FDI inflows, education and entrepreneurship. Low corporate income tax rates are also beneficial for growth (OECD, 2008). However, during the decade 2000-10, the share in GDP of income taxes on households and firms and social security contributions increased, while that of indirect taxes declined slightly in Korea.

Table 1.4. **The tax mix in OECD countries**

Tax revenue, percentage of GDP

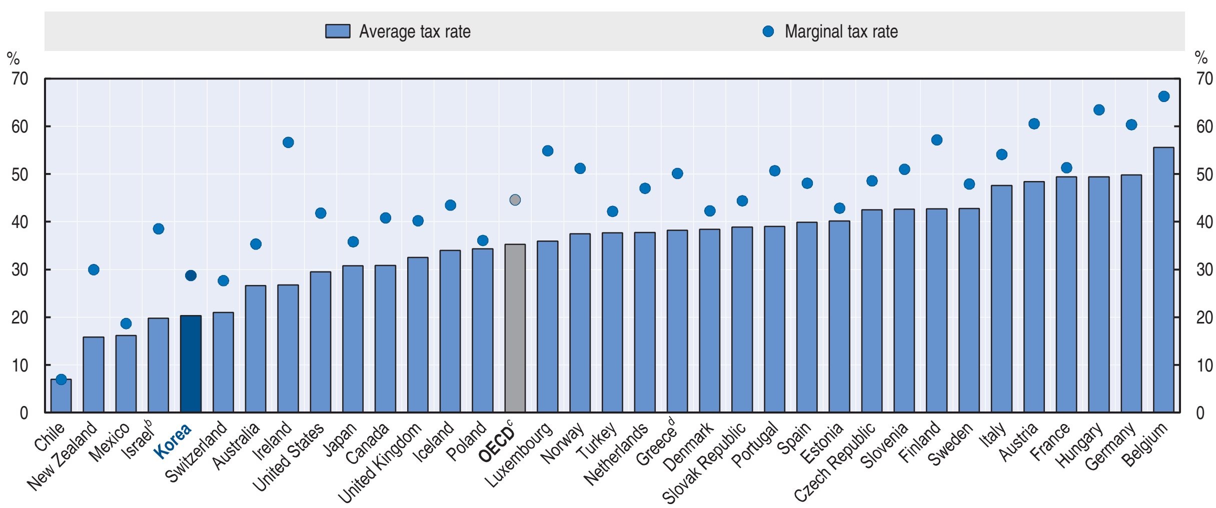
	2000		2010			Change[a]
	Korea	OECD	Korea	*Rank*	OECD	2000-10
Direct taxes on households	3.3	9.3	3.6	*30*	8.4	0.3
Direct taxes on firms	3.2	3.4	3.5	*6*	2.9	0.3
Social security and payroll	3.8	9.3	5.8	*26*	9.5	2.0
Goods and services	8.7	11.3	8.5	*29*	11.0	-0.2
Property	2.8	1.8	2.9	*7*	1.8	0.1
Holding taxes	0.6	0.9	0.8	*16*	1.0	0.2
Taxes on property transactions	2.0	0.6	1.8	*1*	0.4	-0.2
Estate, inheritance and gift taxes	0.2	0.1	0.3	*4*	0.1	0.1
Other	0.8	0.2	0.9	*3*	0.2	0.1
Total	**22.6**	**35.2**	**25.1**	***31***	**33.8**	**2.5**

a) For Korea, in percentage points.

Source: OECD (2012), *Revenue Statistics 2012,* OECD Publishing, Paris*, http://dx.doi.org/10.1787/19963726.*

Figure 1.12. **Average and marginal tax wedges on labour**[a]

Percentage of gross labour costs in 2011 for a single worker with average earnings



a) The tax wedge measures the difference between total labour compensation paid by the employer and the net take-home pay of employees as a ratio of total labour compensation.

b) Information on data for Israel is available at: *http://dx.doi.org/10.1787/888932315602*.

c) Unweighted average of 34 OECD countries' data shown in the chart above.

d) For Greece, data refer to 2010.

Source: OECD Taxing Wages Database (*www.oecd.org/ctp/taxdatabase*).

The large rise in social spending expected during the next four decades should be financed through revenue increases that minimise the negative effect on growth. Indeed, the economic impact of higher taxes depends on how the revenue is raised as well as on how much is raised. Pro-growth tax policy calls for limiting any increase in the tax wedge on labour income and keeping a low corporate tax rate. At the same time, base-broadening to increase the share of wages subject to income tax from around one-half at present toward the OECD average of more than 80% would reduce distortions and help keep marginal tax rates low.

Keeping direct taxes low implies that revenue increases should come primarily from indirect taxes, notably the value-added tax (VAT), which has a smaller negative effect on labour supply. Korea's VAT rate is currently 10%, far below the OECD average of 18%. Another advantage is that the VAT is simple and relatively difficult to avoid or evade in Korea, and its VAT tax base is the ninth broadest in the OECD area, although it is important to further enhance transparency about the tax base. However, a shift in the tax structure from income to consumption taxes would reduce the already low redistributive impact of the tax system, with negative implications for equality. Nevertheless, using the VAT to raise revenue while relying on an expanded EITC and well-targeted social spending to achieve income distribution goals would be the best approach. Environmental taxes and revenues from auctioning permits in an emissions trade scheme are also good candidates for increasing revenue as part of the Green Growth Strategy (Jones and Yoo, 2012). Taxes on property-holding are a third option to raise revenue, as they have a less negative impact on economic activity than direct taxes (Arnold et al., 2011). Increasing property-holding taxes would also promote the efficient use of land and address persistent concerns about real estate prices.

Upgrading compliance with social insurance contributions, particularly for non-regular workers and employees at small firms, is also important to finance ageing-related expenses and allow social security systems to play their intended roles. Beginning in 2011, the collection of contributions was combined under the NHI. Transparency about income and compliance could be further improved by having the National Tax Service collect social insurance contributions.

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Chapter 2

Income distribution and poverty among the working-age population and implications for social welfare policies

This chapter looks at the implications of social welfare policies in income distribution and poverty among the working-age population. Korea has an institutional framework capable of providing an effective safety net for the working-age population. Yet, Korea's poverty rate is high by international standards and its tax/benefit system is one of the least effective among OECD countries in reducing income inequality and in alleviating poverty. To strengthen social cohesion and have a significant effect on poverty alleviation, the challenge for policy reform will be to extend the reach of the three main pillars of the safety net and take measures to improve the accessibility for those whose circumstances result in family income below the poverty threshold; strengthening the employment orientation of the support provided to those who have work capacity; and undertaking systematic and regular monitoring and evaluation of programmes.

2.1. Introduction

During the three decades preceding the Asian financial crisis, Korea has been known for its "egalitarian growth" process, combining sustained economic growth with an equitable distribution of its benefits, in terms of increased well-being for all. The situation has changed. Income inequality in Korea has been increasing since the Asian crisis in 1997 until 2010, and relative income poverty is at an internationally high level. Korea's social safety net responds to these challenges and has gradually been extended during the past decades. During the past five years, real social spending increased by 29% – more than in any other OECD country (OECD, 2012). But more can and needs to be done to improve social policies to tackle increasing inequality and high levels of poverty.

First, Korea's system of cash benefits and direct taxes is one of the least redistributive across OECD countries. The weak impact on income redistribution achieved is the consequence of both the smaller size and the limited progressivity of taxes and benefits.

Second, while Korea's basic social assistance payment, BLSP, ranks between the middle and bottom third of OECD countries in terms of income adequacy, there is an issue of incomplete coverage and limited eligibility. Effective coverage is also an issue for the other pillars of the Korean social safety net for the working-age, the Employment Insurance (EI) system and the in-work benefit EITC.

Third, the mechanics of the Korean tax and benefit system provide relatively strong work incentives – but only for higher-income workers. For unemployed people in search of lower-wage jobs work incentives are very weak, especially if they have children. This is due to a simultaneous withdrawal of cash and in-kind benefits at certain earnings levels which encourages benefit dependency and creates poverty traps.

Fourth, and more generally, Korea's social safety-net system suffers from a lack of coherence and a certain fragmentation (identified earlier by OECD, 2000). Though, the introduction of the integrated computerised database for social security administration ("Happiness e-Eum") in 2010 has brought about substantial improvements, more efforts are needed and a more unified approach to policy is required, both within and across levels of government, to ensure that programmes work together to support those who need to be supported but do not trap people into benefit dependency through the combined impact of the withdrawal of different benefits.

This chapter focuses on the three main pillars of the safety net for the working-age population in Korea and how its effectiveness in reducing income inequality, alleviating poverty and strengthening social cohesion can be improved. In this context, the key recommendations of this chapter are as follows:

- Efforts should be devoted to further extend the reach of the three main pillars of the safety net for working-age people. One option is to further relax eligibility conditions for access to BLSP benefits so as to increase the coverage among those living below the absolute poverty line and ensure that all those eligible are able to take-up the benefit. In order to extend the reach of the EITC system, policy options include abolishing the requirement of having a child or a spouse and continuing to extend the EITC eligibility to self-employed people, once there is adequate transparency about their income. Similarly, expanding the share of workers covered by, and ensuring compliance with, the EI system will expand the reach of that system.

- Relaxing restrictive asset tests would extend the reach of the BLSP and the EITC systems. This should include relaxing or phasing out the "legal supporter criterion" as conditionality for receiving BLSP and relaxing the ceiling on assets to qualify for EITC. In addition, the treatment of homeownership in both the BLSP and the EITC eligibility criteria should be reassessed to allow more homeowners to participate in these programmes and consideration should be given to relaxing the additional assets tests on the BLSP and the EITC.

- It will be key to improve the employment orientation of the support provided to those who have work capacity in order to reduce the risks of benefit dependency and increase employment participation. The current policy efforts to strengthen activation requirements for both EI and BLSP recipients with work capacity go in the right direction and should continue (see Chapter 3). Financial gains from low-paid employment could be increased by reducing the rate at which BLSP benefits are withdrawn with increasing earned income and/or permitting simultaneous receipt of the BLSP and the EITC. In addition, moderate extensions of the phase-out range of EITC payments and of EITC benefit levels could be considered in order to strengthen existing financial work incentives for families with low earnings capacities. Also, the recently implemented homecare allowance should be reconsidered in view of parents' work incentives and work opportunities.

- To ensure all programmes work together in pursuit of common policy objectives the entire suite of social welfare and labour support programmes should be critically reviewed with a view to streamlining programmes, reducing administrative burden, improving take-up, and ensuring that the interactions between programmes are consistent with broader social policy objectives. Systematic and regular monitoring and evaluation should be undertaken to ensure programmes are meeting their objectives, including monitoring the performance of the newly introduced subsidy for EI premiums for low-paid workers in small firms (part of the "Duri Nuri" programme) to evaluate if this measure improves coverage in the longer term and reviewing the impact and cost effectiveness of the Early Re-employment Allowance.

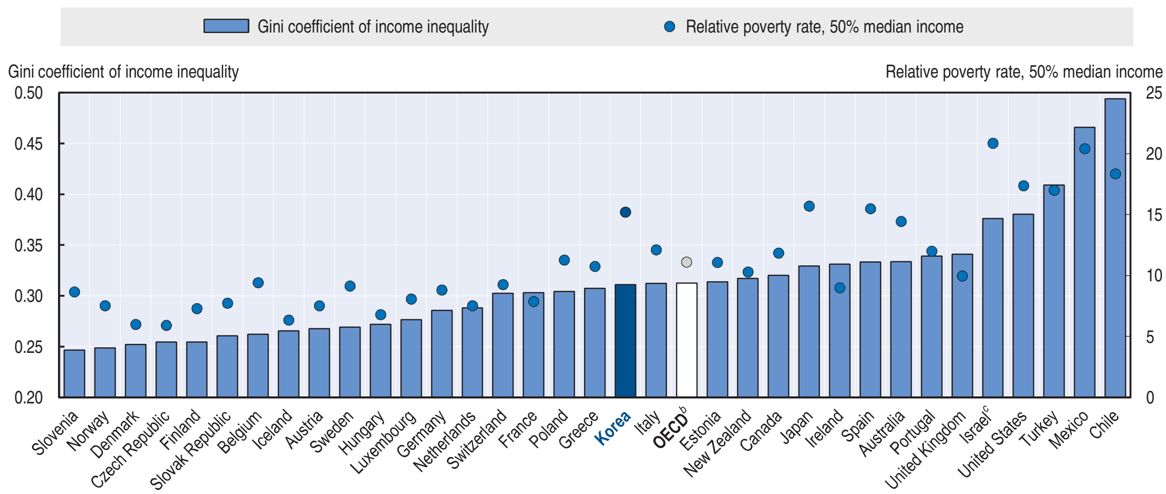
2.2. Income distribution and poverty in Korea: An overview

Levels and trends of inequality and income poverty

Since the 1997 Asian financial crisis, issues of income inequality and poverty feature high on Korea's research and policy agenda [see for instance, Park and Kim (1998) and Hyun and Kang (1999)]. At the latest date for which data are available (2010 or closest), the level of income inequality in Korea is very close to the OECD average, with a Gini coefficient of income concentration of 0.311 (Figure 2.1). However, Korea's relative poverty rate – the share of people living with less than half the median income – is the eighth highest in the OECD at slightly over 15%.

During the past six years, relative poverty remained stable at a level of around 14% to 15%, while absolute poverty oscillated between 7% and 8%. The age profile of poverty is different in Korea from other OECD countries insofar as the elderly face a very high risk of poverty (Figure 2.2). The poverty rate of people aged 66-75 is 45%, three times higher than the rate for the total population. On average across the OECD, there is no significant difference between these age groups. Furthermore, 37% of the elderly were in absolute poverty (Jones and Urasawa, 2012). One reason for high elderly poverty in Korea is that the National Pension Scheme, introduced in 1988, has not matured yet. Another reason is the "legal supporter criterion": many elderly do not qualify for the BLSP because they have younger relatives who could support them – though many actually do not.

Figure 2.1. **Levels of income inequality and poverty, OECD countries, 2010 or latest year available**[a]



Note: Countries are ranked in ascending order of the Gini coefficient of income inequality which ranges from 0 (perfect equality) to 1 (perfect inequality). Relative poverty rates are defined as the share of individuals with income less than 50% of the median for the entire population. Data refer to the distribution of household disposable income in cash across people.

a) Data refer to 2006 for Japan, 2007 for Turkey, 2008 for Greece and Switzerland, 2009 for Austria, Belgium, Chile, the Czech Republic, Estonia, Finland, Hungary, Iceland, Ireland, Italy, Luxembourg, New Zealand, Poland, Portugal, the Slovak Republic, Slovenia and Spain, and 2011 for Korea.

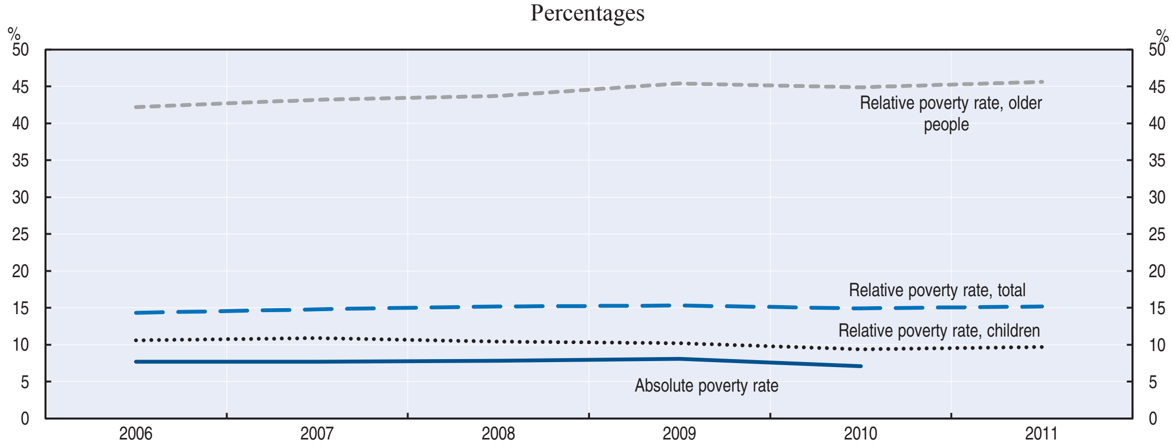
b) Unweighted average of the 34 OECD countries.

c) Information on data for Israel is available at: *http://dx.doi.org/10.1787/888932315602*.

Source: Calculations based on *OECD Database on Income Distribution and Poverty*, *www.oecd.org/els/social/inequality*, Preliminary data.

Figure 2.2. **Relative and absolute poverty by age groups, Korea, 2006-11**

Percentages



Note: Relative poverty rates are defined as the share of individuals with income less than 50% of the median for the entire population. "Absolute poverty" refers to persons below the minimum cost of living. "Children" refer to persons below 18-years old. "Older people" refer to the 66-75 age group (no data available for people aged 76+).

Source: Calculations based on the *OECD Database on Income Distribution and Poverty*, *www.oecd.org/els/social/inequality*, Data (for 2010 and 2011, Preliminary data), and Statistics Korea.

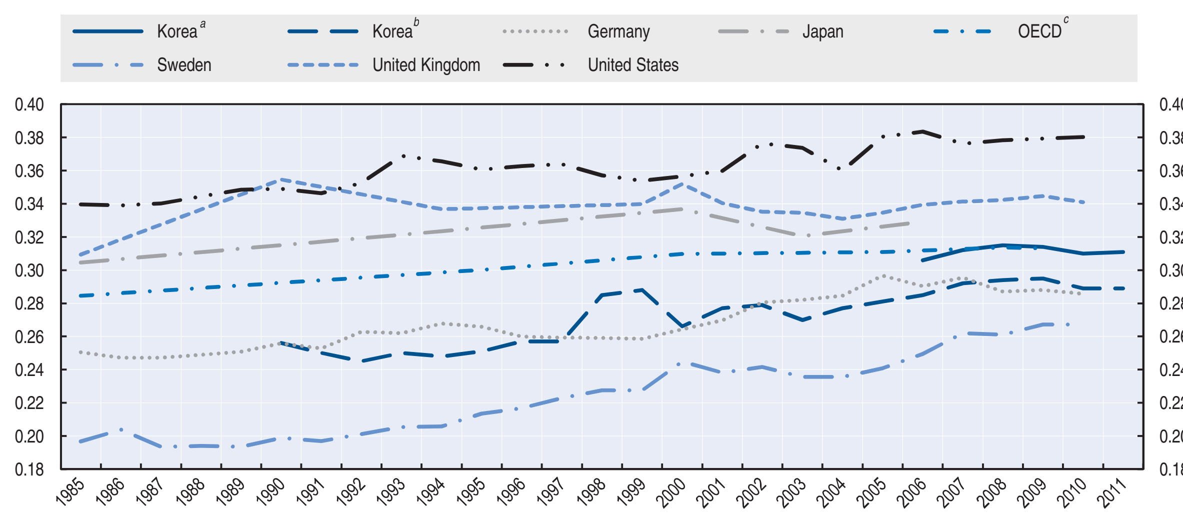
While no progress on elderly poverty was made during the past six years – the poverty rate climbed from 42% to over 45% – children in Korea have a relatively lower poverty risk. Furthermore, it fell slightly from 11% to 10%. In a majority of OECD countries, child poverty rates are somewhat higher (12.6% on average) than those for the entire population (11.1%).

A crucial factor limiting poverty risks is the extent of work intensity in a household: in 2011, relative poverty among couple households in which both adults had a job was as low as 2.5%. At the same time, having a job *per se* is often not sufficient to escape poverty. Among couple households where only one adult is working, poverty is higher than the average for all working-age persons (*OECD Database on Income Distribution and Poverty*, *www.oecd.org/els/social/inequality*, Data).

While both relative and absolute poverty, overall, remained broadly stable in recent years, income inequality increased since the early 2000s and at least until 2010, when it slightly fell for the first time in seven years (Figure 2.3). While earlier Korean data are not comparable with other countries as they cover only urban households with at least two persons, the trend suggests that inequality grew since the early 1990s and, in particular in the aftermath of the Asian financial crisis. It is worth noting that Korea is not an exception, as inequality increased in three-quarters of OECD countries since the mid-1980s, including in traditionally egalitarian countries such as the Nordic countries.

Figure 2.3. **Trends in income inequality in selected OECD countries**

Gini coefficient of income inequality



Note: The Gini coefficient ranges from 0 (perfect equality) to 1 (perfect inequality). Data refer to the distribution of household disposable income in cash across people.

a) All households.

b) Urban households.

c) Unweighted average of the 34 OECD countries to 2008. Provisional estimate for 2009 based on 28 OECD countries.

Source: Calculations based on the *OECD Database on Income Distribution and Poverty*, *www.oecd.org/els/social/inequality*, Preliminary data.

Income inequality can increase because the poor got poorer, or the rich got richer, or both. In general, it is the second of these scenarios which characterised the trend in most OECD countries that experienced rising income inequality up to the Great Recession:

incomes of the top decile and the top quintile grew faster than both middle and low incomes (OECD, 2011a). The recent development in Korea was different. For the period where data are available (2006-11), Korea stands out in that income growth of the lowest incomes (the bottom 20%) lagged significantly behind that of all other income groups (Table 2.1). During that period, total household incomes grew by 1% annually on average, with similar rates for the top four quintiles. Incomes for the lowest 20% group, however, stagnated during that period.

Table 2.1. **Trends in real household income by income groups,[a] Korea, 2006-11**

Average annual percentage change

Total	Bottom quintile	Second quintile	Third quintile	Fourth quintile	Top quintile
1.0	0.0	1.2	1.2	0.9	1.3

a) Data refer to the distribution of household disposable income in cash across people.

Source: Calculations based on the *OECD Database on Income Distribution and Poverty*, *www.oecd.org/els/social/inequality*, Preliminary data.

Income inequality increased in most OECD countries over the past two decades. OECD (2011) looks at the causes of this trend: the single most important driver has been greater inequality in wages and salaries. The labour markets of all countries have gone through profound transformations driven by globalisation, technological changes and policy reforms. For example, technological progress has clearly been a key motor for economic growth; but highly skilled workers have benefitted much more than others. Labour market outcomes have also been significantly shaped by policy and regulatory reforms, both in the markets for goods and services where competition was strengthened and in labour markets, which were made more adaptable. These reforms have promoted productivity and economic growth and brought more people into work, in particular many women and low-paid workers. But the consequence of more part-time and low-paid workers is a widening distribution of wages. Moreover, tax-benefit systems have become less effective at redistributing incomes in many OECD countries, e.g. because transfers to the lowest income groups failed to keep pace with earnings growth.

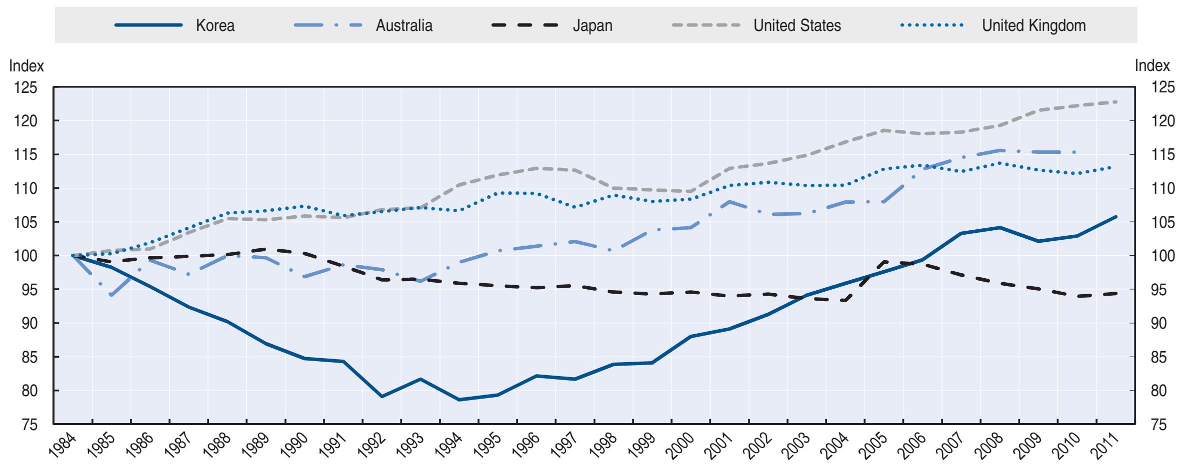
On average, around two-thirds of all income in Korean households is made up of net wages and salaries. When adding earnings from self-employment income, the share is 90% – the highest among OECD countries. It is therefore important to look more closely at trends in labour earnings to fully understand the drivers of income inequality in Korea. The remainder of this chapter therefore focuses on the working-age population: patterns in wage distribution; the redistributive capacity of the tax and transfer system; and the impact of the social safety net in terms of income adequacy and in terms of work incentives.

Importance of the labour market: Trends in wage distribution

Wage dispersion in Korea has developed somewhat differently from income inequality. Comparable data on wages for full-time workers have been collected since almost 30 years, allowing a longer time perspective. In comparison to other OECD countries, the Korean wage distribution displays a unique U-shaped development over time, with rapidly falling wage dispersion between the mid-1980s and mid-1990s and a strong and continuous increase since then that was the largest in the OECD area (Figure 2.4).

Figure 2.4. **Trends in wage dispersion among full-time workers in selected OECD countries**

Index 1984 = 100



Note: Wage dispersion is measured by the D9/D1 earnings percentile ratio, i.e. the ratio of the wages of the 10% best-paid workers to those of the 10% least-paid workers, calculated as the ratio of the upper bound value of the 9th decile to the upper bound value of the 1st decile.

Source: Calculations based on *OECD Database on Income Distribution and Poverty*, *www.oecd.org/els/social/inequality*, Data.

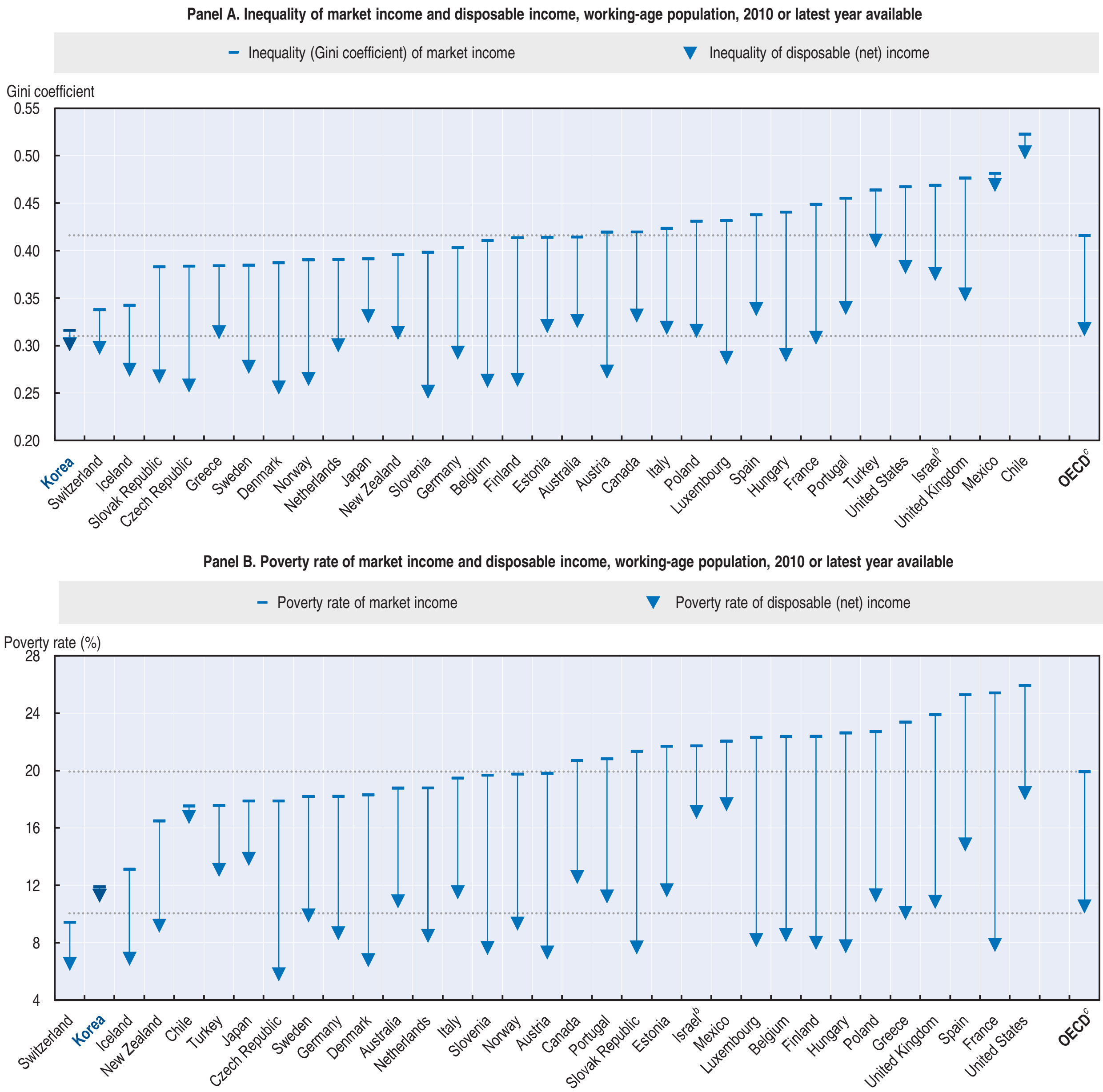
There are a number of reasons for this particular pattern. Kang and Yun (2008) concluded that factors related to human capital played an important role in moulding the U-shaped changes in wage dispersion in Korea. They suggest that the rapid growth in wage inequality since the mid-1990s may be related to skill-biased technological change as the Korean economy became more knowledge-intensive and high-tech. They also suggest that an increase in outsourcing to China and other low-wage countries may explain the surge in wage dispersion in recent years. For the OECD area as a whole, however, recent analyses concluded that increasing trade intensity played less of a role in explaining growing wage dispersion than skill-biased technological change and changes in policies and institutions (OECD, 2011a).

Moreover, in contrast to the pattern of household income inequality, rising wage dispersion since 1994 has been primarily at the *upper* rather than the lower half of the distribution. The ratio of the wages of the 10% best-paid workers to the median wage (D9/D5 ratio) increased by one-fifth while the ratio of the median wage to the wages of the 10% least-paid workers (D5/D1 ratio) rose by less than one-tenth. Such a pattern can be found in a majority of OECD countries.

Importance of taxes and transfers: Redistribution

One way to evaluate the extent of government redistribution is to analyse inequality and poverty before and after cash transfers and taxes, i.e. comparing the distribution of *market* income with that of *disposable* income. In those terms, Korea's tax/benefit system is one of the least effective among OECD countries, despite an undeniable increase in redistributive effectiveness over the past ten years (Cheon et al., 2012). Even though Korea has the lowest market income inequality among OECD countries, its disposable income inequality is close to the OECD average for both the total and the working-age population (Figure 2.5, Panel A).[1] Only Chile and Mexico achieve less redistribution through their tax and benefit systems. Across OECD countries, relative poverty is halved, from around 20% to 10%, when taking account of cash transfers and taxes. The Korean tax/benefit system achieved the smallest poverty reduction in the OECD area in 2011, reducing the relative poverty rate by just 1.1 percentage points relative to market incomes (from 11.9% to 10.8%) (Figure 2.5, Panel B).

Figure 2.5. **Reduction of inequality and poverty by cash transfers and income taxes in OECD countries, working-age population, 2010 or latest year available**[a]



Note: Market incomes are all gross incomes from earnings, savings and capital. Poverty rates are defined as the share of individuals with income less than 50% of the median disposable income for the entire population. Data for Greece, Hungary, Mexico and Turkey refer to transfers only.

a) Data refer to 2006 for Japan, 2007 for Turkey, 2008 for Greece and Switzerland, 2009 for Austria, Belgium, Chile, the Czech Republic, Estonia, Finland, Hungary, Iceland, Ireland, Italy, Luxembourg, New Zealand, Poland, Portugal, the Slovak Republic, Slovenia and Spain, and 2011 for Korea.

b) Information on data for Israel is available at: *http://dx.doi.org/10.1787/888932315602*.

c) Unweighted average of the 33 OECD countries shown in the chart above.

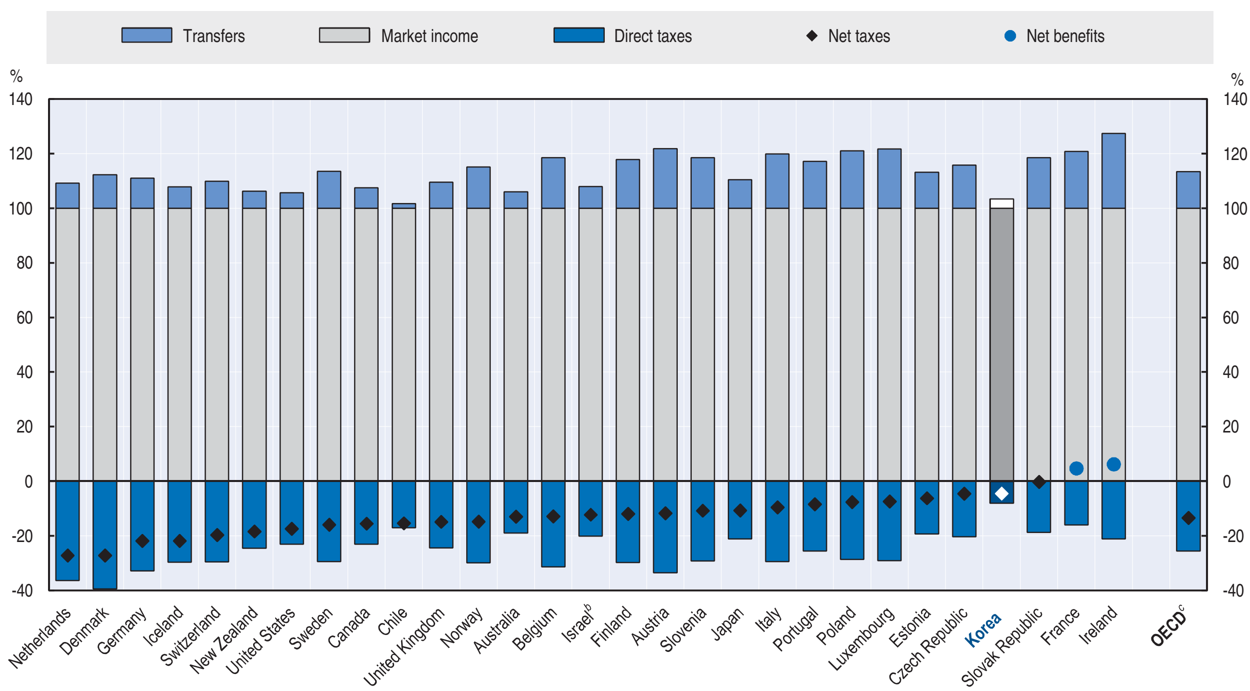
Source: OECD Database on Income Distribution and Poverty, *www.oecd.org/els/social/inequality*, Preliminary data.

The weaker impact of the tax and benefit system on income redistribution in Korea is the consequence of two factors: the low *level* of public social spending and taxation; and the limited *progressivity* in the tax system in particular. The overall tax burden in Korea is low – 25.5% of GDP compared to an OECD average of 33.7% in 2009 – and total cash public expenditure is around one-third of the OECD average (3.4% of GDP in Korea compared to an OECD average of 12.6% in 2009).

Direct taxes and cash benefits are the most direct policy levers for governments to influence distributional outcomes (Figure 2.6). In 2011, direct taxes (income taxes and social contributions) paid by working-age households in Korea amounted to 9% of earned market income, one-third of the OECD average. Moreover, cash benefits were only 4% of earned market income, less than 30% of the OECD average.

Figure 2.6. **Overall amounts of taxes paid and benefits received in OECD countries, 2010 or latest year available**[a]

All households headed by working-age individuals, percentage of market income



Note: Countries are ranked by the average impact of the redistribution system on household income, i.e. by net taxes (taxes *minus* benefits).

a) Data refer to 2006 for Japan, 2007 for Turkey, 2008 for Greece and Switzerland, 2009 for Austria, Belgium, Chile, the Czech Republic, Estonia, Finland, Hungary, Iceland, Ireland, Italy, Luxembourg, New Zealand, Poland, Portugal, the Slovak Republic, Slovenia and Spain, and 2011 for Korea.

b) Information on data for Israel is available at: *http://dx.doi.org/10.1787/888932315602*.

c) Unweighted average of the 29 OECD countries shown in the chart above.

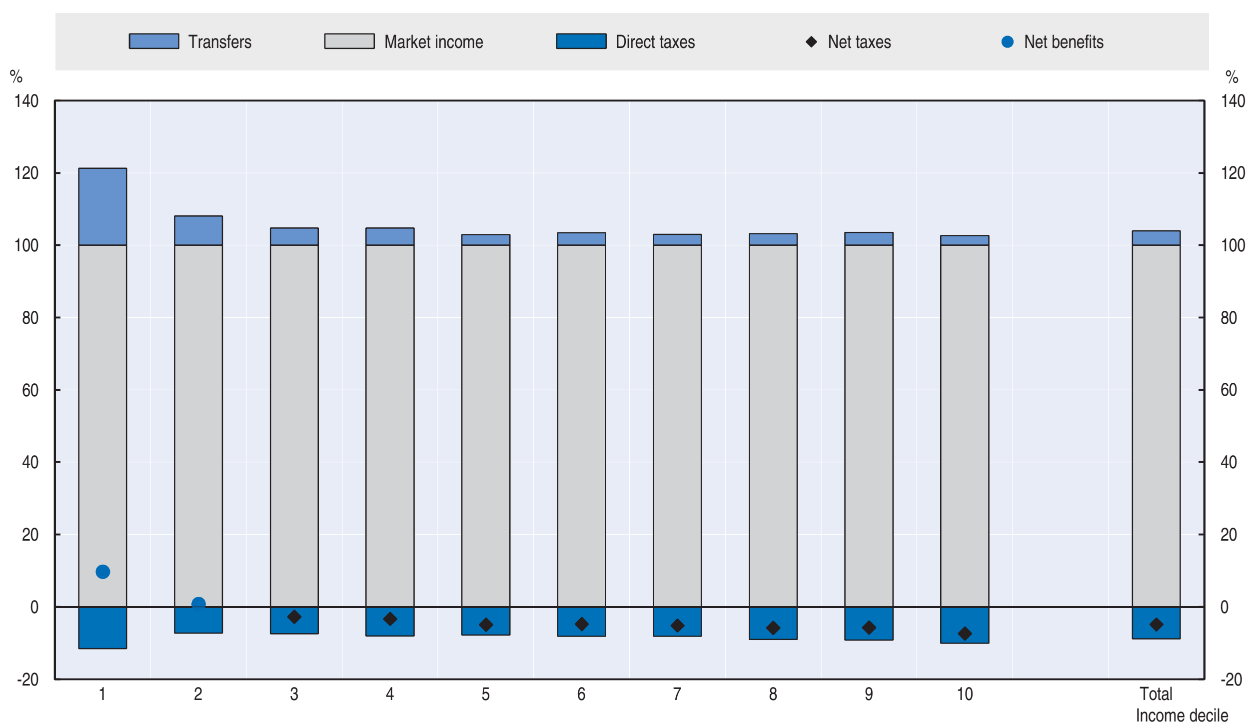
Source: OECD Database on Income Distribution and Poverty, *www.oecd.org/els/social/inequality*, Preliminary data.

In addition to their lower levels, social spending is less targeted and the tax system is not very progressive. Examination of direct taxes paid and cash benefits received across income deciles illustrates this limited progressivity (Figure 2.7). Working-age households in the lowest income decile pay somewhat more of their market income in direct taxes (12%) than do households in the highest decile (10% of their market income) and those in the income deciles between the top and bottom (between 7 and 9%). On the other hand, as in most OECD countries,[2] households in Korea in the bottom of the income distribution do receive more cash benefits, relative to their market income. For the bottom quintile, this is sufficient to make them net beneficiaries. However, the distribution of cash benefits is not targeted: barely a fifth of total cash benefits from the government go to the poorest 20% of the working-age population, while the richest 20% receive almost 30% (among the total population, the poorest 20% receive about a quarter of total cash benefits, while the same share goes to the richest 20%) (*OECD Database on Income Distribution and Poverty*, *www.oecd.org/els/social/inequality*, Preliminary data).

At the same time, redistribution is not achieved only through cash benefits and income taxes – publicly provided services, such as education, health, or care services, also have a redistributive effect. Taken together, these services reduced inequality by one-fifth on average across 27 OECD countries (OECD, 2011a). Although there are no estimates available for this effect in Korea, the relatively large share of services in total social welfare outlays suggests that those have the potential to play an important role for redistribution. At 78%, Korea has the highest share of spending on services (including education) in relation to total social welfare spending (OECD average 54%). Sung and Park (2011), for instance, find that the inequality reduction effect of "in-kind benefits" in 2007 was almost as high as that of all cash transfers and taxes taken together. The spending level on public services (including education), though, is low at less than 10% of GDP, the third lowest in the OECD.

Figure 2.7. **Taxes paid and benefits received by income deciles in Korea, 2011**

Households headed by working-age individuals, percentage of market income



Source: OECD Database on Income Distribution and Poverty, *www.oecd.org/els/social/inequality*, Preliminary data.

2.3. Key features of the Korean social safety net for working-age people

This section examines the principle elements of the social safety net for the working-age population that is supported by public cash transfers and therefore most likely to contribute to reducing income inequality and poverty. The generosity of benefit levels provided by these income support programmes is compared to other OECD countries, and areas where current coverage is inadequate are highlighted. The chapter concludes with a discussion of the adequacy of income support and the factors affecting the risk of poverty among working-age adults and their families, in particular, the extent to which the current design of Korean social assistance helps or hinders families escaping poverty through employment.

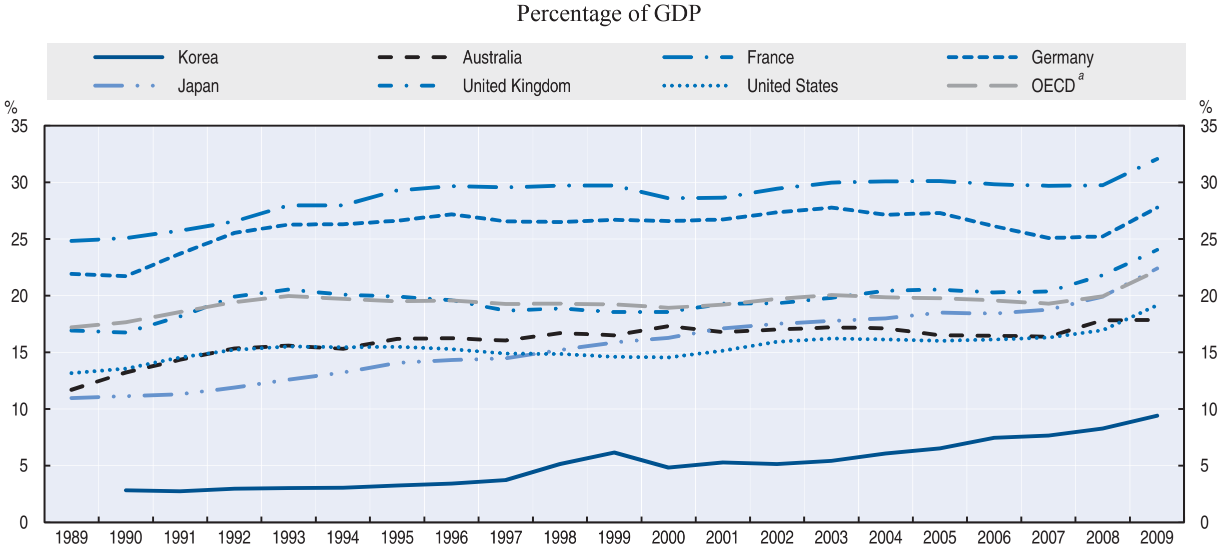
Development of social expenditure

In 2009 *gross* public social spending in Korea, at 9.6% of GDP, was the second lowest in the OECD area and well below the OECD average of 22.1%. The gap on a *net* basis is smaller as less of the benefits are "clawed back" – a reflection of Korea's relatively low tax burden. In addition, private social spending, both mandated and voluntary, is slightly above average in Korea. Total net social spending (public and private) amounted to 12.5% of GDP, the third lowest in the OECD area and barely half the average of 21.8% (for 29 countries).

Despite the low level of gross public social spending compared to other OECD countries, it has risen rapidly, at a 12 % annual average growth rate in real terms since 1990, more than tripling its share of GDP from 2.8% of GDP. This growth rate was the fastest in the OECD and well above the average annual real increase of around 6.7%. The increased absolute share of GDP allocated to public social spending (6.8 points) over the last two decades is not dissimilar to the increases observed elsewhere, including in France (7 points), Germany (6.1 points), the United Kingdom (7.4 points) and the United States (5.6 points) and is less than the increase of 11.3 points in Japan (Figure 2.8).

Figure 2.8. **Public social spending in selected OECD countries, 1989-2009**

Percentage of GDP



a) Unweighted average of the 34 OECD countries.

Source: OECD Social Expenditure Database (*www.oecd.org/els/social/expenditure*).

Development of the public pension system, universal health insurance and Employment Insurance (introduced in 1988, 1989 and 1995 respectively) and, to a lesser extent, the creation of the National Basic Livelihood Security Programme (BLSP) in 2000 all contributed to the more than tripling of public social spending since 1990. Increased expenditure on old-age (including on survivors) and health accounted for over 60% of this increase. In addition, the BLSP expanded the basic social safety net in response to the increased numbers of poor and unemployed following the 1997 financial crisis. This helped to boost the share of public social spending devoted to programmes most likely to be of benefit to working-age people and their families from less than 20% in 1990 to over 30% in 2009.

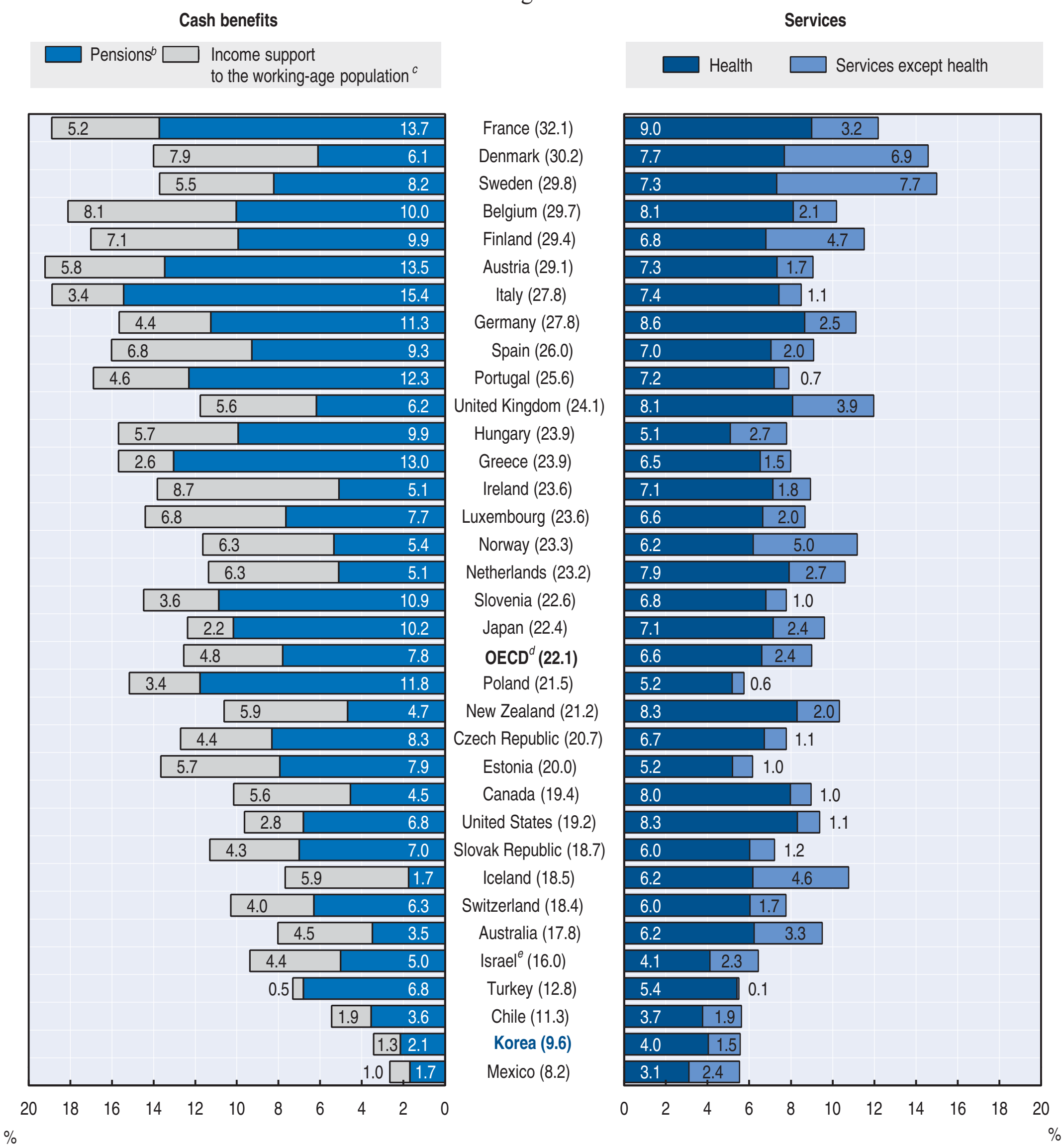
In 2009, however, spending in all areas remained well below the OECD averages (Figure 2.9) and the distribution of spending both across these areas and between cash and services is very different to that of OECD countries on average:

- Korea delivers almost 60% of their social spending (78% if education is included) in the form of services rather than cash transfers. This is the second highest in the OECD area (after Mexico) and well above the OECD average of 40.7% (54% with education).
- Health expenditures, which have more than doubled since 1990 (from 1.5% to 4.0% in 2009), account for over 70% of the expenditures on services (excluding education) and over 40% of total public social spending. Of OECD countries only Turkey and the United States devote higher shares of their public social expenditure to health.
- Pensions (both old-age and survivors), take the next largest share consuming 22% of Korea's public social spending which is still well below the OECD average of 35%. Moreover, Korea's spending, at 2.1% of GDP in 2009, was less than a third of the OECD average but has been catching up: it has more than tripled since 1990. The low level of spending in this area is, at least in part, a consequence of the relatively recent introduction of the National Pension Scheme (NPS) combined with a relatively young Korean population.
- Korea's outlay on income support to the working-age population, at 1.3% of GDP, is far below the OECD average of 4.8%. Only five other OECD countries devote a lower share of their social expenditure budget to income support for the working-age.
- Expenditure on services (other than health) to support the working-age is at least as much as cash transfers. This is due, at least in part, to the low recipient numbers of unemployment and other social assistance benefits combined with support for families being predominantly provided as services. Only three other OECD countries (Sweden, Japan and Mexico) spend more on services (other than health) than on cash transfers to support the working-age population.
- Korea spends 0.61% of GDP on active labour market programmes (ALMPs), just above than the OECD average of 0.55%. The bulk of spending (over 75%) is on direct job creation and employment incentives, however. While these types of measures have some value in a deep recession when alternative employment opportunities are scarce, in general they have been found to be ineffective at helping unemployed people move into stable jobs in the private sector (OECD, 2009a). By contrast, Korea spends barely 2% of the ALMP budget on its Public Employment Service (PES) much less than many other OECD countries (for instance, Australia spends over 50% of its ALMP budget on the PES and less than 16% on direct job creation and employment incentives while the United States spend around 31% and 13% of its ALMP budget on these areas, respectively).

The overall low level of social spending combined with the larger share of the social spending budget used in the provision of services rather than cash transfers provides much of the explanation of the lower reduction in income inequality and poverty achieved through income taxes and cash transfers in Korea.

Figure 2.9. **Public social expenditure by broad social policy area, OECD countries, 2009[a]**

Percentage of GDP



Note: Countries are ranked by decreasing order of public social expenditure as a percentage of GDP. Spending on active labour market programmes (ALMPs) cannot be split by cash/services breakdown; they are however included in the total public spending (shown in brackets).

a) Data for Mexico have been estimated. Data for Switzerland refer to 2008.
b) Data refer to spending relating to "Old-age" and "Survivors" pensions.
c) Data refer to spending relating to "Incapacity benefits", "Family cash benefits", "Unemployment and other social policy areas".
d) Unweighted average of the 34 OECD countries.
e) Information on data for Israel is available at: *http://dx.doi.org/10.1787/888932315602*.

Source: *OECD Social Expenditure Database*, *www.oecd.org/els/social/expenditure*.

Korea's social safety net for the working-age population: Principal policy instruments

Korea's safety net for the working-age, as in many OECD countries, includes both social insurance and means tested social assistance programmes for the very poor and for the disabled. In addition, publically funded support for low-income working families is provided through an Earned Income Tax Credit (EITC) while families with children may be eligible for additional support from child care/child rearing supplements. There is some limited support for low-income lone parents but no general publicly funded family benefit.

Over 60% of the cash transfers provided to non-elderly households in 2009 were accounted for by payments under the programmes[3] analysed in detail below: the National Basic Livelihood Security (BLSP) scheme; the employment insurance scheme (including the return to work bonus); and, the EITC. Expenditures on these programmes have grown rapidly over the last decade and given continued improvement in the coverage of EI and the 2012 extensions to eligibility and increased benefit levels under the EITC are expected to continue increasing. If Korea is to enhance the redistributive impact of its social spending in order to reduce inequality and poverty any increases in social spending should be carefully targeted.

The National Basic Livelihood Security Programme (BLSP)

The National Basic Livelihood Security Programme (BLSP) was implemented in 2000[4] in response to the rapid increase in the number of the poor and unemployed following the 1997 Asian financial crisis and subsequent structural reforms. It is Korea's major social assistance programme for those with no other means of support. Cash expenditures on BLSP more than tripled between 2000 and 2009, although they still amounted to less than 0.4% of GDP in 2009 (0.6% of GDP in 2011 when expenditures on medical assistance are included). Meanwhile, the number of recipients has remained relatively stable, increasing about 10%, from 1.35 million to 1.55 million, between 2002 and 2010 and then falling to under 1.5 million in 2011.

The BLSP provides assistance through seven different benefits to those living under the absolute poverty line – the Minimum Cost of Living (MCL), determined annually by a committee appointed and led by the Minister of Health and Welfare. BLSP benefits are subject to a means test based on the households "recognised income" which is the sum of assessed income and converted property income.[5] The rates applied in converting asset values into "recognised income" put a low cap on the net asset value consistent with BLSP eligibility even though, for homeowners, only the value in excess of the basic deduction is included in calculation of recognised income. In comparison, around two third of OECD countries disregard the value of the claimant's home in determining eligibility to social assistance benefits (OECD, 2011b). For homeowners, access to the BLSP will be eased somewhat when the Korean government implements plans to apply a lower conversion rate (1.04% rather than the current 4.17%) for residential property in 2013. Nonetheless, even this conversion rate used to calculate a *monthly* income amount is high compared to rates used in some other countries – for example, the highest rate used in Australia to calculate a notional *annual* income stream for the pensioner means test is 4.5%. To be eligible for the BLSP the household's combined income must be below the minimum cost of living. The applicant should also have no other means of support from a "legal supporter" (that is, a close family member – parent, son, daughter, son-in-law or daughter-in-law), who is not only liable but also able to support them with sufficient income or assets. Obligation as a "legal supporter" is exempted in some cases such as his/her property value is less than 130% of the total of both his/her and the applicant/recipient's property value.[6] Receipt of BLSP payments continues indefinitely as long as eligibility criteria are met.

Eligible single-person households received a maximum cash payment of KRW 422 180 per month in 2010, equivalent to around 14% of the average wage,[7] which includes a livelihood allowance and an amount to cover cash housing expenses (rent and maintenance/repair). Depending on their circumstances households may also receive in-kind support for medical, education, childbirth and funeral expenses, as well as in-kind housing benefits (provided in the form of maintenance/repair services). Cash benefits are withdrawn one-for-one against the household's "recognised income" unless the recipient is participating in specific programmes[8] (in which case the withdrawal rate is lower). Eligibility for assistance *via* in-kind benefits is entirely withdrawn when recognised income reaches either 100 or 150% of the MCL depending on the specific benefit. Recipients aged 18-64 years with work capability are subject to work availability tests, including job search requirements, to maintain eligibility and must participate in ALMPs but they do not necessarily have access to all labour market programmes, however, as participation in some is only possible for people who are eligible for EI benefits (OECD, 2013, forthcoming). Despite in principle requirements to participate in training programmes run by central and local governments in practice 79% of able-bodied recipients were granted waivers for various reasons in 2011.[9] For those who do participate, the results are poor. Only 6% of those in the local government's Self-Reliance Programme were able to escape poverty in 2009 (Jones and Urasawa, 2012), a share which increased to 10% in 2011, according to the Ministry of Health and Welfare.

In 2009, barely 3% of the population received BLSP livelihood payments, less than half of those below the MCL and far less than the 15% living in relative poverty. The limited coverage appears to be primarily due to strict eligibility requirements that include income, assets and the possibility of assistance from family members. There is also a need for monitoring to ensure equal implementation and access of the BLSP programme.

Employment Insurance (EI)

The main programme of income support for displaced workers is unemployment benefits, which are financed through the Employment Insurance system.[10] Employment Insurance was introduced in 1995 and has gradually been expanded so that it now covers 44% of Korean workers (employees and self-employed) (11 million persons in August 2012).[11] In 2009, almost 26% of cash expenditure on the non-elderly was dispersed as EI-based unemployment benefits and an additional 4% on employment promotion allowances including the Early Re-employment Allowance. In 2008, expenditures on the Early Re-employment Allowance were about KRW 391.6 billion (Hwang, 2011), equivalent to 99% of the expenditure on employment promotion allowances recorded in the *OECD Social Expenditure Database* (*www.oecd.org/els/social/expenditure*) for that year.

Eligibility conditions and the main features of unemployment benefits funded through mandatory insurance in a selection of OECD countries are summarised in Table 2.2. The Korean EI scheme conditions are towards the lower end of the spectrum in terms of both conditions for eligibility and payment of benefits and are similar that of the United States (ignoring the temporary changes in response to the financial crisis in the latter).

In 2010, Korean EI beneficiaries received 50% of their previous average wage. The minimum daily benefit is set at 90% of the minimum wage (or 21% of the average worker wage)[12] and the daily maximum is KRW 40 000 (almost 40% of the average wage in 2010). The benefit rate is similar to that applied in Austria, Estonia and the Slovak Republic, and above that applied in Turkey. Furthermore, two of the four OECD countries that pay flat rate employment insurance benefits (Greece, Ireland, Poland and the United Kingdom) do so at a level (relative to the average wage) similar to or less than the minimum payable benefit in Korea. The maximum benefit payable in Korea is also relatively low but it is of a similar magnitude to that payable in Austria, Belgium, Hungary, Italy, Turkey and the United States.

Table 2.2. **Unemployment insurance benefits, selected OECD countries, 2010**

	Employment (E) and contribution (C) conditions	Waiting period (days)	Maximum duration (months)	Payment rate (% of earnings base)	Earnings base[a]	Benefit range (% AW)[b]		Permitted employment and disregards
						Minimum	Maximum	
France	C: 4 months in 28 months	7	24	57-75	Gross	28	228	Income <70% of reference earnings, hours worked/month <110 and duration <15 months. Benefit reduced depending on income ratio to reference earnings.
Germany	E: 12 months, C: 12 months in 2 years	0	12	60	Net	–	92	Total loss if working more than 15 hours/week.
Japan	E+C: 6 months in 1 year (min 11 days/month)	7	9	50-80	Gross earnings (excl. bonuses)	–	53	No benefits if employed.
Korea	E+C: 6 months in 18	7	7	50	Gross earnings	21	39	Earnings disregard then excess deducted from EI benefit. Benefit stops if employed more than 60 hours per month.
United Kingdom	C: 12 months in 2 years	3	6	Fixed amount (10% of AW)	–	–	–	Income over GBP 260 (520 for couples) reduces benefit by same amount.
United States[c]	E: 20 weeks (*plus* minimum earnings requirement)	0	23	53	Gross	13	41	Tapered withdrawal of benefits. Benefit totally withdrawn when earnings equal 1.5 times the gross benefit.

– Not applicable.

a) Gross: Gross employment income; Net: Gross *minus* income taxes *minus* social security contributions (SSC).

b) Single 40-year-old worker without children, benefits may differ depending on family situation. All benefit amounts are shown on an annualised basis.

c) The information reflects the situation of the Michigan unemployment benefit scheme of which payment duration has been extended due to high unemployment rates. Emergency Unemployment Compensation and Extended Benefits are paid after exhaustion of regular unemployment insurance benefits (26 weeks).

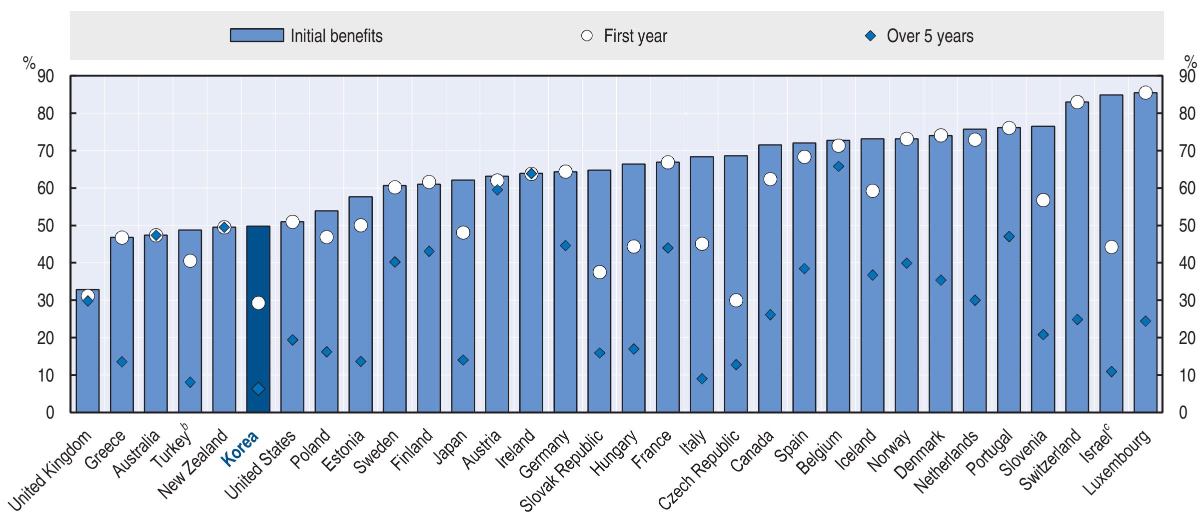
Source: OECD Tax and Benefit Models (2012), *www.oecd.org/els/social/workincentives*.

The duration of benefits increases with age and the previous contribution record, and ranges from 90 to 240 days. Under specific circumstances an individual receiving unemployment benefits can receive an Individual Extended Benefit of 70% of the unemployment benefit for up to 60 days.[13] The maximum duration, excluding any extension of benefits, a prime-age worker could expect to receive EI benefits for is 210 days (or seven months). This is one of the shortest in the OECD, as only five countries have benefit durations of less than seven months (the Czech Republic, Israel, the Slovak Republic, the United Kingdom and the United States – ignoring the temporary extensions enacted in response to the financial crisis that are currently in place).

The generosity of the Korean EI scheme, as measured by the average *net* (i.e. post-tax) replacement rate (NRR), is among the lowest in the OECD (Figure 2.10). Among OECD countries Korea has the lowest NRR over the first year of unemployment and over a five-year unemployment spell and the 6th lowest when initially qualifying. Furthermore, of the five countries with lower initial NRRs three pay flat rate benefits (and in two of these, Australia and New Zealand, the benefit is a publicly funded means tested assistance benefit which is not insurance based).

Figure 2.10. **Net replacement rates in OECD countries, 2010**[a]

Percentage of previous net income



a) Net replacement rate is the ratio of net income while out of work to net income while in work. Calculations consider cash incomes (excluding, for instance, employer contributions to health or pension insurance for workers and in-kind transfers for the unemployed) as well as income taxes and mandatory social security contributions paid by employees. To focus on the role of unemployment benefits, they assume that no social assistance or housing-related benefits are available as income top-ups for low-income families. Any entitlement to severance pay is also not accounted for. Net replacement rates are calculated for a prime-age worker (aged 40) with a "long" and uninterrupted employment record resulting in the maximum duration of EI benefits in Korea being 210 days (or seven months). They are averages over four different stylised family types (single- and two-earner couples, with and without children) and two earnings levels (67% and 100% of average full-time wages) and are shown for the initial level of Unemployment benefit (UB) entitlement, averaged over 12 months and averaged over 5 years.

b) Average worker (AW) value is not available. Calculations are based on average production worker (APW).

c) Information on data for Israel is available at: *http://dx.doi.org/10.1787/888932315602*.

Source: OECD Tax and Benefit Models (2012), www.oecd.org/els/social/workincentives.

There is some debate as to the effective rate of coverage of Korean employees by EI, with estimates ranging from 65% to 86% of employees (summarised in OECD, 2013, forthcoming). Both the numbers of insured individuals and the coverage have increased over time and, according to the Ministry of Employment and Labor, just over 11 million individuals were covered by EI at the end of August 2012. This implies a ratio of insured individuals to wage and salary workers of 62% and to total employment of 44% (as at 25 October 2012, *www.moel.go.kr/english/statistics/major_statistics.jsp*). To improve compliance amongst low-paid workers, from July 2012 the Korean government will pay (on application) 50% of the contribution for low-income earners (less than KRW 1.25 million per month).

OECD analysis of KLIPS data (2005-09) suggests that only around 50% of displaced workers receive income support from EI benefits, retirement benefits or National Basic Livelihood Security in the 12 months following displacement. The incidence of income support is higher among workers who are not re-employed within one year than those who find work more quickly. This is particularly so for EI benefits with 32% of those who were not employed within one year receiving EI benefits compared with 20% of those who were re-employed within a year (OECD, 2013, forthcoming). The finding in this analysis – that only 1% of displaced workers received BLSP benefits in the year following displacement is also of concern. There is no legislative constraint on access to the BLSP relating to EI receipt, provided eligibility criteria are satisfied. Yet, it appears that households who receive EI rarely receive BLSP payments either during or immediately following receipt of EI benefits, possibly related to asset and legal support criteria.

The Earned Income Tax Credit (EITC)

Earned Income Tax Credits (EITCs), a form of in-work benefit used in a number of OECD countries, can be an important tool for reducing poverty. EITCs reduce taxes or provide refunds when the deduction is larger than the tax amount, thereby raising take-home pay for working families at the lower end of the earnings distribution. An OECD review of the evidence on the employment and distributional effects of in-work benefits concluded that they have significantly positive employment effects among those primarily targeted by the payment and contribute to poverty reduction (OECD, 2008). Further, the tax burden needed to finance in-work benefits is lower in countries with relatively dispersed gross earnings distributions (i.e. the efficiency cost is lower), as is the case in Korea (Immervoll et al., 2007). The empirical evidence also points to EITC as a potentially effective instrument in reducing poverty and encouraging employment, compared to minimum wages, for at least some groups (Pearson and Scarpetta, 2000). The impact of an EITC in increasing total labour supply and decreasing unemployment is greater in countries with a wide earnings distribution, low tax rates on labour, low benefits for the non-employed and a low minimum wage (Bassanini et al., 1999). As each of these conditions holds in Korea, an EITC is likely to be particularly effective and could be a major tool to reduce inequality and poverty.

Korea introduced such an in-work tax credit in 2008. Until 2012, it offered a maximum of KRW 1.2 million (just over 3% of the AW in 2010) per year to families with an employed individual and at least one child under 18 where the gross annual household income was less than KRW 17 million and whose assets, including real estate, did not exceed KRW 100 million. Persons who received benefits from the BLSP for three months or more are excluded from the EITC. In 2012, eligibility was extended to couples without children, the income and property tests[14] were relaxed somewhat and the maximum benefit was varied according to the number of children in the household.

However, single individuals remain ineligible. Korea thus remains the only OECD country (of the seven with fully refundable tax credits for low-income working families – Canada, Finland, France, Korea, New Zealand, the United Kingdom and the United States) which restricts eligibility according to family status.[15] The KRW 100 million limit on assets (equivalent to around 2.5 times the annual AW) is much more restrictive than the asset test applied in France (which effectively allows assets of over 20 times the annual AW) and also than that in the United States which limits investment income, including realised capital gains, to a little over USD 3 000 per year and as such excludes non-income generating assets such as owner occupied housing. Also, despite increasing the maximum allowable home value the restriction on homeownership can result in a stricter test of eligibility than that for the BLSP. For example, a family of three or more children whose only asset is a KRW 75 million house would qualify for some assistance under the BLSP but is not eligible to benefit from the EITC.

Table 2.3. **Earned Income Tax Credits (EITCs), Korea and selected OECD countries, latest year available**[a]

Family type	Korea	Canada	Finland	France	New Zealand	United Kingdom	United States
A. Maximum benefit (% of AW)							
Single	–	2.1	1.6	2.4	1.5	7.9	1.0
Couple	1.9	3.8	3.2	2.6	1.5	13.4	1.0
Family with one child	3.8	4.0		2.6-2.7	8.0	13.4	6.7
Family with two children	4.6	3.8		2.7	8.0	13.4	11.0
Family with three children	5.4	3.8		2.8	8.0	13.4	12.4
B. Benefit phased out at (% of AW)							
Family type	Korea	Canada	Finland	France	New Zealand	United Kingdom	United States
Single	–	37	220	62	21	39	29
Couple	35	57	440	92	21	54	40
Family with one child	46	57		81-91	189	54	77-89
Family with two children	57	57		92-98	189	54	88-99
Family with three children	68	57		94-117	189	54	94-106

AW: Average worker.

Note: Finland: individual entitlement no addition for children, maximum for couple assumes both adults receive the maximum tax credit; *France:* the credit varies with family size and employment status, amounts calculated from tax benefit models assuming only one adult working in any family type; *New Zealand:* does not include the minimum income guarantee for working families with children or the Independent Worker Credit for households without children (maximum = 1% of the AW) which applies to earnings between 50 and 100% of the AW; *United Kingdom:* does not include the child tax credit; *United States:* does not include the temporary crisis response tax credits – making work pay (2009-10) and working family tax credit (2009-current).

– Not applicable.

a) For Korea, data refer to 2012 and for the remaining selected OECD countries, they refer to 2010.

Source: OECD Tax and Benefit Models (2012), *www.oecd.org/els/social/workincentives*.

Since July 2012 the Korean EITC provides a maximum benefit ranging from KRW 700 000 for a couple with no children up to KRW 2 million for a family with three or more children. At just under 2% of the AW the maximum support available for childless couples is similar to that provided in most other OECD countries with EITC provisions to singles (ranging from 1% in the United States to 2.4% in France) and to childless couples (ranging from 1% in the United States to 3.8% in Canada). The exception is the United Kingdom – where the maximum available for singles is 7.9% and for couples is 13.4%. Even under the newly introduced scheme the maximum benefits provided to families with children through the Korean EITC, ranging from 3.8 to 5.4% of the AW, are much lower than in the two other countries – New Zealand (8%) and the

United States (6.7% to 12.4%) – where the EITC is the principle mechanism for delivering support to low-income working families with children.

The 2012 EITC provisions remain tightly targeted and are only available to families with relatively low earnings with the credit having been entirely phased out by the time family earnings reach around 35% of the average wage for childless couples and at around 67% of the average wage for a family with three or more children. These thresholds are roughly equivalent to the 120% MCL threshold used in determining eligibility for, at least some of, the in-kind benefits available to low-income families. Based on 2010 data, less than 10% of full-time full-year workers in Korea earn less than 35% of the AW and less than 40% earn less than 67% of the AW (*OECD Earnings Distribution Database*). It is also more tightly targeted than the EITC schemes in other countries, as the credit is phased out from a lower level of family earnings and at relatively high rates, particularly in the case of families with children. For a family of three or more children, the credit is entirely phased out by KRW 25 million (around two-thirds of the AW). In contrast, in the United States and New Zealand, for instance, the credit is not entirely phased out until well over the AW and at family earnings levels either around or well over the AW, respectively.

In 2011, 0.52 million households benefited from the EITC and total payments were KRW 402 billion. This was slightly lower than in 2010 when 0.57 million households (3.6% of the total) received the EITC and total payments were KRW 437 billion (Statistics Korea), or, as discussed earlier, 0.04% of GDP. In the three years following its introduction (2009-11) the average payment has been around KRW 770 000 per household. In 2012, 0.75 million households, an increase of 44%, received the EITC and total payments were KRW 614 billion, an increase of 52.7%.

It is clear that a small share of households benefit from the EITC and that the additional financial incentive it offers is relatively limited. If the EITC is to have a stronger redistributive impact in Korea, it must be accessible to more low-earning households. Using the EITC to improve work incentives further up the earnings scale would also contribute to reductions in inequality and poverty. Any such extensions through increases in the phase out range should be relatively moderate, however, as Korean policy settings already achieve comparatively strong work incentives for most families with earnings at or above the AW (see Section 2.5).

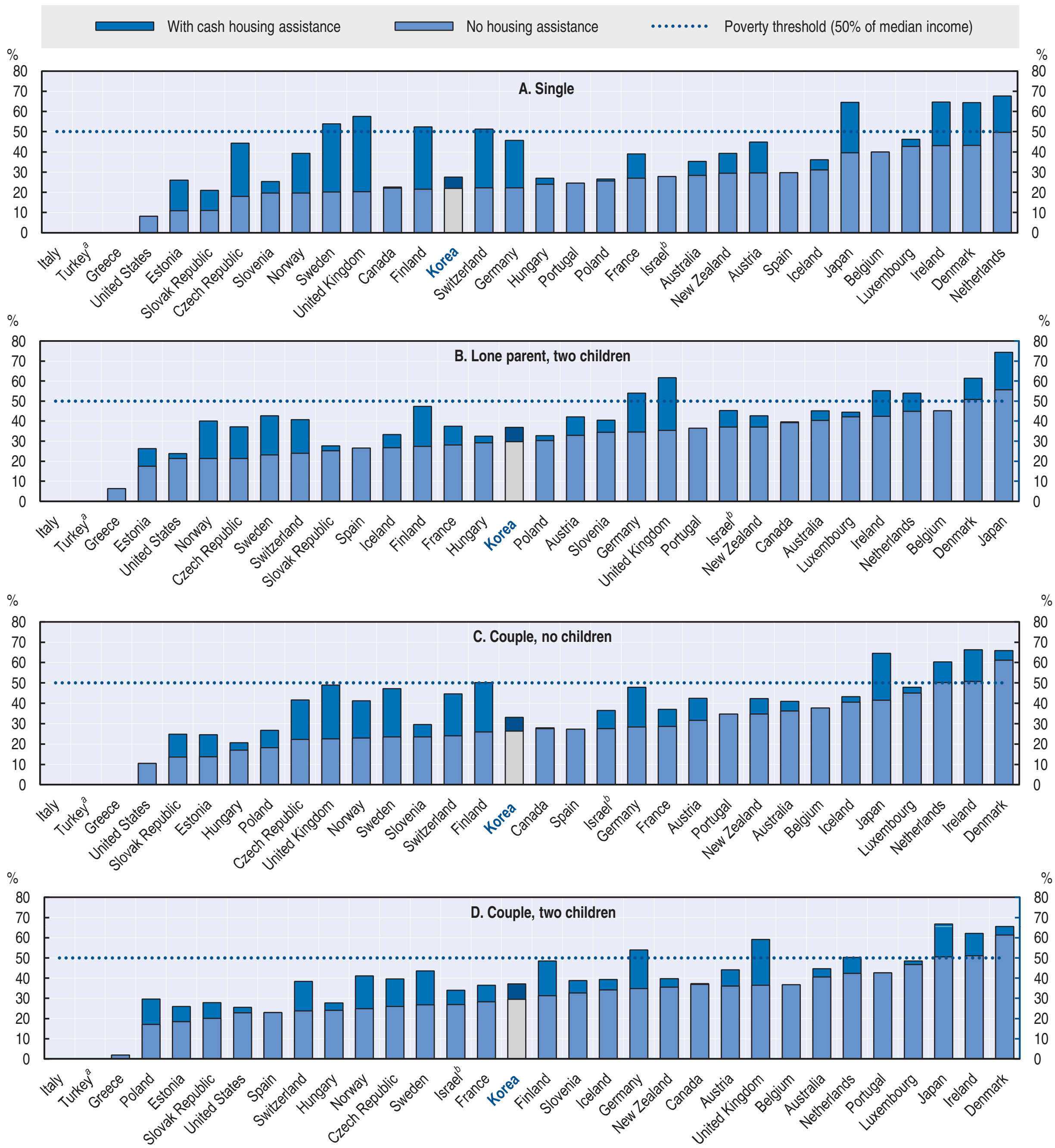
2.4. Income adequacy of the Korean social safety net for working-age people

The National Basic Livelihood Security Programme (BLSP)

The maximum disposable income provided to families through the BLSP (including the incorporated cash housing assistance) is less than 30% of equivalised median income for single households, just over 30% for childless couples and just below 40% for families with two children (Figure 2.11). In the absence of housing assistance the BLSP puts Korea toward the middle of OECD countries in terms of the income adequacy provided by their cash minimum income benefit.[16] After taking into account cash housing benefits, however, Korea falls to the bottom third of OECD countries for each of the four standard family types characterised in the *OECD Tax and Benefit Models (2012)*, *www.oecd.org/els/social/workincentives*.[17]

Figure 2.11. **Income levels provided by cash minimum income benefits, OECD countries**

Net income value in percentage of median household incomes, 2010



Note: Details of assumptions made in the calculations are available in the table "Income Adequacy" which is available under the statistics heading on the Benefits and Wages website referenced below. Countries are ranked in ascending order of the category "No housing assistance".

a) Average worker (AW) value is not available. Calculations are based on average production worker (APW).

b) Information on data for Israel is available at: *http://dx.doi.org/10.1787/888932315602*.

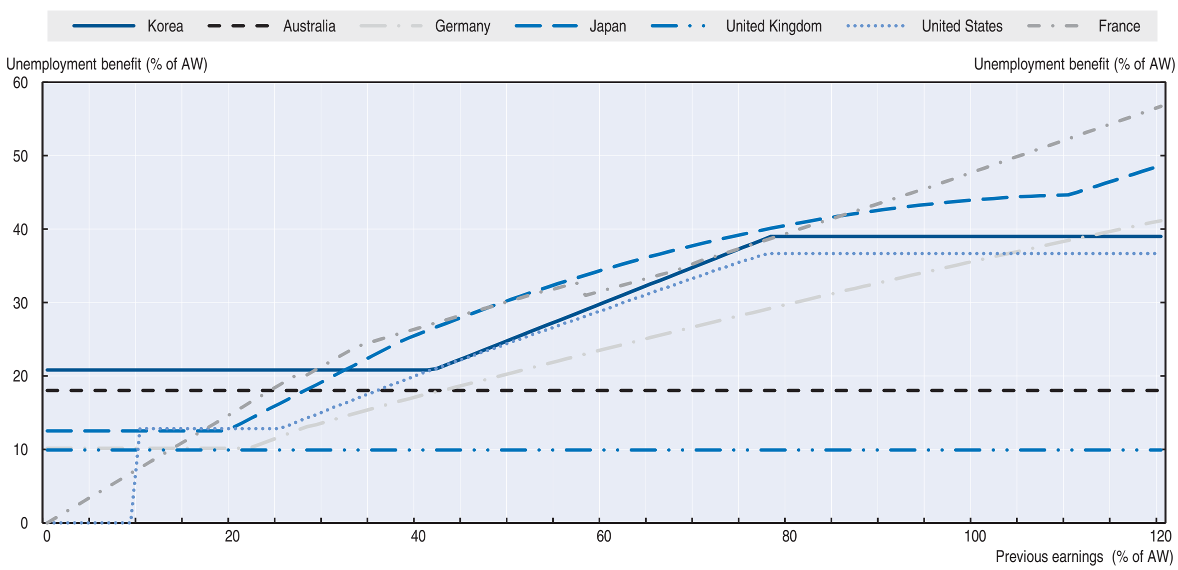
Source: OECD Tax and Benefit Models (2012), *www.oecd.org/els/social/workincentives*.

Employment Insurance (EI)

The fact that Korea's EI benefits generate net replacement rates that are amongst the lowest in the OECD does not mean, necessarily, that the benefits are inadequate. Average NRRs in Korea are low compared to other OECD countries as a result of the relatively low benefit cap, the short duration over which benefits are paid and the fact that in-work incomes are higher due to lower tax burdens imposed on below average earners than is the case in other countries.

The impact of the benefit cap is clearly illustrated in Figure 2.12. Until previous earnings reach the level at which the benefit cap is reached (80% of the AW), initial EI benefits in Korea are similar to those paid in several other OECD countries. It is the benefits paid to individuals who had close to or above average earnings in their previous employment that are relatively low compared to other countries.

Figure 2.12. **Unemployment benefits at the beginning of an unemployment spell, selected OECD countries, 2010**

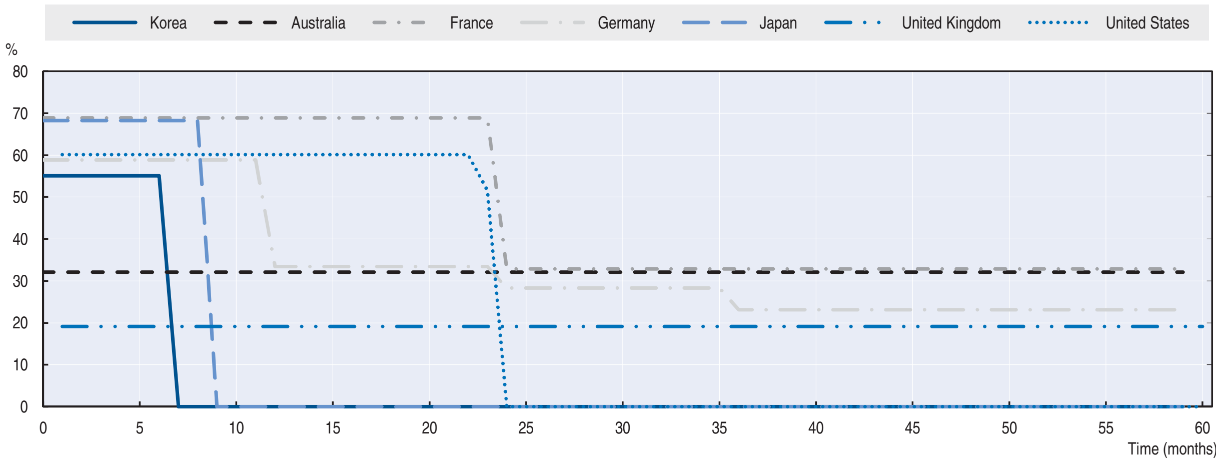


Note: The unemployment benefit received by a single 40-year-old worker, with a "long" and uninterrupted employment record. The benefit, when initially becoming eligible, is expressed as a proportion of the average worker (AW) wage in each country and is shown against the level of earnings received prior to becoming unemployed. Calculations consider the unemployment insurance benefit only but in the case of France and the United States take account of the benefit "clawback" through personal income tax and social contributions. All national currency amounts are expressed as annual amounts assuming 52 (five-day) weeks.

Source: OECD Tax and Benefit Models (2012), www.oecd.org/els/social/workincentives.

The short maximum duration of EI benefits in Korea is illustrated in Figure 2.13. This figure portrays the NRR (out of work income measured as a percentage of in-work income) for a single individual who had been earning 67% of the AW prior to becoming unemployed. Comparison of benefit levels, at previous earnings of 67% of the average wage, in Figure 2.12 to the net replacement rate (NRR) in the first month of EI receipt in Figure 2.13 also clearly demonstrates the influence of taxes and social contributions in the calculation of NRRs. For example, the initial benefit level in Germany, at 26% of the AW is well below that in Korea (33%), however the initial NRR in Germany is above that in Korea (59 and 55% of the AW, respectively). The lower NRR is the consequence of the low tax burden in Korea – Korean lower-wage workers (earning 67% of the AW) take home 90% of their wage while, in contrast, German workers take home only 65%.

Figure 2.13. **Evolution of net replacement rates over a five-year unemployment spell, selected OECD countries, 2010**



Note: Calculations are post tax and social contributions for a single individual who prior to becoming unemployed earned 67% of the average worker (AW) under the assumptions that he/she would be able to command the same wage on returning to work and that no social assistance "top-ups" or cash housing benefits are available. Month one refers to the first month of benefit receipt, i.e. following any waiting period. Any income taxes payable on unemployment benefits are determined in relation to annualised benefit values (i.e. monthly values multiplied by 12) even if the maximum benefit duration is shorter than 12 months.

Source: OECD Tax and Benefit Models (2012), *www.oecd.org/els/social/workincentives*.

From the perspective of poverty alleviation the minimum EI benefit alone is not sufficient to ensure a standard of living equivalent to the 50% relative poverty threshold for any family reliant on just one EI benefit recipient. It does, however provide an income above the minimum cost of living (as determined by the Ministry of Health and Welfare) for single and two person households and, in conjunction with the lone parent child-rearing support subsidy, a lone parent with two children. In contrast, the maximum EI benefit is less than the relevant minimum cost of living for families of four or more. It is however sufficient to raise single- and two-person families above the 50% median income threshold.

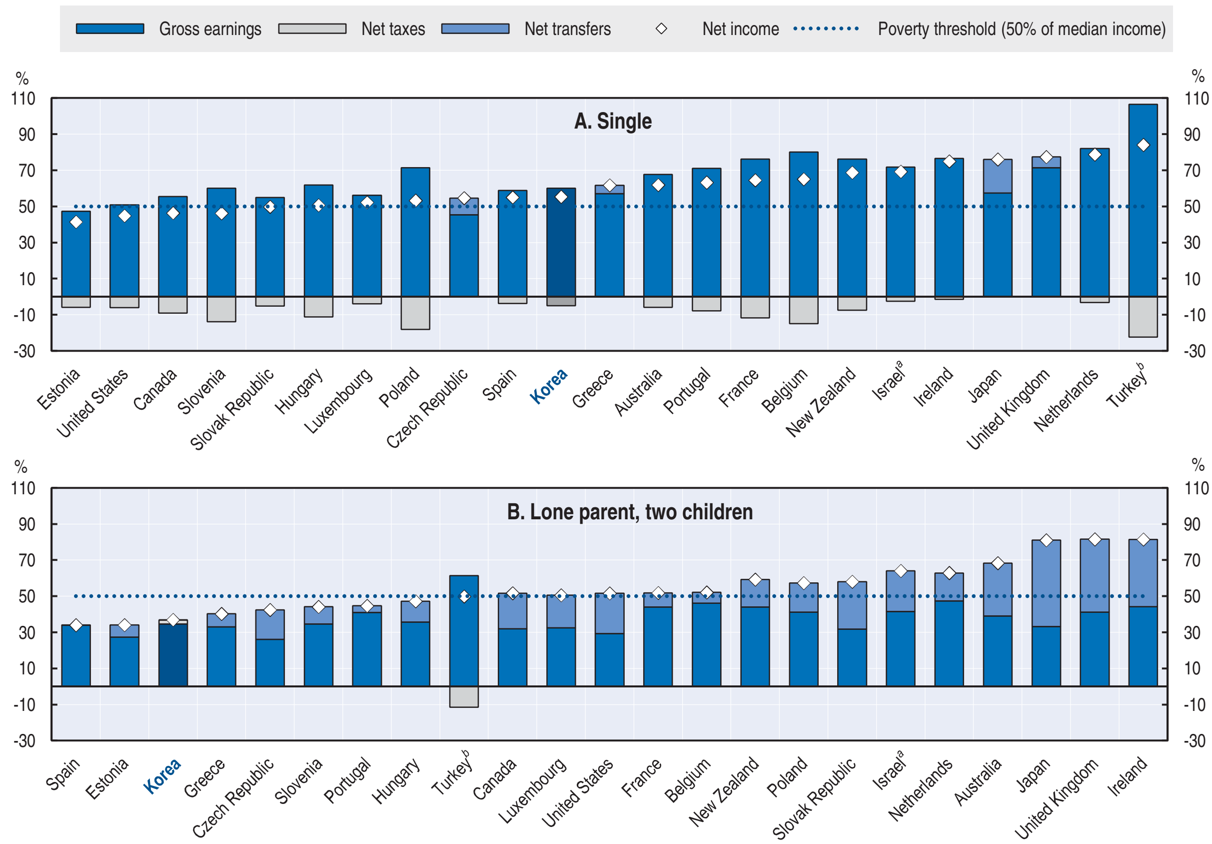
In-work poverty

Full-time employment at the Korean minimum wage only guaranteed a disposable income above the 50% relative poverty threshold for single person households in 2010. On this indicator of income adequacy Korea ranks toward the middle of OECD countries with minimum wages (Figure 2.14, Panel A). The income generated for lone parents, with two children, by full-time employment at the minimum wage does not rank so well being the third lowest and well below the 50% relative poverty threshold (Figure 2.14, Panel B). The situation is similar for couples with and without children as a single worker employed full-time at the minimum wage also does not generate sufficient income to lift the family above the relevant poverty threshold.

These relatively disappointing results highlight some of the issues with current policy settings. In 2010 full-time employment of one spouse at the minimum wage provided a disposable income of just under 40% of the relevant median income for the childless couple. Had the extension of eligibility for the EITC to childless couples applied in 2010 this household's disposable income would have been almost 3% higher but this would not have been nearly sufficient to lift the family above the poverty threshold. EITC provisions need to be more generous if they are to be successful in reducing in-work poverty.

Figure 2.14. **Income levels provided by full-time minimum wage employment, OECD countries**

Net income value in percentage of median household incomes, 2010



Note: Median net household incomes are for a year around 2008 expressed in 2010 prices and are before housing costs (or other forms of "committed" expenditure). Results are shown on an equivalised basis (equivalence scale is the square root of the household size) and account for all relevant cash benefits (social assistance, family benefits, housing-related cash support as indicated). Income levels are net of any income taxes and social contributions and account for all cash benefit entitlements of a family with a working-age head employed full-time at the minimum wage. Annual minimum wages as reported on *OECD.Stat*. Where there is no country-wide minimum, weighted averages of regional minimum wages are used (Japan). Calculations for families with children assume two children aged 4 and 6 and neither child care benefits nor child care costs are considered. Countries are ranked in ascending order of the category "Net income".

a) Information on data for Israel is available at: *http://dx.doi.org/10.1787/888932315602*.

b) Average worker (AW) value is not available. Calculations are based on average production worker (APW).

Source: OECD Tax and Benefit Models (2012), *www.oecd.org/els/social/workincentives*.

For the families with children full-time employment at the minimum wage actually had no impact on disposable income if they are eligible for BLSP benefits. This is the consequence of the combined effect of the 100% withdrawal of the BLSP as earnings rise and the inability of the family to access EITC (by virtue of the BLSP not being fully withdrawn at this earnings level). While disposable income would be higher if the BLSP recipient was eligible for the 70% withdrawal rate and would bring him/her much closer to the poverty threshold (around 45% of median income) this would still not be sufficient to lift the family out of poverty.

Access to safety net benefits

With the exception of large families reliant on a single EI recipient, Korean families in receipt of either EI or BLSP benefits can achieve standards of living which, while comparatively low, are not the lowest in the OECD area and which are at least consistent with Korean definition of minimum living standards. The limited impact of the safety net system in reducing income inequality and alleviating absolute poverty is more the consequence of the *limited access* to these benefits by households in need than the level of the benefit payments.

Korea can improve its social safety net. To increase the effectiveness of the BLSP, the eligibility conditions, e.g. in terms of the legal supporter criterion should be further relaxed so as to reach a larger share of those living below the absolute poverty line. Also, in order to meet the diverse needs of the poor more effectively, access to the different benefits included under the BLSP should be tailored to the specific needs (including subsistence, housing, and education benefits) rather than determined by a single standard as under the current system.

Despite making good progress in legally extending the scope of the EI system, there are still major holes. Many of the workers at most risk of displacement are poorly covered by unemployment benefits and other forms of income support and as such are at serious risk of falling into poverty if they lose their job. More efforts are needed to expand actual coverage of, and ensure compliance with, the EI system, so that unemployment benefits can fulfil their role as the primary means of income support for displaced workers. New subsidies for EI premiums for low-paid workers in small firms are a step in the right direction. It will be important to monitor the performance of these subsidies to see if they improve coverage in the longer term.

2.5. The impact of taxes and benefits on work incentives

As shown above, access to the labour market and work intensity are important prerequisites to lower poverty risks. This final section considers to which extent the current settings of Korea’s tax/benefit system encourage or discourage taking up work. Both EI and BLSP benefits are subject to high withdrawal rates. EI payments are subject to a 100% withdrawal rate once earnings exceed the disregard (equivalent to 120% of the minimum daily wage) and are also withdrawn entirely if the beneficiary is re-employed and recommences contributions to the Employment Insurance System and/or works 60 hours, or more, per month. Similarly, if recipients of the BLSP take up employment the cash part of the benefit is subjected to different withdrawal rates depending on participation in particular programmes. A 70% withdrawal rate applied to the income earned by the disabled in the “Job Rehabilitation Programmes”, “Self-Support Cooperative”, students and all recipients taking part in the self-support labour programme in 2010 (country specific information at *www.oecd.org/els/social/workincentives*).

Are people trapped in poverty by the BLSP?

The relatively low tax burdens imposed on workers in Korea could be expected to provide strong financial incentives for individuals to take up employment. Average effective tax rates (AETRs), by measuring the proportion of earnings taken up by taxes, social contributions and benefit withdrawal, provide an indication of the impact that tax and benefit systems have on the financial incentives to take up employment. The AETRs generated by the Korean tax-benefit system for BLSP recipients, across a range of family types and different earning levels, are displayed in Table 2.4, as is the contribution to the AETR of each main elements of the tax-benefit system. It is clear that for many of the scenarios depicted, work incentives are strong in Korea compared to those in many other OECD countries. This is particularly so for those earning relatively high wages (or working long hours) where Korea often ranks first among all OECD countries.

Table 2.4. **Average effective tax rates (AETRs) faced by BLSP recipients on returning to full-time employment, 2010**

			Social assistance	Income tax	Social security	Housing benefits	Family benefits	In-work benefits	AETR	OECD average	Rank (Korea)
33% of AW level	No children	Single person	33.1	0.4	7.8	8.5	0.0	0.0	49.7	70.3	6
		One-earner married couple	56.2	0.0	7.8	14.6	0.0	0.0	78.6	76.7	18
		Two-earner married couple 67%	0.0	0.8	7.8	0.0	0.0	0.0	8.6	23.5	4
	Two children	Lone parent	72.8	0.0	7.8	18.8	0.0	-9.5	89.9	61.6	27
		One-earner married couple	73.2	0.0	7.8	19.0	0.0	0.0	100.0	70.5	23
		Two-earner married couple 67%	0.0	0.6	7.8	0.0	0.0	0.0	8.4	36.6	1
50% of AW level	No children	Single person	21.8	0.9	7.8	5.6	0.0	0.0	36.1	60.7	7
		One-earner married couple	37.1	0.7	7.8	9.6	0.0	0.0	55.2	70.3	9
		Two-earner married couple 67%	0.0	1.2	7.8	0.0	0.0	0.0	9.0	25.2	3
	Two children	Lone parent	48.0	0.1	7.8	12.4	0.0	0.0	68.3	58.7	21
		One-earner married couple	58.9	0.0	7.8	15.3	0.0	0.0	81.9	70.2	19
		Two-earner married couple 67%	0.0	1.1	7.8	0.0	0.0	0.0	8.9	35.6	1
67% of AW level	No children	Single person	16.3	1.4	7.8	4.2	0.0	0.0	29.7	54.5	6
		One-earner married couple	27.7	1.2	7.8	7.2	0.0	0.0	43.8	64.3	6
		Two-earner married couple 67%	0.0	1.6	7.8	0.0	0.0	0.0	9.4	27.3	2
	Two children	Lone parent	35.8	0.7	7.8	9.3	2.4	0.0	56.0	57.6	13
		One-earner married couple	43.9	0.6	7.8	11.4	0.0	0.0	63.7	66.4	15
		Two-earner married couple 67%	0.0	1.5	7.8	0.0	0.0	0.0	9.3	35.6	1
100% of AW level	No children	Single person	10.9	4.5	7.8	2.8	0.0	0.0	26.0	48.3	2
		One-earner married couple	18.5	3.8	7.8	4.8	0.0	0.0	35.0	54.6	6
		Two-earner married couple 67%	0.0	4.6	7.8	0.0	0.0	0.0	12.4	29.8	1
	Two children	Lone parent	24.0	2.3	7.8	6.2	1.6	0.0	41.9	55.3	7
		One-earner married couple	29.4	1.9	7.8	7.6	0.0	0.0	46.8	60.4	8
		Two-earner married couple 67%	0.0	3.0	7.8	0.0	0.0	0.0	10.8	35.7	1
150% of AW level	No children	Single person	7.3	7.8	6.8	1.9	0.0	0.0	23.8	45.7	1
		One-earner married couple	12.4	7.4	6.8	3.2	0.0	0.0	29.8	49.2	3
		Two-earner married couple 67%	0.0	7.9	6.8	0.0	0.0	0.0	14.7	32.8	1
	Two children	Lone parent	16.0	6.4	6.8	4.1	1.1	0.0	34.4	50.9	5
		One-earner married couple	19.6	6.1	6.8	5.1	0.0	0.0	37.6	54.0	4
		Two-earner married couple 67%	0.0	6.9	6.8	0.0	0.0	0.0	13.6	36.9	1

AETR: Average effective tax rate; BLSP: National Basic Livelihood Security Programme.

Note: Social assistance refers to BLSP livelihood allowance, *Family benefits* refer to the child-rearing subsidy available to lone parents and *In-work benefits* refer to the Earned Income Tax Credit (EITC). In the case of the two-earner married couple the second spouse is assumed to have full-time earnings equal to 67% of AW. As there are no specific provisions relating to hours of employment the results can also be interpreted as AETRs of taking up part-time employment that pays the specified proportion of the full-time average wage. A rank of 1 indicates that Korea has the lowest AETR in that category.

Source: OECD Tax and Benefit Models (2013), *www.oecd.org/els/social/workincentives*.

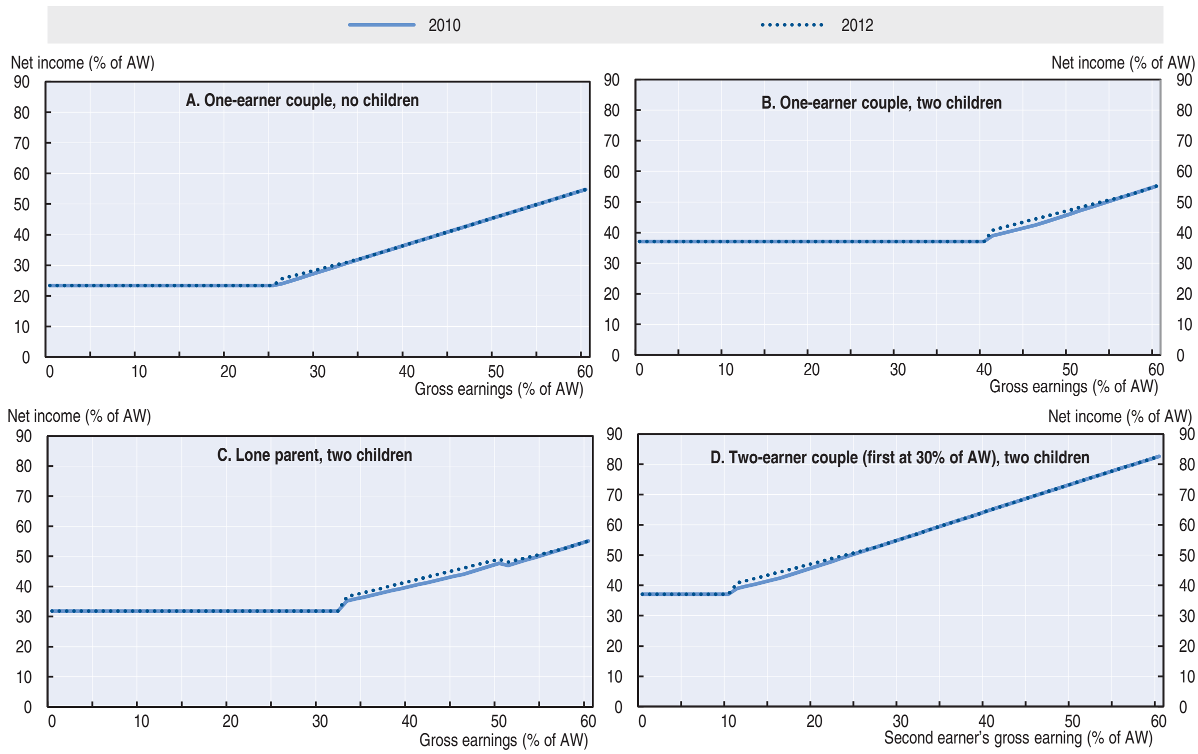
For many jobless households in receipt of the BLSP the incentives to taking up low wage full-time employment, however, are relatively poor (that is, the AETRs are relatively high), despite relatively low tax burdens. In 2010, the AETRs are above the OECD average for; *i)* one adult of a jobless couple taking up a full-time job at 33% of the AW (slightly above the minimum wage); and *ii)* for lone parents and single earners in a jobless couple with two children taking up full-time employment at either 33% or 50% of the AW. It is also evident from the table that the driving force behind these high AETRs in these cases is the rapid withdrawal of the BLSP and also that the EITC is, in fact, relatively ineffective in improving incentives to take up employment. This is the consequence of the combination of restrictions on receipt of the EITC by BLSP recipients and of the rapid withdrawal of the EITC as earnings increase. Even taking into account the changes to the EITC introduced in 2012 the financial incentives for taking up low paid full-time employment for these households remain relatively low with AETRs falling by at most 6 percentage points.

Each panel in Figure 2.15 shows how the disposable income of a particular family changes as they move into employment under the current EITC provisions compared to those in place in 2010 highlighting the limited capacity of the current EITC to improve the financial work incentives faced by BLSP recipients. Extension of EITC eligibility to couples without children, once the BLSP is fully withdrawn increases disposable income from employment by less than 2% of the AW and only for total earnings between 25% and 35% of the AW (Panel A). The increase in disposable income is similar for families with two children (at most 2% of the AW) though, as the BLSP is not fully withdrawn until total earnings reach a higher level, the impact is apparent at slightly higher earnings levels (from a third of the AW for a lone parent (Panel C) and from 40 for a couple family up to 55% of the AW). This small improvement in work incentives for couples with children does, however, impact both a single earner (Panel B) and a second earner where the first earner is a low-wage earner (Panel D).

The income gains from employment in Korea relative to continuing to receive the BLSP benefit are much lower than in several other countries for individuals, particularly those with children, who are only able to command relatively low wages (or work short hours), even taking into account the potential impact of the 2012 changes to the EITC. Figure 2.16 illustrates, with the case of a lone parent with two children, the much stronger net income gains from taking up employment, over *lower earnings ranges* (up to one-third of the AW) in the United States (where the EITC has a greater impact), Australia (where minimum guaranteed income benefits is withdrawn more gradually) and France (where an EITC is combined with an activation payment called "*revenu de solidarité active*", which effectively withdraws social assistance at the rate of 50%) and the United Kingdom. At somewhat higher income ranges (half the average wage and above) income gains in Korea are, however, stronger than in Australia, France and the United Kingdom.

Figure 2.15. **Increase in net income as work effort increases, Korea, 2010 and 2012**

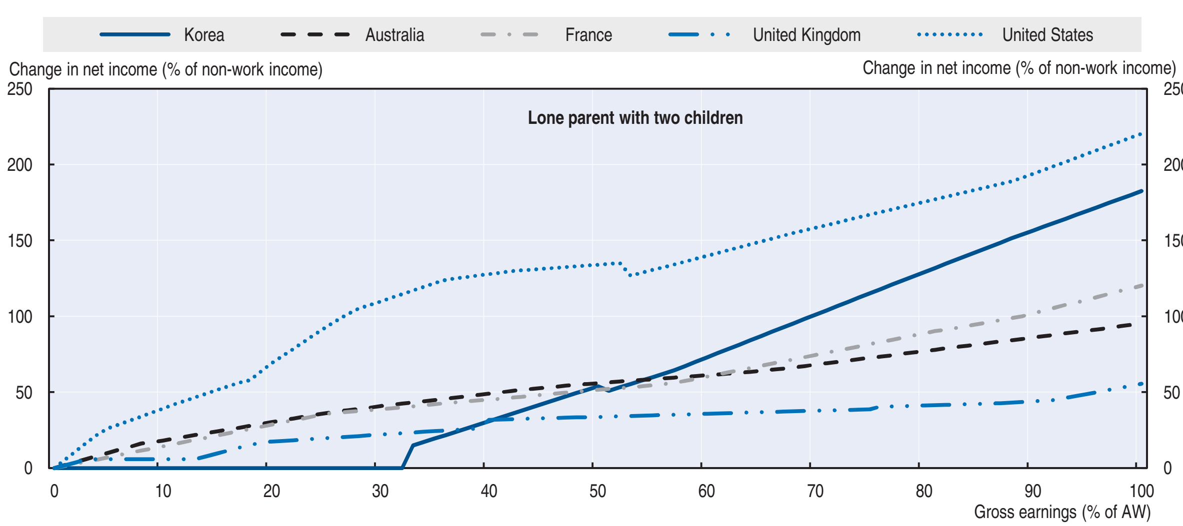
Percentage of average worker (AW)



Note: The 2012 series is modelled as if the changes to the Earned Income Tax Credit (EITC) introduced in 2012 had been in place in 2010.

Source: OECD Tax and Benefit Models (2012), www.oecd.org/els/social/workincentives.

Figure 2.16. **Increase in net income as work effort increases, selected OECD countries, 2010**



Note: The Korean series is modelled as if the changes to the Earned Income Tax Credit (EITC) introduced in 2012 had been in place in 2010. The United States (2010) series includes the additional temporary in-work credits introduced in response to the financial crisis.

Source: OECD Tax and Benefit Models (2012), www.oecd.org/els/social/workincentives.

Policies to improve returns from employment

The functioning of the BLSP and its interaction with the EITC can be improved in order to strengthen work incentives for BLSP recipients with low earnings capacity. As noted above, only certain BLSP recipients with earned income have their benefit withdrawn at a rate below 100%, the consequence of participation in particular programmes. The 100% withdrawal rate faced by the remainder, combined with restrictions on access[18] to the EITC of BLSP recipients provides no financial incentive to take up low-paid employment (Figure 2.15). Such employment, however, may have a higher probability of providing a pathway to self-sufficiency than employment through the specific programmes and as such could be of greater benefit to the individual/family and result in greater savings to the government.

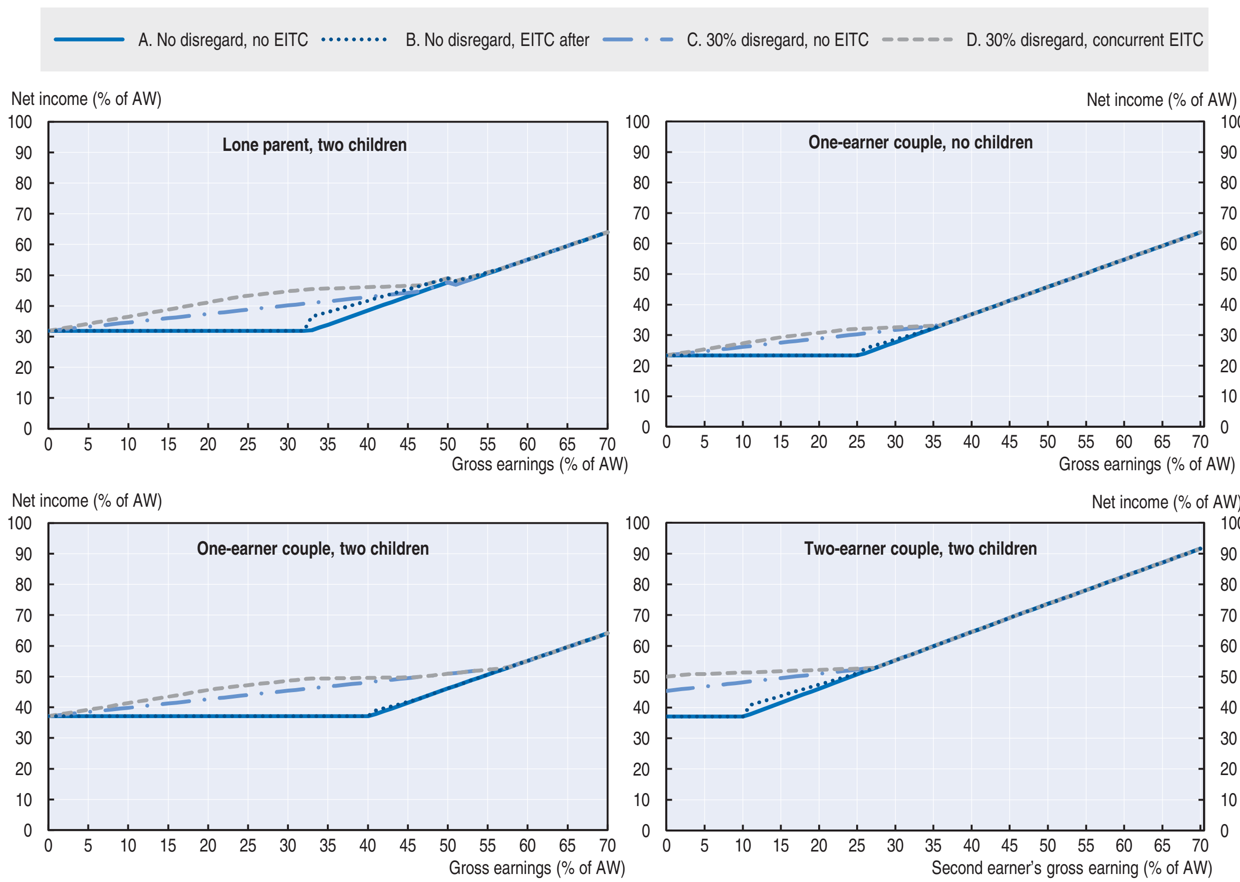
The following exercise compares three existing scenarios with one in which BLSP benefits are reduced for all recipients with earnings by a taper rate of 70% combined with concurrent access to the both the BLSP and the EITC. Each panel in Figure 2.17 portrays net income profiles for earnings up to 70% of the AW under four different scenarios for the specific families. The worst case scenario, which in fact reflects the situation for many current BLSP recipients, occurs when a potential worker is faced with a 100% withdrawal rate of BLSP benefits and is unable to take advantage of the in-work benefits provided through the EITC as a consequence of their receipt of the BLSP (Series A in Figure 2.17).

Enabling access to the EITC by individuals no longer in receipt of BLSP, as can occur if they have not received BLSP payment for more than three months, or if the decision to take up employment is being considered in the first three months of the year, provides only a small income gain and only over a relatively small range of earnings (Series B). The income gains from low paid employment are much stronger for BLSP beneficiaries whose benefit is withdrawn at 70% (those who participate in specific programmes that are eligible for the 30% disregard on earned income). Whether or not these BLSP beneficiaries are restricted from accessing the EITC once their BLSP benefit is withdrawn makes little difference as for most of the family types shown the EITC has been phased out by the earnings level at which BLSP benefits are fully withdrawn (70% withdrawal of the BLSP is depicted in Series C with no access to the EITC, and by the upper bound of Series B and C where EITC is available once BLSP has been fully withdrawn).

The combination of a 70% withdrawal rate of BLSP benefits with simultaneous access to the EITC (Series D) results in net income profiles which are more conducive to taking up employment. This outcome is similar to those observed in France and Australia in that taking up employment at a job paying around 50% of the AW increases the family's disposable income by around 50%.

To achieve stronger growth in net incomes over low earnings ranges, either the BLSP would have to be withdrawn at a lower rate and/or the income gain provided through the EITC would have to be further increased or a combination of the two. While there are advantages and disadvantages with either policy tool the above exercise shows that it is likely that the best results can be achieved by a realignment of both. Increasing in-work income by lowering the BLSP withdrawal rate could have a stronger behavioural impact than would the same increase achieved through an increase in the EITC. This is the consequence of the potentially significant time delays between taking up employment and receiving the financial benefit of the EITC, thereby obscuring the link between individual behaviour and financial reward. In addition, the BLSP is paid monthly so the income gain from a reduced taper rate is more immediately apparent. On the other hand, as the EITC is delivered through the tax system, it has the potential to have a broader reach and consequently a higher take-up rate, making it more effective in reducing in-work poverty.

Figure 2.17. **Improving returns from low-paid employment for BLSP recipients, Korea**



BLSP: National Basic Livelihood Security Programme; EITC: Earned Income Tax Credit.

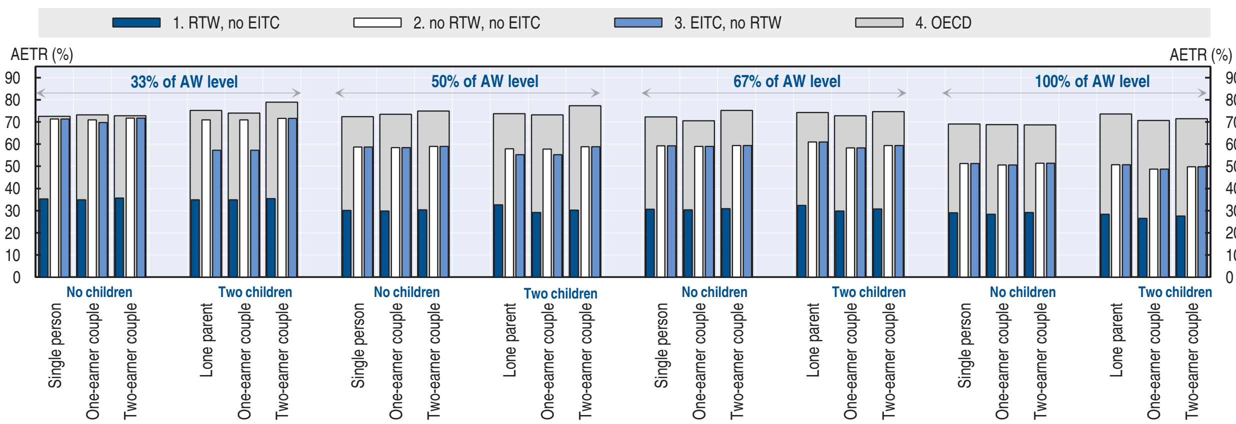
Note: The modelling uses 2010 policy and wage settings with the exception of the EITC which, for scenarios B and D, is modelled as if the changes made to the EITC in 2012 had been in place in 2010. In the two-earner couple, the first earner is assumed to be employed full-time at the minimum wage.

Source: OECD Tax and Benefit Models (2012), www.oecd.org/els/social/workincentives.

Are incentives stronger for EI recipients?

EI recipients face comparatively strong financial incentives for quickly returning to employment and, as a consequence, Korean AETRs for returning to work from unemployment benefits are amongst the lowest in the OECD area. As shown in Figure 2.18 which shows these Korean AETRs under a variety of policy scenarios and compares them to the OECD average, this is the case even if EI recipients are ineligible to benefit from the EITC (on account of either home ownership or other accumulated assets (Series 1). These strong incentives are the consequence of the generous (relative to the EI payment) re-employment bonus called "Early Re-employment Allowance" (RTW).[19] However, incentives are not so strong for EI recipients who do not qualify for the maximum potential bonus. In fact, AETRs for those who are not able to claim the bonus are approximately twice as high (Series 2) and for low income workers are much closer to the OECD average (Series 4). For re-employed workers with incomes and assets low enough to qualify for the EITC, the returns to employment are only improved significantly for families with children and relatively low earnings (Series 3).

Figure 2.18. **Average effective tax rates (AETRs) on returning to full-time employment, EI recipients, Korea versus OECD, 2010**



AW: Average worker; EI: Employment Insurance; EITC: Earned Income Tax Credit; RTW: Early Re-employment Allowance.

Note: The EITC is modelled as if the conditions applying in 2012 applied in 2010. All other parameter settings are based on 2010 values. In modelling the RTW, it is assumed that the unemployed individual qualifies for both the maximum level of benefits given his/her previous earnings and the maximum duration of benefit entitlement as has been unemployed and receiving EI benefits for less than a month.

Source: OECD Tax and Benefit Models (2012), www.oecd.org/els/social/workincentives.

The effectiveness of the Early Re-employment Allowance in encouraging EI beneficiaries to take up employment opportunities more quickly than they would otherwise have done is questionable. The requirement for the job to last for at least six months, the fact that it is a transitional payment and that there is potential for delays before the receipt of the Allowance all contribute to potential recipients heavily discounting the effect it could have on their income. In addition, its monetary value, which is dependent on the EI entitlement (in terms of both cash and duration) on becoming unemployed, diminishes rapidly as the unemployment spell increases. Discussion with representatives of the Korean Labor Institute suggested that while the bonus is quite generous, it is not very effective in terms of reducing unemployment duration – at most decreasing unemployment durations by a single week. As in 2009 expenditure on this scheme was of a similar order to that on the EITC it is important to ensure that the RTW is effective. If that turns out not to be the case, RTW bonus should be abolished, allowing the EITC to become the principal policy instrument for maintaining strong incentives for EI recipients to return to work.

Additional barriers to taking up employment

Child care and child rearing supports

The cost of child care can create additional barriers to taking up employment, especially for lone parents and second earners in families with young children. Korea, as do many OECD countries, has policies in place to reduce the parental cost of formal child care. Changes to Korea's child care policy settings prior to 2008 effectively lowered the net cost of child care for low income families, thereby improving work incentives, particularly those headed by lone parents. This was achieved by increasing the generosity of subsidies and targeting them more tightly to lower income families while fees were increased. These changes also resulted in increased costs faced by the higher-income families. Even so, in 2008, after taking into account taxes and benefits, the cost of full-time child care for two children at a publically supported child care centre, faced by a family with two parents both earning the average wage was equivalent to 15% of the average wage and consumed just under 10% of the family's disposable income. These levels were below the OECD averages of 20 and 13%, respectively. In addition Korea was one of the few OECD countries where, within the broader tax-benefit framework, child care policy settings resulted in child care cost [both in absolute (percentage of AW) and relative terms (percentage of family budget)] declining as earnings get lower (Richardson, 2013, forthcoming).

In 2008, only families with recognised income below 120% of the MCL standard received the full subsidy (equivalent to fees in publically supported centres). Since then the Korean government has broadened the eligibility criteria for child care fee support and by 2011 families with incomes in the bottom 70% of the income distribution received the full-subsidy (*www.oecd.org/els/social/workincentives*). This increased generosity has weakened the targeting of support for child care costs. Further, in contrast to many OECD countries, this assistance to reduce the parental cost of child care is not tied to the child care being for labour market related reasons such as employment, job search or training. As a consequence, the potential impact on labour market participation of women, and mothers in particular, is likely to be less than if there were direct links.

In 2012, the full-subsidy was extended to all 5-year-olds, regardless of the household income and it is to be extended to all 3- and 4-year-olds from 2013. In addition, in March 2012, the government announced free child care for all children under 2. To the extent that these planned extensions weigh on the budget, targeting to low-income parents could limit the strain on government budgets. This would have the advantages of addressing barriers to work for those who are most likely to respond to stronger work incentives and, at the same time, improving the prospect that their children benefit from access to early childhood education.

Korea introduced a means-tested allowance for children who do not use child care centres in 2009.[20] Such "homecare" or "child-rearing" subsidies have been shown to reduce incentives to employment for lone parents and second earners in eligible families. When eligibility is conditional on the non-use of child care the net cost of child care is increased as the family must forego the homecare subsidy if they use child care and this, in turn, for those requiring child care to take up employment, decreases the financial gain from working. Similarly, where the subsidy is income or work tested it directly impacts on the AETR of taking up employment reducing the financial gains from employment at any earning, or hours, levels which result in withdrawal of the benefit (Richardson, 2013, forthcoming).

The "homecare" subsidy in place in Korea has negative impacts on work incentives for lone parents, particularly those who need to use child care to work and have low earnings capacity. A lone parent who requires formal child care for a 2-year old in order to go to work faces AETRs of well over 100% at any earnings level where the BLSP is still being withdrawn. For example, the AETR facing this lone parent for taking up a full-time job at the minimum wage is increased by over 10 percentage points and net income is less than that provided by the BLSP if the lone parent did not work. This effectively raises the net cost of child care by 3% of the AW or an amount equivalent to 9% of the family's disposable income. If the child is younger, or there are additional children who also attract the subsidy, the AETR would be higher still. If the lone parent is able to access informal child care the negative impact of the homecare subsidy withdrawal will not take effect until just before gross earnings reach 50% of the AW. Even so, with just one child aged two the AETR of taking up employment at 50% of the AW increases from just over 70% to almost 80%. It will have similar negative impacts on the work incentives for potential second earners in couple families who qualify for the subsidy even though one partner is already working (that is the earnings of the already working partner are insufficient to lift the family's income above the eligibility threshold of 120% of the MCL).

Intersection of withdrawal criteria and lump-sum withdrawal

Incentives to take up employment, or increase work hours, at least on the margin, are negatively impacted if benefits are withdrawn in their entirety (that is, as a lump sum) once income reaches a particular level. As a consequence the family's attainable standard of living falls when the benefit is withdrawn. Where cash benefits are withdrawn in one hit, disposable income falls and in the case of in-kind benefits the family will have to spend some of their disposable income replacing the withdrawn benefits and as such have less left to support the standard of living they were achieving immediately prior to the withdrawal of benefits.

The BLSP includes seven different cash and in-kind benefits to assist recipients with the cost of living allowance, housing, medical care, educational, childbirth, funeral and self-support benefits. Assistance with the cost of living allowance and most housing assistance[21] are provided in the form of a monthly cash benefit while the other benefits are provided as services according to the family's circumstances. Some of these in-kind benefits are withdrawn when recognised income reaches the minimum living criteria and the remainder (generally those related to education and, in specific circumstances, access to the Medical Aid Programme) when recognised income reaches 150% of the family's minimum income threshold.

The fact that BLSP recipients receive all or none of the in-kind benefits creates strong incentives to enter the system and equally strong disincentives to leave. It thus contributes to the low turnover of BLSP recipients reported by MOHW officials (50% have been recipients since 2000). As noted above, work incentives under the BLSP can be improved by tapered withdrawal of both cash and in-kind benefits. One way to taper withdrawal of in-kind benefits is through a voucher system where the value of the voucher is adjusted according to both the individual needs and income.

The 120% MCL criteria plays a critical role in Korean social policy settings. In addition to being the cut-off point for many in-kind services, it is the point at which benefits under the EITC are fully phased out and the threshold at which eligibility for some other cash benefits (e.g. the child rearing support available to lone parents and the homecare support for parents of children less than 3-years old) are withdrawn, also as a lump sum. This highlights two major weaknesses in the capacity of the Korean policy settings to perform as an effective active social policy – the lack of coherency and the overly high degree of fragmentation.

While work incentives can be improved by tapered withdrawal of both cash and in-kind benefits this will only moderate, not resolve, the problem of excessive effective tax rates generated by the withdrawal of multiple benefits over the same income range. Though, the introduction of the integrated computerised database for social security administration ("Happiness e-Eum") in 2010 has brought about substantial improvements, more efforts are needed and a more unified approach to policy is required, both within and across levels of government, to ensure that programmes work together to support those who need to be supported but do not trap people into benefit dependency through the combined impact of the withdrawal of different benefits. Policy makers should respond to perceived gaps or issues within the context of the existing policy environment taking into account potential interaction effects between new and existing programmes. Better still would be to undertake a holistic review of all existing programmes with a view to working toward refining the social policy system in such a way that the system is clearly focused on providing a socially acceptable standard of living for those who cannot do so for their selves but also encourages, and ultimately ensures, those capable of self-sufficiency realise that potential.

The scope to achieving coherency across programmes, even at the national level, is constrained by the creation of a large number of small programmes that respond to a specific problem. To illustrate, the "Happiness e-Eum" collects administrative information on around 300 programmes but does not cover all programmes. Moreover, there are nine national ministries involved in delivery of the BLSP benefits. At a minimum simplification/rationalisation of these programmes should result in budgetary savings through reduced duplication of administration. Further savings should also be possible through increased integration of delivery. As well as reducing administrative costs, such action should reduce the gaps through which eligible people can fall.

An effective safety net should provide an adequate standard of living for those who are either permanently of temporarily unable to provide for themselves. For those who are only temporarily unable (or are partially able) to provide for their selves, effective social policy should ensure that "work pays". In conjunction with easing access to the BLSP and improving the effective coverage of the EI system Korea's activation strategy must increase the employment chances of those with work capacity. The following chapter examines, amongst other things, how Korea's activation policy can be more effective in moving those who can into work.

Notes

1. It should be noted that redistribution and poverty reduction tends to be lower when (market) incomes are distributed more equally (see OECD, 2011a). The correlation is, however, far from being perfect and is suggested for poverty reduction (correlation coefficient of 0.32 for the countries included in Figure 2.5) but not for inequality reduction (correlation coefficient of between -0.1 and 0.2 depending on whether the outliers Chile and Mexico are included).
2. In the mid-2000s, the poorest 20% were net benefit recipients in almost all countries, with cash transfers adding up to around two-thirds of market income on average, much higher than the 12% in Korea.
3. The in-depth analysis of these programmes is made possible by virtue of their inclusion in the OECD Tax and Benefit Models (2012) (*www.oecd.org/els/social/workincentives*).
4. Prior to implementation of the BLSP, the Korean government provided limited protection mainly for those who were unable to work due to age or disabilities under the Livelihood Protection System (LPP). LPP covered about 1.5 million persons (3% of the population) in 1997.
5. Assessed income is equal to actual income minus expenses based on household characteristics and any earned income deduction. Converted property income is calculated, on a monthly basis, by multiplying the net property value (that is, after accounting for recognised deductions and liabilities) by one of three conversion factors determined by the type of property – general at 4.17%, financial at 6.26%, and vehicles at 100%. The Korean government plans to lower the conversion rate applied to residential property (to 1.04%) in 2013.
6. The asset test on "legal supporters" was further relaxed to 185% in 2012 (KIHASA Interview).
7. The payment increases with household size. In 2011, the payment increased by KRW 306 409 (an additional 70%) for the second person and by KRW 218 022 for each subsequent person.
8. Those with working ability are provided with support to raise their work incentives. If they participate in the self-reliance program, they can deduct up to 50% of their earned income on their taxes. For those who join the labour market, the Hope Growing Bank Accounts, matched savings accounts that encourage low-income families to save and build assets, was introduced in 2010, in addition to the 30% deduction of earned income. The programme is conditional on the efforts to work out of BLSP benefits and intends to increase work incentives by assisting them to build their own assets.
9. As of June 2011, there were around 16 000 able-bodied recipients who were granted waivers for the participation in training programmes owing to unavoidable circumstances including study and care for a family member. The number of participants in self-reliance programmes was approximately 44 000 and about 130 000 joined the labour market. It is necessary to facilitate conditions to work by, for example, providing care services for their family members, for beneficiaries facing unavoidable circumstances. However, for those who work in the market, still remain on benefit due to low income and do not receive the training, there is a need to encourage and increase their participation.
10. In contrast to many other OECD countries, Korea's Employment Insurance system finances active labour market programmes (ALMPs), vocational training for existing employees,

maternity and child care leave, as well as unemployment benefits and a number of other income support payments for unemployed workers. A number of other allowances are also available for displaced workers under the EI system. The Job Center can grant a Payment for Extended Training, equal to the unemployment benefit, for up to two years to individuals who are taking part in vocational training programmes recommended by the Job Center. In practice, however, use of this measure is negligible (OECD, 2013, forthcoming).

11. All employees in workplaces with one or more employees should be registered and contributing to EI, with the exclusion of *i)* workers aged 65 years and over (these workers are exempt from contributions for unemployment benefits, maternity and child care leave, but should pay contributions for employment security and vocational skills development); *ii)* part-time employees whose contractual hours are less than 60 hours per month (or 15 hours per week); and *iii)* some other groups of workers including government officials, private school teachers, some foreign workers and special post office staff. Since 2006, the self-employed have been progressively allowed to take part in the EI system voluntarily and from 2012, this applies to self-employed with less than 50 employees.

12. The average worker (AW) wage referred to throughout this chapter is used in the OECD Tax and Benefit Models as the benchmark value for making inter-country comparisons. For full details see the Tax and Benefit Methodology documentation available at *www.oecd.org/els/social/workincentives*.

13. Special Extended Benefits can also be paid to all unemployment benefit recipients who have exhausted their benefits if the government declares that the employment situation is particularly bad though this mechanism has not been used since the 1997 financial crisis.

14. From July 2012, annual household gross income must be less than 13, 17, 21 or KRW 25 million for couples without children, and households with 1, 2 or more than two children respectively. The income ceiling ranges from 35% to 68% of the AW wage. Property requirements continue to be strict requiring that the total assets of the household, including real estate, must be less than KRW 100 million. The maximum market value of the (at most) one residence a household can possess has been increased from of KRW 50 to KRW 60 million. In addition, since 2012, those who have not been receiving BLSP as of March of the year when they request the EITC will be able to receive the tax credit, unlike previously where those who received BLSP in the previous year were not eligible for the EITC (Ministry of Strategy and Finance, 2012a).

15. According to the Ministry of Strategy and Finance, there are plans to extend eligibility progressively to self-employed as well as to seniors aged 60 or older living alone who will be eligible for the tax credit of up to KRW 700 000 a year when their annual income is less than KRW 13 million.

16. The comparison is to 29 and 30 OECD countries. Greece, Italy, Mexico and Turkey do not have minimum guaranteed income schemes though Greece does provide cash family benefits to workless families. There is currently no tax–benefit model for Chile. The calculations include family benefits (paid in most other OECD countries but not in Korea).

17. The OECD Tax and Benefit Models compute tax and benefit amounts for a number of different household situations. The four "typical" family types used are a single adult without children; a lone parent with two children; a couple family without children; and a couple family with two children.

18. Households that have received BLSP benefits for more than three months are ineligible to claim EITC benefits. Until 2012, this restriction was implemented based on BLSP receipt in the year of and the year prior to the tax year of the potential EITC claim. For 2012, eligibility for the EITC is restricted to households that have not received BLSP since March in the year of the EITC claim (Ministry of Strategy and Finance, 2012a). While this is an

easing of the restriction it could result in families in identical situations, in terms of their BLSP receipt and annual earnings levels, except for the timing of BLSP receipt during the year being treated differently. For example, those receiving the BLSP in January and February would be eligible for the EITC but not those receiving the BLSP in any other two months of the year.

19. The Early Re-employment Allowance is equivalent to between one-half and two-thirds of the benefit entitlement remaining when the jobseeker takes up a job, provided they have at least 30 days of entitlement remaining. The employment must guarantee more than six months of continuous employment but entitlement is not conditioned on working hours. The request for payment should be filed within three years from the date marking the sixth month after the day of re-employment or business start-up (to be paid in a single payment).

20. In 2010, children aged less than 24-months old in households of the marginally poor or with less income were given KRW 100 000 per month. In 2011, the eligibility was broadened to children aged less than 36-months old (previously less than 24-months old) and the subsidy amount became dependent on the child's age (KRW 200 000 for children aged less than 12-months old; KRW 150 000 for children aged 12-months to less than 24-months old; and KWR 100 000 for children aged 24-months to less than 36-months old). There is also some political pressure to further expand the scope of this subsidy.

21. Under certain circumstances housing assistance may be available as maintenance and/or repair services.

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Chapter 3

Policies to tackle labour market duality in Korea

This chapter examines one of the key issues in the Korean policy debates about how to stem the rise in income inequalty: labour market duality. In the context of rapid population ageing and an increasingly difficult school-to-work transition for many youth, strong dualism also threatens to lower the growth potential of the economy. Against this background, the first goal of this chapter is to provide an empirical overview of labour market dualism in Korea and compare the main patterns which emerge with those observed in other OECD countries. This analysis confirms that dualism is unusually strong in Korean and is an important source of earnings inequality and the highest rate of labour turnover in the OECD area. The chapter also identifies effective policy strategies for reducing labour market duality. It argues that well designed policies can reduce the most harmful aspects of duality and thus contribute to stronger and more equitable growth in Korea.

3.1. Introduction

Labour market duality – as exemplified by large differences in employment conditions between regular and non-regular workers – has become one of the key issues in the Korean policy debates. Many argue that the labour market has become increasingly segmented since the 1997 economic crisis and that this has resulted in rising earnings inequality, discrimination and employment insecurity (KDI, 2009; Koh et al., 2010). Increased labour market dualism feeds into broader policy concerns about rising income inequality and unacceptably high risks of poverty and social exclusion (Chapter 2). In this context, many have concluded that policies to tackle labour market duality need to be an important component of a comprehensive strategy to strengthen social cohesion by making the Korean economic growth more inclusive. Policies to tackle duality should also be only one, albeit important, component of a comprehensive strategy to achieve better labour market performance. Other components of such a strategy, which are not analysed in this chapter, include removing incentives for informal employment, reducing average working hours while increasing the flexibility of working time arrangements for regular workers, and implementing co-ordinated packages of demand- and supply-side measures to boost employment of youth and older workers.

This first goal of this chapter is to provide an empirical overview of labour market dualism in Korea and compare the main patterns which emerge with those observed in other OECD countries. This analysis confirms that dualism is unusually strong in Korean, as is reflected in one of the highest incidences of temporary employment among OECD countries and the highest gender pay gap. Dualism is also shown to be an important source of earnings inequality and the highest rate of labour turnover in the OECD area. The chapter also argues that the highly segmented labour market reduces economic efficiency, because it prevents many workers from realising their full productive potential; either consigning them to low-productivity jobs or discouraging them from participating in paid employment. If not addressed with appropriate policies, the efficiency penalty associated with duality could undermine the growth potential of the Korean economy in coming decades, as the population ages and the potential labour supply shrinks.

A second goal of the chapter is to identify effective policy strategies for tackling labour market duality. It argues that well designed policies can reduce the most harmful aspects of duality and thus contribute to stronger and more equitable growth in Korea. However, policy makers need to be aware of the complexity of the challenge posed by labour market duality. One difficulty is that intense international competition and rapid technological change place a premium on labour market flexibility and cost competitiveness. In this context, an attempt to rapidly generalise the employment conditions typically enjoyed by regular workers in large firms to the workforce at large is bound to fail. What is needed is a more gradual and nuanced approach that reduces the barriers that trap too many workers in jobs that do not allow them to develop their full productive potentials, while also better reconciling labour market flexibility with employment security for workers. Such an approach will need to reduce the sharp differences in employment conditions between regular and non-regular jobs. Even more fundamentally, the template for good career jobs needs to become more flexible so as to encompass workforce groups who are currently pushed to the margin of the labour market, such as workers changing employers or who require a part-time work schedule.

Another complication facing policy makers is that employers, workers and their representative organisations will need to play an active role in reforming the labour market institutions and practices that need to adapt in order to tackle duality. In particular, employers' human resource practices will need to evolve, so as to provide good career prospects to a larger and more diverse share of the workforce. Government policy has a number of levers, such as regulation, fiscal incentives and educational efforts to encourage socially beneficial changes in the behaviour of private labour market actors, but much of the initiative will ultimately need to come from employers, workers and their representative organisations, who will need to re-examine well-entrenched practices and consider how best to adapt them to a changing economic and demographic context.

The policies discussed in this chapter are only one component of the broader strategy that is needed to reconcile the continued strong growth performance of Korea with greater equity and social cohesion. Most OECD countries have experienced widening earnings inequality during the past several decades due, in considerable part, to the impacts of skill biased technical change and deepening international economic integration (OECD, 2011a). In this demanding economic environment, there are limits to how far earning differentials can be compressed and job security guaranteed without undermining the dynamism of the Korean economy and the competitive strength of its export sector. This means that policies to reduce labour market duality need to be combined with effective income support programmes, including for low-income workers (Chapter 2). Tackling duality will also require the government to assure that persons wishing to work have the supports they need to do so effectively, such as high quality and affordable child care for parents of young children (Chapter 4) and good primary health care for older workers who need to manage chronic health problems (Chapter 5).

The chapter is organised as follows. Section 3.2 provides an overview of labour market duality in Korea and shows that it is more pronounced than in most other OECD countries. The equity and efficiency costs of duality are analysed in Section 3.3. The next two sections identify policy measures that can reduce duality, in large part by building on past reforms. Section 3.4 discusses polices to reduce overall duality while Section 3.5 focuses on policies that reduce the specific barriers facing women, older and younger workers when they attempt to access jobs that allow them to develop their full productive potential.

The chapter argues that in order to tackle overall labour market duality, the following actions are needed:

- The Korean government has recently undertaken numerous reforms to address labour market duality. Insofar as they support the convergence of labour rights between non-regular and regular workers and reduce the number of workers who become trapped in low quality jobs, these are promising steps. Looking forward, one key will be to monitor closely the effects of these reforms with a view to improving their effectiveness and ensuring that they are coherent and mutually reinforcing.

- One key priority is to further relax employment protection for permanent workers. In particular, the remedy procedure for unfair dismissal should be simplified and accelerated, since the current procedure often involves an excessively long delay before the final court decision is reached. Relaxing employment protection for regular workers would reduce the incentive for firms to hire non-regular workers as a means to enhance employment flexibility.

- One focus of recent labour market reforms has been to provide greater employment protection for non-regular workers. This has the potential to provide these workers with greater employment security even as the incentive for employers to overuse precarious forms of employment is reduced. While the increase in protection has gone about as far as is desirable for fixed-term and part-time workers, there is considerable scope to better harmonise employment protection legislation across different types of non-regular job contracts. In particular, the rules limiting the use of temporary agency workers appear to be too strict by comparison to those applying to workers hired on fixed-term contracts and part-time workers. Aligning the Korean regulation with that of the other OECD countries would require replacing the "positive-list system", which largely limits such workers to certain authorised occupations and industries, with a "negative-list system", which allows them in general, except in certain specified cases. Since this issue has been the source of fierce disagreements between employers and labour organisations, it will be important to develop a broad consensus among stakeholders before moving forward with the implementation of such a reform.

- The corporate pension scheme has the potential to make an important contribution to reducing duality, if firms can be convinced to replace the retirement allowance with a corporate pension. Despite recent improvements, the corporate pension scheme is still not attractive enough to many employers to convince them to switch. Discontinuing tax preferences for retirement allowances would be a big step in the right direction.

- Additional measures to enforce the minimum wage have been introduced recently which is welcome given evidence of significant non-compliance. Another welcome change was allowing fixed-term worker trainees, who are under contract for less than one year, to be covered by the minimum wage law. While expanding the coverage of the legal minimum wage should help to contain the phenomenon of low pay among temporary employees, thus supporting the effort against labour market duality, experience for other OECD countries suggests that it might also act as a disincentive to employ certain groups of low-skilled workers, particularly youth lacking job qualifications. To counter this risk, a number of other countries have introduced a lower minimum wage for young workers engaged in jobs requiring investment in training and found that this arrangement can encourage firms to invest more in hiring and training youth. This approach may be of limited relevance to Korea, given the very high educational attainment of most youth, but it will be important for the government to closely monitor whether the legal minimum wage becomes a barrier to employment for some workforce groups.

- The key priority with respect to active labour market policies is to improve outreach to non-regular workers. At present, these workers more often miss out on activation policy than their regular counterparts. The new Successful Employment Package is a promising step, but in order to tackle the labour market duality problem, the Package should also be used as a tool to boost the longer-run career prospects of the non-regular workers, by combining subsidised work experience with training.

- Another priority is to ensure that non-regular workers are more effectively covered by the social insurance system. The decision to unify the collection of social security contributions under the National Health Insurance

Corporation (NHIC) is an important step forward, although much remains to be done in order to achieve a high degree of integration between main social insurance schemes. Doing so would narrow the gap in labour costs between regular and non-regular workers, while also making the social protection system more effective and reducing the size of the informal sector.

Beyond these general policies to reduce overall duality, a number of other measures are required to provide women, youth and older workers with greater access to high productivity employment:

- The Korean government recently has taken a number of promising measures to improve the labour market situation of all three groups. It will be important to monitor the effectiveness of these initiatives closely, since many of them may need to be reinforced in order to change strongly engrained labour market practices, such as the common expectations that regular workers not interrupt their careers when their children are young, work long hours and retire from their career job well before the age of pension entitlement; as well as cultural values, such as the high value Koreans place on academic study *vis-à-vis* vocational education.
- One key to helping more women to successfully combine good careers with family life is to offer regular workers – especially women – greater flexibility in working time and work schedules, while remaining in good career jobs. Another priority is to expand access to high quality and affordable child care.
- The key priority with respect to older workers is to reduce the incidence of early retirement from career jobs. This will require additional measures to loosen the strong linkage between seniority and compensation, while also improving the access of older workers to training. Relaxing employment protection for regular workers could also contribute to reduce the incidence of early retirement by providing large employers with alternatives to early retirement when adapting their workforce.
- Educational choices need to become more responsive to labour market requirement in order to reduce the skill mismatch. Further efforts to strengthen vocational education and career guidance for youth are required, although much has already been done in this area. Policies to improve the dynamism and productivity of the service sector could also help to expand the demand for highly educated workers and reduce the number of non-working or underemployed university graduates.

3.2. Labour market duality in Korea: Overview of a complex phenomenon

Non-regular work

The clearest manifestation of labour market dualism in Korea is non-regular workers who account for a little more than one-third of all employees – according to the definition adopted by the Economic and Social Development Commission (formerly the Tripartite Commission) in 2001 – and whose pay and other terms of employment are considerably less attractive than those for regular workers (Table 3.1).[1] Non-regular work takes a number of different forms which involve one or more of the following characteristics:

- *Temporary or contingent workers* who account for 57% of non-regular employment in 2011 and the large majority of which have fixed-term contracts;
- *Part-time workers* who account for 28% of non-regular employment in 2011;[2]
- *Atypical workers* who have a number of different employment statuses (e.g. independent contractors, dispatched workers, daily and on-call workers) who account for 41% of non-regular employment in 2011.[3]

Table 3.1. **The incidence and relative pay of different types of non-regular employment, 2003-11**

Panel A. Employed persons by status[a]

Year	Wage workers	Non-regular workers		Of which[b]: Temporary workers, with: Fixed-term contract	Open-ended contract, expect job to continue[c]	Open-ended contract, but could be dismissed[d]	Part-time workers	Atypical workers: Dispatched	Daily	Others[e]
2003	14 149	4 606	*32.6*	*52.2*	*5.4*	*7.9*	*20.2*	*2.1*	*12.8*	*24.1*
2005	14 968	5 483	*36.6*	*49.8*	*5.5*	*10.7*	*19.0*	*2.2*	*13.1*	*22.0*
2007	15 882	5 703	*35.9*	*44.4*	*9.7*	*8.1*	*21.1*	*3.1*	*14.8*	*23.7*
2009	16 479	5 754	*34.9*	*48.9*	*3.0*	*9.1*	*24.8*	*2.9*	*15.3*	*23.6*
2011	17 510	5 995	*34.2*	*44.5*	*5.7*	*7.3*	*28.4*	*3.3*	*16.0*	*22.7*

Panel B. Hourly wages of non-regular workers relative to regular workers
Index "Regular worker" = 100

Year	Regular workers	Non-regular workers	Of which: Temporary workers, with: Fixed-term contract	Open-ended contract, expect job to continue[c]	Open-ended contract, but could be dismissed[d]	Part-time workers	Atypical workers: Dispatched	Daily	Others[e]
2003	100.0	71.6	70.7	88.4	55.8	85.1	68.0	63.2	65.5
2005	100.0	70.5	74.5	89.1	54.1	76.7	76.1	53.7	66.6
2007	100.0	70.9	76.3	98.1	48.0	66.6	70.8	52.0	61.9
2009	100.0	61.5	65.5	87.2	48.7	56.2	69.7	47.6	60.0
2011	100.0	65.3	69.0	93.7	52.4	59.3	66.5	47.4	63.7

a) Thousands of workers and percentages (shown in italics).
b) The sum of the categories of non-regular workers exceeds 100% due to double-counting.
c) Workers' whose term is not fixed and can be renewed regularly.
d) An employee could be dismissed, for example, due to seasonal factors, completion of a project or the return of an employee that they were replacing.
e) "Others" corresponds to three underlying types of atypical employment: *independent contractors*, *daily/on-call workers* and *in-house workers*. The hourly wage index for "Others" in Panel B is an employment-weighted average for these three employment types.

Source: Statistics Korea, Economically Active Population Survey (EAPS), Supplementary results of the EAPS by employment type (August) for Panel A; and Korea Labor Institute (2011), "2011 KLI Labor Statistics of NRWs" for relative earnings and OECD calculations based on the MOEL Survey on Labor Conditions by Type of Employment for Panel B.

The share of employees who are non-regular workers rose sharply in the years following the 1997 economic crisis, reaching a peak of 37% in 2004. Since then the incidence of non-regular work has declined modestly to 34% in 2011. Temporary forms of employment have accounted for most of the overall evolution in non-regular employment, suggesting that one of the main impulses driving the strong secular increase in non-regular work has been employers' demand for greater flexibility in adjusting the size and composition of their workforces. The modest decline in temporary forms employment since 2007 may reflect the regulatory changes intended to discourage overuse of these types of jobs by employers that are discussed in Section 3.4 below.[4]

The hourly wages of non-regular workers are far lower than those of regular workers and this pay penalty appears to be increasing. On average, the hourly wage penalty for non-regular workers was 28% in 2003 but it rose to 35% in 2011 (Table 3.1, Panel B). While all types of non-regular employment pay less well than regular employment, the pay penalty varies somewhat, with daily workers receiving a particularly low hourly wage (less than one-half the average wage for regular workers in the most recent years). Non-regular workers are also much less likely than regular workers to receive other forms of compensation, such as bonuses and allowances. Beginning with Ahn (2006), a number of researchers have argued that a significant part of the overall wage gap for non-regular workers can be attributable to differences in the quality of these workers. However, a considerable share of the total pay difference remains, even after taking into account individual characteristics, such as education and job tenure, confirming that non-regular workers are subject to discriminatory treatment.

Kim (2010) argues that a considerable share of regular workers under the definition used in Table 3.1 (38% in 2008), might plausibly be reclassified as a type of non-regular workers ("disadvantaged workers") because they have little job security and face a pay penalty similar to that associated with workers who are classified as being in non-regular employment in Table 3.1. Expanding the concept of non-regular workers to include disadvantages workers would bring their total share employment to 52% in 2008.[5] Even in the absence of a consensus about the best definition of non-regular work, there appears to be general agent that a substantial share of workers in Korea hold jobs that provide substantially less job security and lower compensation than is available to core workers in large corporations.

Certain workforce groups are particularly likely to hold non-regular jobs, while other groups have a low incidence of non-regular work (Table 3.2). In particular, older workers are strongly over-represented among non-regular workers. The share of non-regular workers who are 60 or older is nearly 5 times as high as the corresponding share for regular workers (16 versus 3.5%). As is discussed in Section 3.5, this reflects the common pattern under which regular workers retire at relatively young ages from their career jobs and then commence "second careers" in non-regular jobs. By contrast, workers under age 30 are not over-represented among non-regular workers in Korea. These age patterns differ sharply from those seen in many European countries, where youth account for a large share of temporary workers. Korean women are more likely than men to hold non-regular jobs, as is also the case in most other OECD countries. Korea also conforms to the common pattern that the least-educated workers have the highest incidence of non-regular employment.

The prevalence of non-regular employment also varies across occupations, sectors and firm size. Assembly and elementary workers have an above-average incidence of non-regular employment, while the opposite is true of administrators and managers, and clerks. Non-regular employment is particularly common in the construction sector, while it is relatively rare in manufacturing. Non-regular workers are also over-represented in smaller firms. Indeed, more than two-thirds of all non-regular workers are employed by firms with less than 30 employees. Not surprisingly, non-regular jobs are much less stable than standard jobs; the average job tenure for non-regular workers is only about one-third that for regular workers (two years and two months versus six years and seven months). Although the situation has been improving, it is still the case that the majority of non-regular workers are not enrolled in job-related social insurance schemes (Section 3.4).

Table 3.2. **A comparison of regular and non-regular workers, 2011**

Percentages

Age	Less than 30-year old	30-59-year old		More than 60-year old
All employees	20.9	71.4		7.8
Regular workers	20.9	75.6		3.5
Non-regular workers	20.7	63.3		16.0
Gender	Male		Female	
All employees	57.3		42.7	
Regular workers	62.9		37.1	
Non-regular workers	46.6		53.4	
Education	Middle school or less	High school		Tertiary
All employees	15.2	39.0		45.8
Regular workers	9.7	36.8		53.5
Non-regular workers	25.9	43.1		31.0
Occupation[a]	Assembly and elementary workers	Administrators and managers	Clerks	Other
All employees	36.6	24.2	21.5	17.7
Regular workers	30.9	27.4	26.8	14.9
Non-regular workers	47.5	18.1	11.3	23.0
Sector	Manufacturing	Wholesale and retail	Construction	Other
All employees	19.7	12.0	8.0	60.4
Regular workers	25.3	12.6	5.9	56.2
Non-regular workers	9.0	10.8	12.0	68.3
By size of establishment	Less than 30 employees	30 to 299 employees		More than 300 employees
All employees	58.8	29.9		11.2
Regular workers	53.1	32.7		14.1
Non-regular workers	69.8	24.6		5.6
Tenure		Average tenure		
Regular workers		6 years and 7 months		
Non-regular workers		2 years and 2 months		
Coverage by social insurance	Employees' pension scheme	Employees' health insurance		Employment insurance
Regular workers	79.1	80.9		77.4
Non-regular workers	38.2	44.1		42.3

a) For the top three occupations for regular workers. The administrators and managers category includes engineers.

Source: Statistics Korea, Economically Active Population Survey (EAPS), Supplementary results of the EAPS by employment type (August).

The two most common reasons employers give for hiring non-regular work are to reduce labour costs and increase employment flexibility (Table 3.3). Whereas these two reasons are cited by nearly a third of employers, considerably smaller numbers cite task-specific reasons such as hiring non-regular workers to perform peripheral tasks (18.5%)

or short-term tasks (13.9%). The emphasis employers place on broad concerns about labour costs and flexibility suggests that one of the keys to limiting the use of non-regular workers is to reduce the cost and flexibility advantage they offer to employers, by comparison with employing regular workers.[6] The steep increase in non-regular employment following the 1997 economic crisis also suggests that human resources management and industrial relations practices for regular workers may not offer employers sufficient flexibility and control over their labour costs to compete successfully in the global economy, except when they combine their core workers with a sizeable buffer of non-regular workers.

Table 3.3. **Reasons given by firms for hiring non-regular workers**

Percentages based on a government survey of firms

	Reduce labour costs	Increase employment flexibility	Perform peripheral tasks	Perform short-term tasks	Other reasons	Total
All industries	**32.1**	**30.3**	**18.5**	**13.9**	**5.2**	**100.0**
Manufacturing	28.7	34.5	17.9	14.7	4.1	100.0
Non-manufacturing	35.4	26.1	19.1	13.2	6.2	100.0
By firm size						
Less than 30 workers	35.5	28.9	15.8	13.2	6.6	100.0
30-99 workers	28.5	27.6	18.7	18.2	7.0	100.0
100-299 workers	37.7	26.2	15.5	14.3	6.3	100.0
300-499 workers	34.3	29.4	19.6	12.7	3.9	100.0
More than 500 workers	28.1	49.9	22.9	9.6	1.6	100.0

Source: Cited from Ahn, J., D.B. Kim and S.K. Lee (2003), *Non-regular Workers and Policy Agenda III* (in Korean), Korea Labor Institute, Seoul, previously published in OECD (2007, Table 5.14), *OECD Economic Survey: Korea 2007*, OECD Publishing, Paris, *http://dx.doi/org/10.1787/eco_surveys-kor-2007-en.*

Different types of employers tend to hire non-regular workers for somewhat different reasons. Manufacturing firms are particularly attracted by the flexibility advantage offered by non-regular employment, while employers in other sectors (predominantly, service sector employers) emphasise lower labour costs. One-half of firms with more than 500 workers cited increased employment flexibility as a reason for hiring non-regular workers compared with less than a third of smaller firms. Larger firms were also more likely to make use of non-regular workers to perform peripheral tasks. These patterns suggest that policies intended to avoid the overuse of non-regular employment or to improve employment conditions for non-regular workers need to take account of the different reasons that different types of firms have for hiring non-regular workers. Similarly, different measures to limit the use of non-regular work or to improve their pay and job security may need to be combined with measures to reduce the labour costs or rigidities associated with regular employment.

Why do so many workers accept non-regular employment when it typically offers lower pay and than regular employment and is also associated with less job security? While some of the lower average pay of non-regular workers reflects differences in characteristics such as their educational qualifications and age, much of the pay penalty appears to reflect differential treatment of workers with equivalent productive potentials.[7] In fact, a little over one-half of non-regular workers indicate that they would prefer regular employment (Table 3.4). The most common reasons for accepting their job that are cited by involuntary non-regular workers are to obtain immediate income (77%) or their inability to find a more desirable job (13%).

Table 3.4. **Reasons given by non-regular workers for accepting non-regular employment**

In 2011, percentages

	Total	Temporary workers	Part-time workers	Atypical workers
Voluntary non-regular workers	**47.6**	**55.1**	**44.7**	**35.4**
Satisfied with working condition	44.4	49.5	35.3	40.4
To obtain job security	23.2	30.7	3.5	17.2
To balance work with other activities[a]	19.0	14.1	43.5	14.1
To have more flexibility in working hours[b]	13.4	5.6	17.7	28.4
Involuntary non-regular workers	**52.4**	**44.9**	**55.3**	**64.6**
To obtain immediate income	76.5	74.6	68.3	83.5
Cannot find a desirable job	13.0	15.4	12.7	10.3
To balance work with other activities[a]	7.8	8.4	15.1	3.0
To have more flexibility in working hours[b]	2.7	1.6	4.0	3.2

a) Includes balancing work with family responsibilities and educational and vocational training, as well as to accumulate job experience.

b) This category includes obtaining performance-based pay.

Source: Statistics Korea.

Nearly one-half of non-regular workers cite a positive reason for accepting their job, most often that they are satisfied with the working conditions (44%).[8] Workers' preference and needs are diverse and some benefit from certain characteristics of non-regular jobs, especially the greater working-hours flexibility and lower stress associated with some of these jobs. Part-time workers are particularly likely to say that their job helps them to balance work with other activities, such as family responsibilities. As will be discussed in Section 3.5, greater working time flexibility can help to increase female participation rates, especially when their children are young. However, it would also be desirable to improve the pay and other conditions attached to part-time work in Korea, which are often less advantageous than in other OECD countries and this discourages its uptake. OECD (2010a) shows that the pay penalty associated with part-time employment in Korea is the second largest out of 28 OECD countries for which data are available.

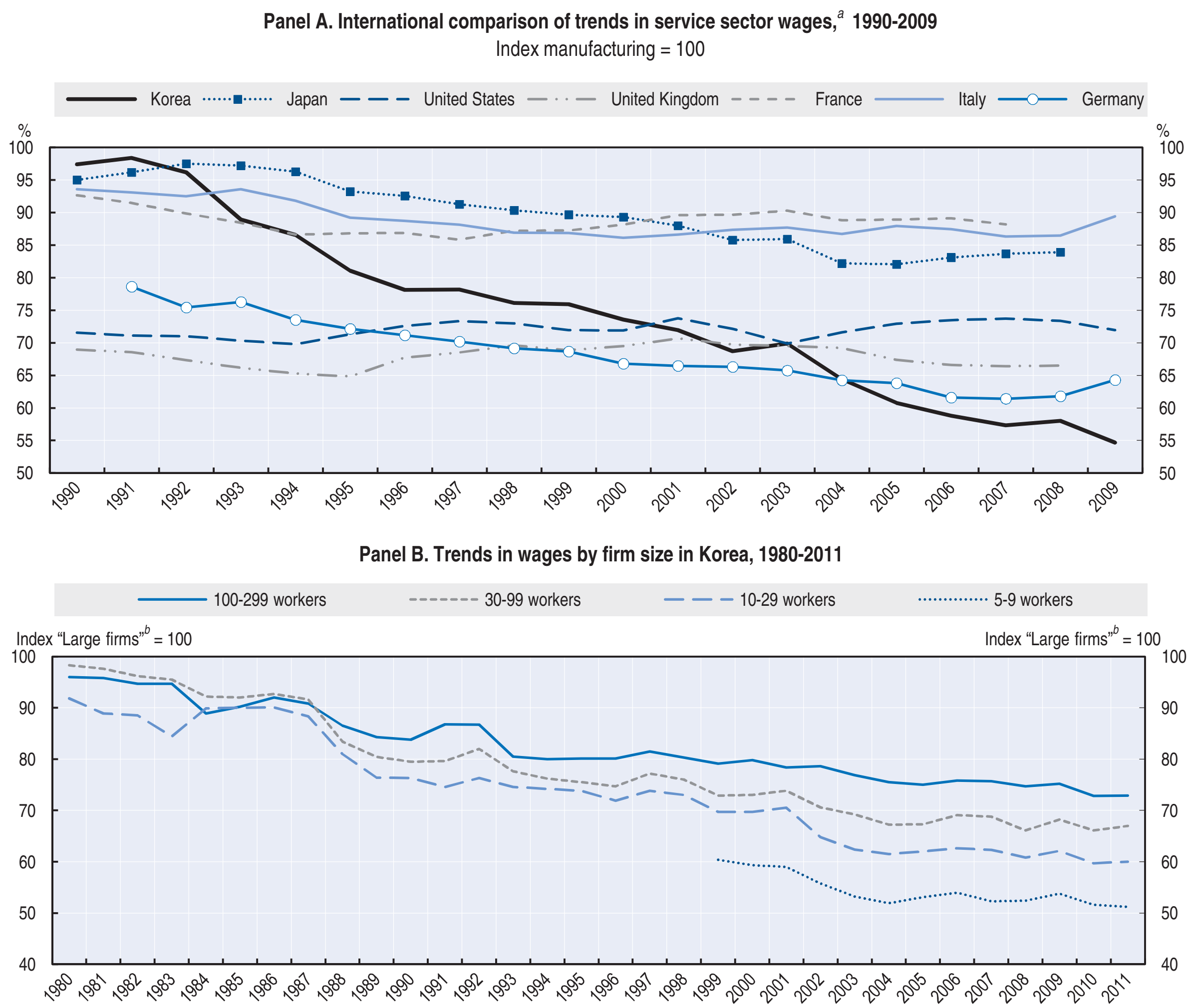
The underdevelopment of the service sector and smaller firms

The high level of labour market dualism in Korea is also a result of the relative under-development of the service sector and of small- and medium-sized enterprises (SMEs), which are far less productive than large manufacturing firms. To a considerable extent, this reflects the very strong productivity performance of large manufacturing firms, which have become world leaders in a number of areas. However, it also reflects notable weaknesses in the performance of the service sector (OECD, 2012a; Park and Shin, 2012). Smaller productivity gains in service sector firms and SMEs have translated into large cumulative declines in the relative wages of workers employed in those firms, as compared to the wages in large manufacturing firms. Low productivity and wages in service sector and smaller firms are thus an important source of earnings inequality. Going forward, it will become increasingly difficult for overall productivity and living standards in Korea to converge on those in the highest income countries if the productivity performance the service sector, which accounts for a large and rising share of total employment, does not improve.

While wages in the service sector have fallen relative to those in manufacturing in most large OECD countries, the decline has been much steeper in Korea than elsewhere (Figure 3.1, Panel A). For example, average service sector wages were nearly as high as manufacturing wages at the beginning of the 1990s in both Korea and Japan, but are now only 55% as high in

Korea as compared to 84% as high in Japan. The wage gap between SMEs and larger firms has also increased substantially (Figure 3.1, Panel B). Currently, average wages in firms with 5-9 workers are about one-half wages in firms with more than 300 employees.

Figure 3.1. **Trends in relative wages for workers employed in the service sector and firms of different sizes**



a) Compensation per employed person in the service sector as a percentage of compensation per employed person in manufacturing.

b) "Large firms" corresponds to firms with more than 300 employees.

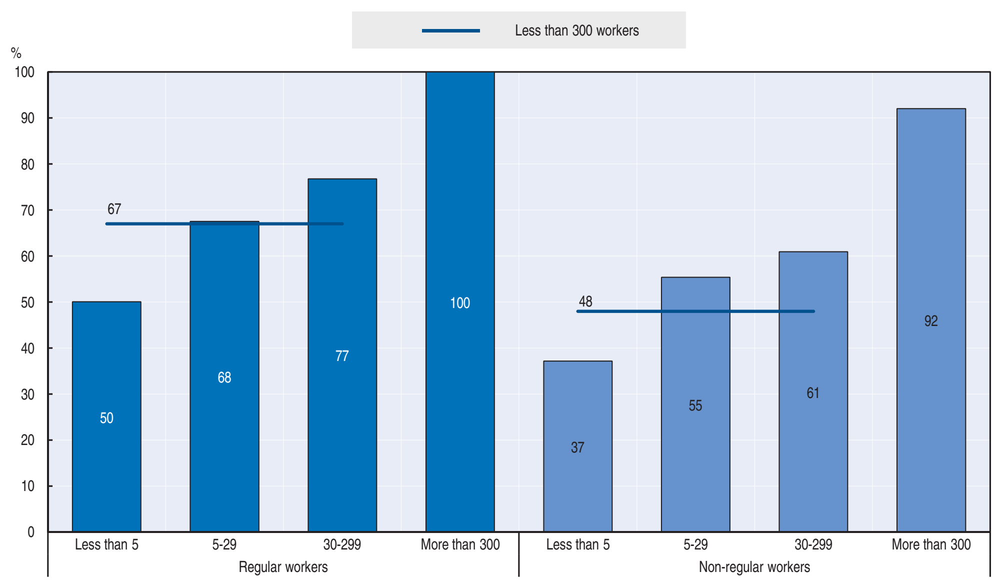
Source: OECD STAN Indicators Database for relative sector wages in Panel A; and Statistics Korea, *Report on the Labor Force Survey at Establishments*, several issues (available at: *http://laborstat.moel.go.kr* > Statistics > MOEL Survey Data) for relative wages by firm size in Panel B.

Since the incidence of non-regular work is higher in smaller and service-sector firms, than in large manufacturing firms (Table 3.2), there is considerable overlap between the labour market segmentation associated with non-regular work and that associated with the underdevelopment of SMEs and service sector firms. Nonetheless, both the type of employment and the type of firm play independent roles in creating dualism. Figure 3.2 illustrates this point by showing how firm size and employment type interact to influence pay levels. Among the key findings:

- Average wage levels rise sharply with firm size for both regular workers and non-regular workers, with the firm size effect being somewhat stronger for non-regular workers.[9]
- Non-regular workers always earn less than regular workers within the same size class. However, these differences are smaller than the overall pay difference between regular and non-regular workers, due to the greater concentration of non-regular workers in smaller firms. While non-regular workers earn 65% as much as regular workers for the entire economy (Table 3.1), they earn 92% as much within the largest firms (Figure 3.2). The relative wage of non-regular workers falls with firm size, but is still 74% within the smallest size category.
- Non-regular workers in the largest firms, employing 300 or more workers, earn more than regular workers in firms employing fewer than 300 workers (92% of the average regular worker wage in the largest firms, versus 67%).

Figure 3.2. **Relative pay by type of employment and firm size**

In 2011, index of relative pay (regular worker in firms with 300 or more workers = 100)



Source: OECD calculations using the MOEL Survey on Labor Conditions by Type of Employment.

Firm size also influences other employment conditions such as access to bonuses and employer-sponsored training, and enrolment rates in job-related social insurance schemes (e.g. National Pension, National Health Insurance and Employment Insurance; see Table 3.11 in Section 3.4). Similarly, OECD (2013a) shows that large firms make far fewer dismissals than smaller firms. When they reduce their workforce, this study estimates that firms with 500 or more employees encourage early retirement or separate workers with severance pay 60% of the time, while 81% of workforce reductions in firms with less than ten employees take the form of dismissals without severance pay.

The large differences in pay and other employment conditions across different types of firms have important implications for policies to reduce dualism. Most obviously, it means that the labour market policy measures (discussed in Sections 3.4 and 3.5 of this chapter) need to be supplemented by other measures to promote productivity improvements in the service sector and SMEs (OECD, 2012a). Another implication is that a large share of the earnings inequality associated with duality cannot be redressed by antidiscrimination laws that prevent employers from discriminating unfairly in setting pay levels for different groups in their workforce. These regulations are very important for improving the relative employment conditions of non-regular workers in large firms, as for equity reasons more generally. The recent government initiative to revise the Acts so as to allow supervisors to take corrective measures when discriminatory activities are identified, may increase their effectiveness within large firms. However, anti-discrimination regulations cannot be expected to address the large share of overall earnings inequality that is attributable to low earnings in SMEs.

Mobility of non-regular workers

This section analyses mobility between different types of employment. The large differences documented above in employment conditions between regular and non-regular workers would be less worrisome to the extent that workers in non-regular employment typically can move into better regular jobs. That is, it is important to know whether non-regular jobs more often serve as stepping stones to better jobs or as long-term traps that confine many worker in low-paying and precarious jobs for a large part (or all) of their working lives. Longitudinal data which follow the same workers over time are required to study these mobility patterns and this section reports new calculations of transition probabilities based on the Korean Labor and Income Panel Study (KLIPS), waves 5-12 (2002-09). While these results provide a useful indication of mobility patterns the results reported here should be treated with caution since the KLIPS sample is not fully representative of the national labour force in Korea[10] and it is not possible using the variables contained in this survey to classify employees exactly according to whether their jobs falls within the official definition of non-regular employment.[11]

Table 3.5 provides an overview of mobility between three types of employment (regular, non-regular and self employment) and two types of non-employment (unemployment and inactivity). One-year and three-year transition probabilities were estimated using data from the Korean Labor and Income Panel Study (KLIPS), waves 2-12. The values presented are average rates for 2002-09. The key result is that approximately one-third of all non-regular workers in a given year move into regular jobs the following year, suggesting the mobility is quite high for non-regular workers. However, a closer look suggests that it would be premature to conclude that non-regular employment is a reliable stepping stone to regular employment:

- The three-year transition probability of moving from non-regular to regular employment is not much higher than the one-year rate (38% versus 34%), suggesting that a considerable share of non-regular workers could be trapped in poor jobs.
- Many of the workers observed to move from a non-regular job in one year to a regular job the next year, cycle back into a non-regular job in the third year. More generally, there is a group of workers who cycle frequently between the two categories of employment, suggesting that their true status may not be measured reliably in the KLIPS data. This measurement problem appears to particularly affect workers who do not have a fixed-term contract but are classified as temporary workers based on their subjective appraisals of whether they will be able to continue in their present job and why (i.e. the second and third categories of temporary workers shown in Table 3.1). The apparently high mobility of this group of workers may be largely spurious and, in any case, provides little insight into the mobility prospects of other groups of non-regular workers.

- If mobility patterns are assessed instead using workers' self-assessments of whether they are regular or non-regular workers, then the estimated mobility rates are far lower. As is shown in Table 3.A1.1 in the annex to this chapter, the one-year transition probability of moving from non-regular to regular employment then becomes 12%, rather than 34%. Workers' self-assessments are likely to differ somewhat from the official definition, but may be more closely linked to significant changes in job quality.
- Kim (2009) and Ahn (2006) analyse the one-year mobility of non-regular workers compared with other types of workers using data from the EAPS. Even though their analysis makes use of the official definition, their estimated transition probabilities are overall more similar to the results obtained here with the KLIPS data when using workers' self-assessments rather than the best possible approximation to the official definition. Ahn also shows that much of the mobility between these two types of employment is between non-regular work and the subset of regular work where pay and job security are similarly low to that for non-regular workers ("seemingly disadvantaged workers").

Table 3.5. **One-year and three-year mobility of non-regular workers compared with that for other workers**[a]

Average percentages, 2002-09

A. One-year transition rates					
	Current labour force status by status one year earlier (percentage distribution)				
Labour force status in initial year	Regular employment	Non-regular employment	Self-employment	Unemployment	Inactive or unpaid family worker
Regular employment	76.3	12.8	2.1	2.3	6.6
Non-regular employment	34.2	47.1	3.4	3.0	12.3
Self-employment	2.6	1.6	88.6	1.0	6.2
Unemployment	25.4	15.0	4.9	18.6	36.2
Inactive or unpaid family worker	4.5	3.6	1.6	2.2	88.1
B. Three-year transition rates					
	Current labour force status by status three years earlier (percentage distribution)				
Labour force status in initial year	Regular employment	Non-regular employment	Self-employment	Unemployment	Inactive or unpaid family worker
Regular employment	66.7	13.9	5.4	2.3	11.7
Non-regular employment	37.5	32.3	8.3	3.2	18.7
Self-employment	6.1	3.5	78.9	1.3	10.3
Unemployment	29.5	21.5	6.8	8.7	33.5
Inactive or unpaid family worker	9.2	5.5	3.0	2.3	80.1

a) Non-regular workers identified using the closest possible approximation of the official definition in the KLIPS dataset (as advised by the MOEL).

Source: OECD calculations using microdata from the Korean Labor and Income Panel Study (KLIPS), waves 5-12 (2002-2009).

The estimates in Table 3.1 suggest that a little less than one-half of non-regular workers in a given year are also non-regular workers the following year. By contrast, regular workers and the self-employed are much more likely to remain in the same employment status (one year probabilities of 84% and 89%, respectively). Indeed, there is very little mobility between self employment and either regular or non-regular dependent employment. There is somewhat more movement from regular to non-regular employment with a one-year transition probability of 13%. Further investigation revealed that this is particularly common for workers having recently moved from non-regular to regular status, where measurement errors may cause mobility to be overestimated, and for older workers who pursue second careers after retiring from regular jobs.

Unemployed persons have nearly as high a probability of moving into regular employment as non-regular workers. For example, 25% of the unemployed are regular employees one year later, as compared to 34% of non-regular workers. However, non-regular workers are substantially less likely to move into regular jobs than the unemployed when workers' self-assessments of employment type are used (Table 3.A1.1). This suggests that the employment experience acquired in non-regular employment may not be much valued by many employers when recruiting regular workers. There also may be a stigma effect associated with being a non-regular worker, although lower mobility for non-regular workers than for the unemployed could also reflect differences in the qualifications of the two groups. Preliminary OECD analysis of panel data for a number of other OECD countries finds that transitions rates from non-regular to regular employment usually exceed those from unemployment to regular employment. Non-regular employment may thus be more often a trap in Korea than in other advanced economies, but no strong conclusions can be drawn on this question from the analysis reported here, due to the difficulty in identifying non-regular workers in the KLIPS.

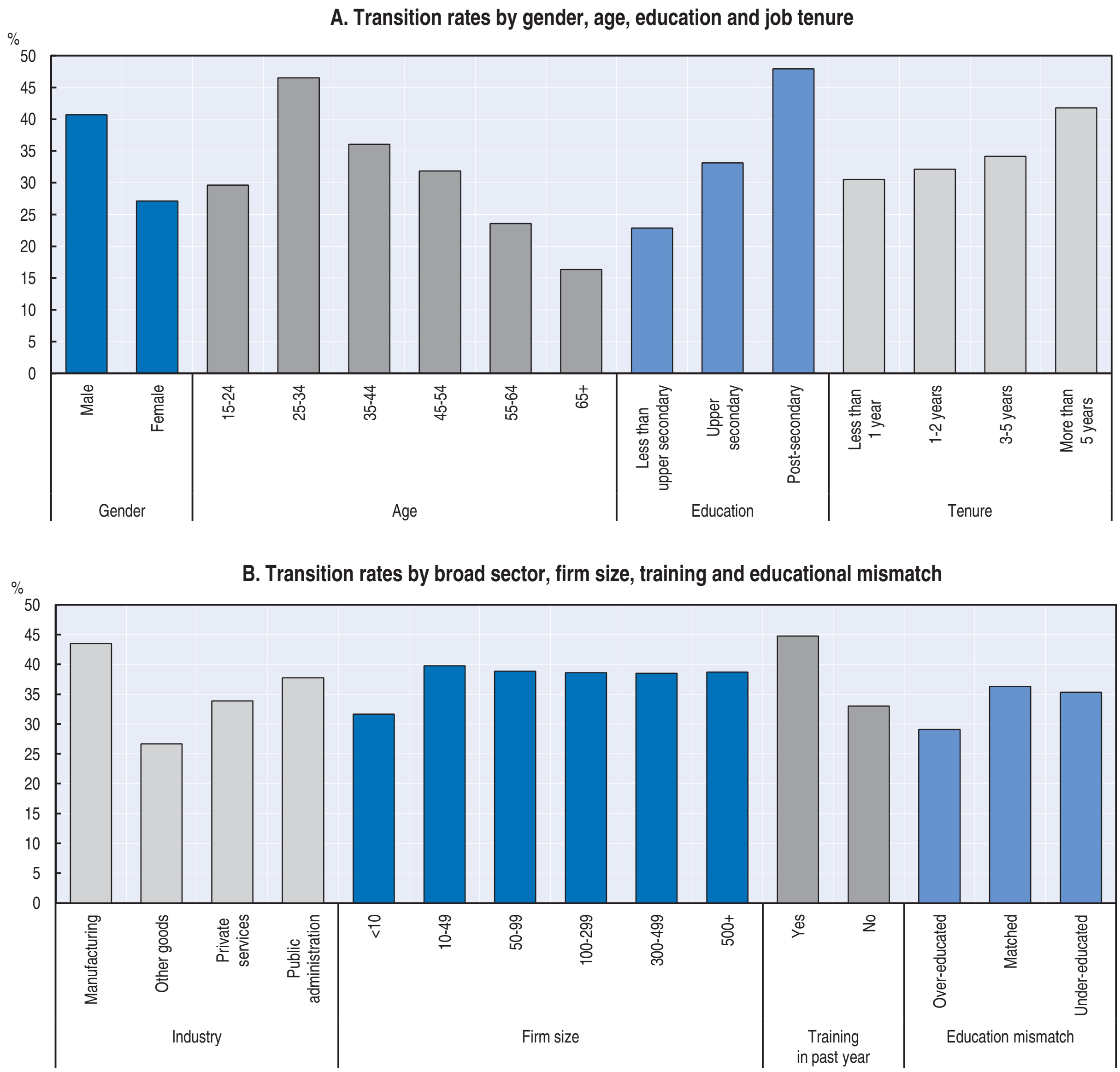
Figure 3.3 shows that some non-regular workers have a better chance than others to move to regular employment. This form of mobility is more common for men than for women. It is also much more frequent for non-regular workers aged 25-34 than for their older counterparts. Upward mobility is also more common for better educated workers.[12] Non-regular workers with more years of job tenure are moderately more likely to move to regular jobs than non-regular workers who have been with the same employer for a shorter period of time.[13] These patterns should be considered as only suggestive, however, because many of them change if mobility is assessed using workers' self-assessment of employment type (e.g. mobility is then very similar for men and women, rather than significantly higher for men).

There are also differences across broad industries in the probability that a non-regular worker moves into regular employment. This form of mobility is most common in manufacturing, but also relatively common in public administration and private services, whereas it is less common in other goods producing industries (i.e. agriculture, mining and construction). Perhaps surprisingly, given how much pay and other employment conditions vary with firm size, mobility varies relatively little with firm size, except that it is moderately lower for firms with fewer than ten employees. Non-regular workers who receive training are more likely than other non-regular workers to move into regular employment, but non-regular workers who are over-educated for their job are less likely to move into regular employment than other workers.[14]

Table 3.6 examines the relationship between skill development and use and employment type in more detail. Non-regular workers are considerably more likely to report that they are over-educated for their jobs than are regular workers (28% versus 17%), but as was noted above their unused (or under-used) qualifications do not appear to help them move into regular employment. Non-regular workers also report that they are receiving less continuing vocational training and either learning no new skills at work or only skills that are highly specific to their current jobs. These patterns suggest that non-regular workers frequently are not able to fully apply their skills at work and that they have relatively little access to formal training or other on-the-job learning that could help them to qualify for better jobs.[15]

Figure 3.3. **One-year mobility from non-regular[a] to regular work for different workforce groups**

Average percentages, 2002-09



a) Non-regular workers identified using the closest possible approximation of the official definition in the KLIPS dataset (as advised by the MOEL).

Source: OECD calculations using microdata from the Korean Labor and Income Panel Study (KLIPS), waves 5-12 (2002-2009).

Table 3.6. **Skills use and development for regular, non-regular[a] and self-employed workers**

Average percentages, 2002-09

Educational mismatch	Very over-educated	Over-educated	Matched	Under-educated	Very under-educated
All paid workers	1.6	17.9	79.0	1.4	0.1
Regular workers	1.2	16.1	81.3	1.4	0.1
Non-regular workers	3.0	24.7	70.7	1.6	0.1
Self-employed workers	1.4	16.3	81.0	1.2	0.1
Portability of skills learned on current job	**Fully general skills**	**Partly general skills**	**Mostly specific skills**	**No learning**	
All paid workers	50.4	33.3	10.3	6.1	
Regular workers	53.7	33.9	8.1	4.4	
Non-regular workers	43.7	33.6	13.9	8.8	
Self-employed workers	48.8	31.6	11.9	7.6	
Continuing vocational training in the past year	**Received training**	**No training**			
All paid workers	10.9	89.1			
Regular workers	13.2	86.8			
Non-regular workers	10.1	89.9			
Self-employed workers	6.7	93.3			
Who paid for continuing vocational training	**Worker**	**Worker's family**	**Employer**	**Government**	**Other**
All paid workers	13.7	0.8	64.9	19.2	1.4
Regular workers	7.1	0.8	70.9	20.4	0.9
Non-regular workers	10.3	0.7	73.6	13.8	1.6
Self-employed workers	46.3	1.0	28.9	20.2	3.5

a) Non-regular workers identified using the closest possible approximation of the official definition in the KLIPS dataset (as advised by the MOEL).

Source: OECD calculations using microdata from the Korean Labor and Income Panel Study (KLIPS), waves 5-12 (2002-2009).

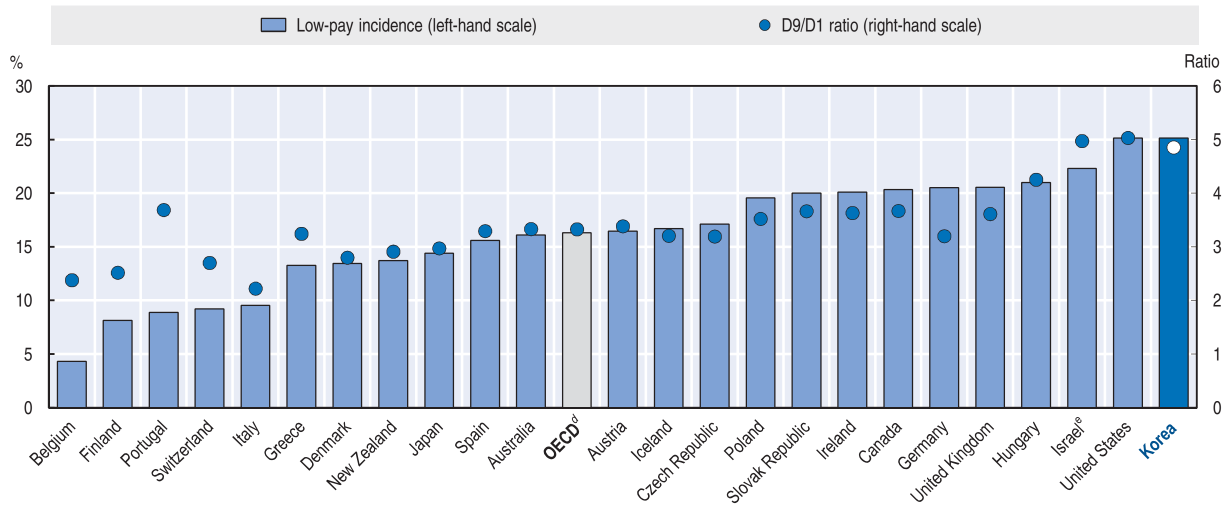
Is Korean labour market dualism different?

The preceding sections have shown that labour market dualism is strong in Korea in the sense that a large share of the workforce are non-regular workers or are employed in SMEs and service sector firms, and these workers experience significantly worse pay and other employment conditions than regular workers in large firms. Furthermore, mobility into regular jobs appears to be difficult for many non-regular workers. In analysing the appropriate policy response, it is useful to compare these patterns with those observed in other OECD countries, to highlight Korea's specificities and possible ways to handle them. Indeed, this sub-section finds both similarities and differences between the labour market duality found in Korea and that characterising other OECD countries.

Figure 2.4 in Chapter 2 shows that earnings inequality has risen particularly rapidly in Korea since the mid-1990s, at the same time that non-regular work was expanding. Indeed, Korea now has the highest incidence of low-paid work among full-time workers in the OECD area and the third highest level of overall earnings dispersion, just below the United States and Israel (Figure 3.4). These patterns need to be interpreted carefully since data sources and definitions are not fully harmonised across the countries shown. Nonetheless, these data suggest that growing labour market dualism – in the form of an increased incidence of non-regular work and rising pay penalties for non-regular, SME and service sector employment – probably has had a strong impact in raising earnings inequality in Korea. These developments have increased the need to further develop the income support system for low-income workers (Chapter 2).

Figure 3.4. **The incidence of low-paid work[a] and earnings dispersion[b]**

In 2011 or latest year available[c]



a) The incidence of low pay refers to the share of full-time workers earning less than two-thirds of median earnings. Earnings include both fixed pay and bonuses, except for Japan where it is limited to fixed pay. When only fixed pay is considered for Korea, the incidence of low pay declines to 22%, still substantially higher than the 14% rate in Japan.

b) Earnings dispersion is measured by the ratio of 9th to 1st deciles limits of earnings for full-time workers.

c) Data refer to 2008 for Iceland, 2009 for the Czech Republic and France, and to 2010 for Australia, Austria, Belgium, Denmark, Finland, Germany, Greece, Hungary, Ireland, Israel, Italy, Poland, Portugal, the Slovak Republic, Spain, Sweden and Switzerland.

d) Unweighted average of the countries shown above.

e) Information on data for Israel is available at: *http:/dx.doi.org/10.1787/888932315602*.

Source: OECD Earnings Distribution Database.

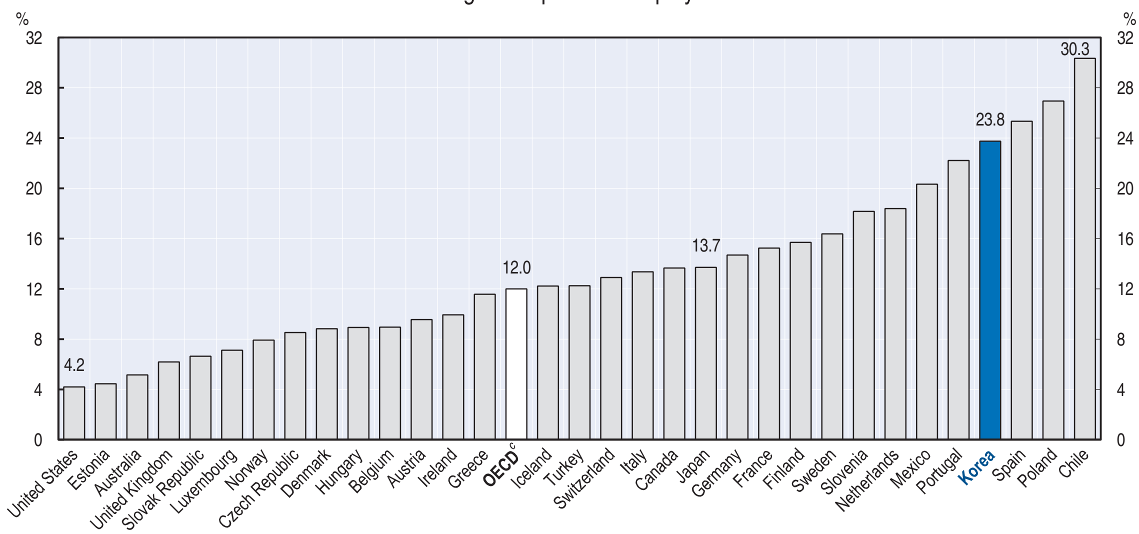
Increased dualism also appears to have had an unusually large impact on job stability in Korea. Panel A of Figure 3.5 compares the incidence of temporary employment in OECD countries. According to the internationally harmonised definition used by the OECD, temporary work accounts for 24% of total employment in Korea in 2011, making it the largest component of non-regular work.[16] This is double the OECD-average incidence of temporary work. Only three OECD countries have higher incidences of temporary work than Korea: Chile, Spain and Poland. Temporary employment has declined modestly in Korea since reaching a peak of 27% in 2004.

One of the concerns about temporary employment is that it may expose workers to higher levels of employment insecurity. This could be an important concern in Korea because the worker turnover rate implied by the high incidence of low job tenure is the highest observed in the OECD area (Panel B of Figure 3.5). Worker turnover can play a useful role in reallocating workers from declining firms and sectors to more dynamic ones, but much of the very high level of turnover in Korea appears to reflect “churning” of workers through on-going jobs.[17] These statistics suggest that the increase in temporary employment since the 1997 economic crisis has provided employers with considerable flexibility to adjust the size and composition of their workforces, but also that the associated adjustment costs may be excessively high and unfairly concentrated on non-regular workers. Another concern is that very high turnover rates in Korea reduce employers’ incentives to train their workers. As is shown in Table 3.6 (above), most continuing vocational training is funded by employers and this type of training is less often provided to non-regular workers than to regular workers.

Figure 3.5. **Two indicators of numerical flexibility in the Korean labour market**

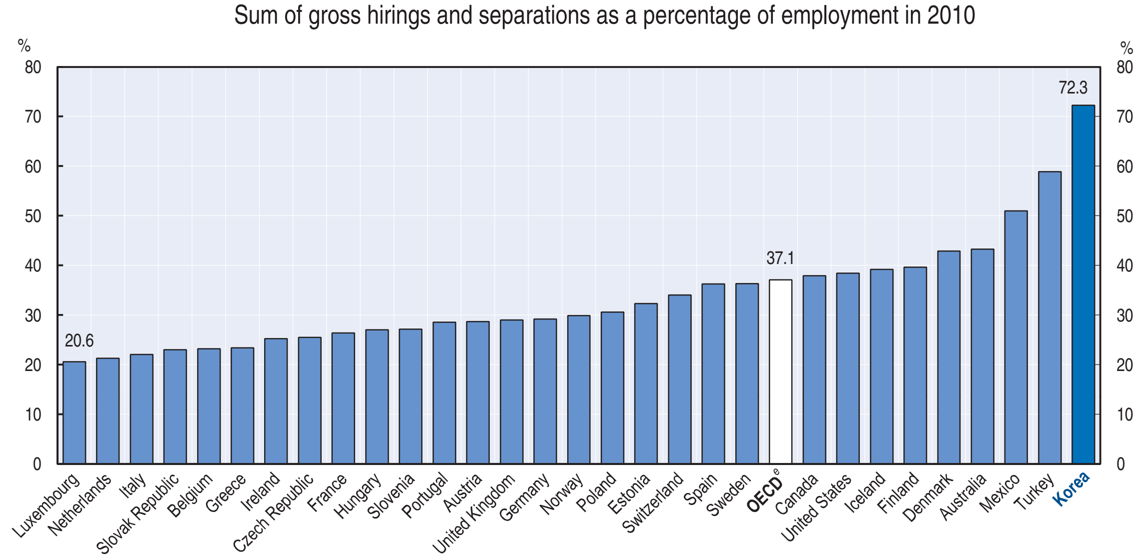
Panel A. International comparison of temporary[a] employment

Percentage of dependent employment in 2011[b]



Panel B. International comparison of worker turnover[d]

Sum of gross hirings and separations as a percentage of employment in 2010



a) Following the internationally harmonised definition of the OECD, temporary employees are wage and salary workers whose job has a pre-determined termination date as opposed to permanent employees whose job is of unlimited duration. National definitions broadly conform to this generic definition, but may vary depending on national circumstances. Country-specific details are available at *www.oecd.org/dataoecd/13/57/43103377.pdf*. For Korea, temporary employment encompasses workers with a fixed-term contract, temporary agency workers and daily/on-call workers (excluding double-counting). This definition of temporary workers differs from the national definition used in Table 3.1.

b) Data refer to 2006 for Australia, 2004 for Mexico and 2005 for the United States

c) Weighted average of OECD countries whose data are available in 2011.

d) Hirings in year *t* are estimated by the number of workers in year *t* with less than one year of tenure. Separations are then estimated as the difference between hirings and net employment change.

e) Weighted average of OECD countries shown in Panel B.

Source: *OECD Online Employment Database* available at *www.oecd.org/employment/database* for temporary employment, and OECD calculations using the *OECD Job Tenure Database* for worker turnover.

The high turnover rates observed in the Korean labour market have a positive side for employers, who have considerable numerical flexibility in managing their workforce, but also for workers. The high turnover rates in Korea reflect, in part, the speed with which unemployed workers are able to find and move into new jobs. The efficiency of job matching is indicated by both the low unemployment rate in Korea and also by the low share of unemployed persons in Korea who become long-term unemployed. In 2011, the unemployment rate in Korea, at 3.4%, was less than half the 8% average rate for the OECD area. Among all unemployed Koreans, 7% had been unemployed for six months and over and under 1% for a year or more, while the corresponding averages for the OECD area were 48% and 34%. High turnover rates in Korea are reflected in a relatively low average job tenure (5.1 years in 2011, while job tenure in the OECD countries in the EU range from 8.0 years in Denmark to 12.0 years in Italy). Despite this fluidity, 18% of all employees in Korea have held their current job for ten years or longer.

Internationally harmonised statistics are also available for part-time employment, defined in terms of weekly working hours being below 30. According to this definition, part-time employment accounts for 14% of employment (OECD, 2012b), somewhat smaller than the share of temporary workers.[18] Compared with full-time workers, part-time workers in Korea face a larger wage penalty than in most other OECD countries and also report considerably lower perceptions of job security (OECD, 2010a). This difference helps to explain why a large majority of part-time workers say they prefer a part-time job in most European and North American countries, in contrast with part-time workers in Korea (Table 3.4).

A final insight from international comparisons is that non-regular workers in Korea appear to be more at-risk of becoming trapped in poor quality jobs than their counterparts in other OECD countries. Panel A of Table 3.7 shows that temporary workers in Korea – defined according to the OECD harmonised definition – are less likely to move into permanent employment than their counterparts in 15 other OECD countries. This is true over both a *one-year* and a *three-year* horizon. This form of mobility is also quite low in Japan, whereas the "stepping-stone" pattern is much more prevalent in Europe. One likely reason for this contrast is that the majority of temporary workers in Europe are young and temporary jobs often provide a bridge between study and stable career jobs.[19]

Mobility patterns in Korea and Japan can be compared for a more comprehensive definition of non-regular work that encompasses e.g. part-time work and some additional forms of atypical work. Table 3.7, Panel B shows that the mobility rate of non-regular workers into regular employment is actually higher in Korea than in Japan, but how much higher is difficult to judge because the estimates vary a lot depending on how non-regular employment is identified in the KLIPS. When workers' self-assessment of employment type is used, the overall mobility rate for all non-regular workers is similar to that for only temporary workers in Korea (as calculated in Panel A using the internationally harmonised definition), whereas it is sharply lower in Japan where the one-year transition probability falls from 18% to 8%. This appears to reflect the large number of Japanese women who work part-time and have a very low propensity to move into regular employment. Using instead the official definition of non-regular employment (as best it can be implemented in the KLIPS) results in much higher estimated mobility rates for Korea.[20]

Table 3.7. **International comparison of one-year and three-year mobility of temporary and non-regular workers**[a]

Percentages

A. Transitions from temporary to permanent employment in 16 countries[b]

	1 year after			3 years after		
	Permanent worker	Temporary worker	Not employed	Permanent worker	Temporary worker	Not employed
Luxembourg	58.7	27.9	13.4	79.7	11.8	8.5
Austria	55.9	35.3	8.8	67.5	22.6	9.9
United Kingdom	51.9	29.9	18.3	63.4	15.1	21.5
Netherlands	49.1	40.9	10.0	69.9	17.6	12.5
Germany	46.6	38.5	14.9	60.0	23.5	16.4
Belgium	45.0	49.3	5.6	71.4	23.2	5.4
Ireland	41.6	44.5	13.9	66.1	15.8	18.2
Denmark	35.2	46.2	18.6	61.3	20.5	18.2
Finland	31.2	45.6	23.2	44.7	30.0	25.3
Spain	29.1	52.4	18.5	46.0	37.5	16.5
Greece	28.3	49.1	22.6	36.0	47.8	16.2
Italy	27.2	49.7	23.1	47.2	30.3	22.5
Portugal	24.6	64.5	10.8	55.0	31.3	13.7
France	18.1	52.1	29.9	45.3	30.6	24.1
Japan	17.5	72.1	10.4	24.9	59.7	15.4
Korea	**11.1**	**69.4**	**19.5**	**22.4**	**50.9**	**26.7**

B. Transitions from non-regular to regular employment in Japan and Korea[c]

	1 year after			3 years after		
	Regular worker	Non-regular worker	Not employed	Regular worker	Non-regular worker	Not employed
Japan	7.5	81.5	11.0	10.7	71.5	17.8
Korea						
Official definition[d]	**35.4**	**48.7**	**15.9**	**40.9**	**35.2**	**23.9**
Self-assessment[e]	**12.4**	**69.8**	**17.8**	**19.3**	**53.7**	**27.0**

a) Self-employed persons are excluded from the samples used to calculate transition probabilities.

b) Following the internationally harmonised definition of the OECD, temporary workers include workers with fixed-term contract and temporary agency workers. In Korea, this category also includes daily/on-call workers. This definition of temporary workers differs from the national definition used in Table 3.1.

c) Consistent with national practice in Japan and Korea, non-regular work includes some types of non-standard jobs that need not be temporary, most notably part-time employment.

d) Non-regular workers identified using the closest possible approximation of the official definition in the KLIPS dataset (as advised by the MOEL). Average values for waves 5-12 (2002-2009).

e) Non-regular workers identified using the workers' own assessment of their employment relationship as regular or non-regular. Average values for waves 2-12 (1999-2009).

Source: European countries: OECD calculations using the European Community Household Panel, waves 5-8 (*OECD Employment Outlook 2006*). Japan: Calculations based on the Keio Household Panel Survey as reported in Shikata (2012), "Is Temporary Work 'Dead End' in Japan? Labour Market Regulation and Transition to Regular Employment", *Japan Labor Review*, Vol. 9, No. 3. Korea: OECD calculations using microdata from the KLIPS, waves 2-12 (1999-2009).

3.3. The policy rationale for reducing labour market duality

Reducing inequality

The most widely discussed reason for the Korean government to take further policy measures to reduce duality is that the currently high degree of labour market segmentation increases inequality and discrimination, potentially endangering social cohesion. The empirical evidence presented in Section 3.2 confirms that labour market dualism has been an important driver of the recent strong increase in earnings inequality. The expansion of non-regular employment also appears to be an important factor in explaining why labour turnover is higher in Korea than in any other OECD country, a likely source of insecurity for workers and underinvestment in continuing vocational training by employers. These equity concerns are heightened by the finding that mobility out of non-regular employment and into good career jobs may be quite low.

The highly dual nature of the labour market in Korea also undermines the effective operation of crucial social protection programmes, notably, Employment Insurance, National Health Insurance and National Pension. As is discussed in Chapter 2 and in Section 3.4 below, almost all employees should be enrolled in these employment-linked social insurance schemes, but many non-regular workers and employees in SMEs are not. Widespread noncompliance undercuts the effectiveness of these programmes, since it means that many of the workers most needing these forms of assistance will not qualify for benefits when they need them, even as the financial strength of these schemes is undermined.

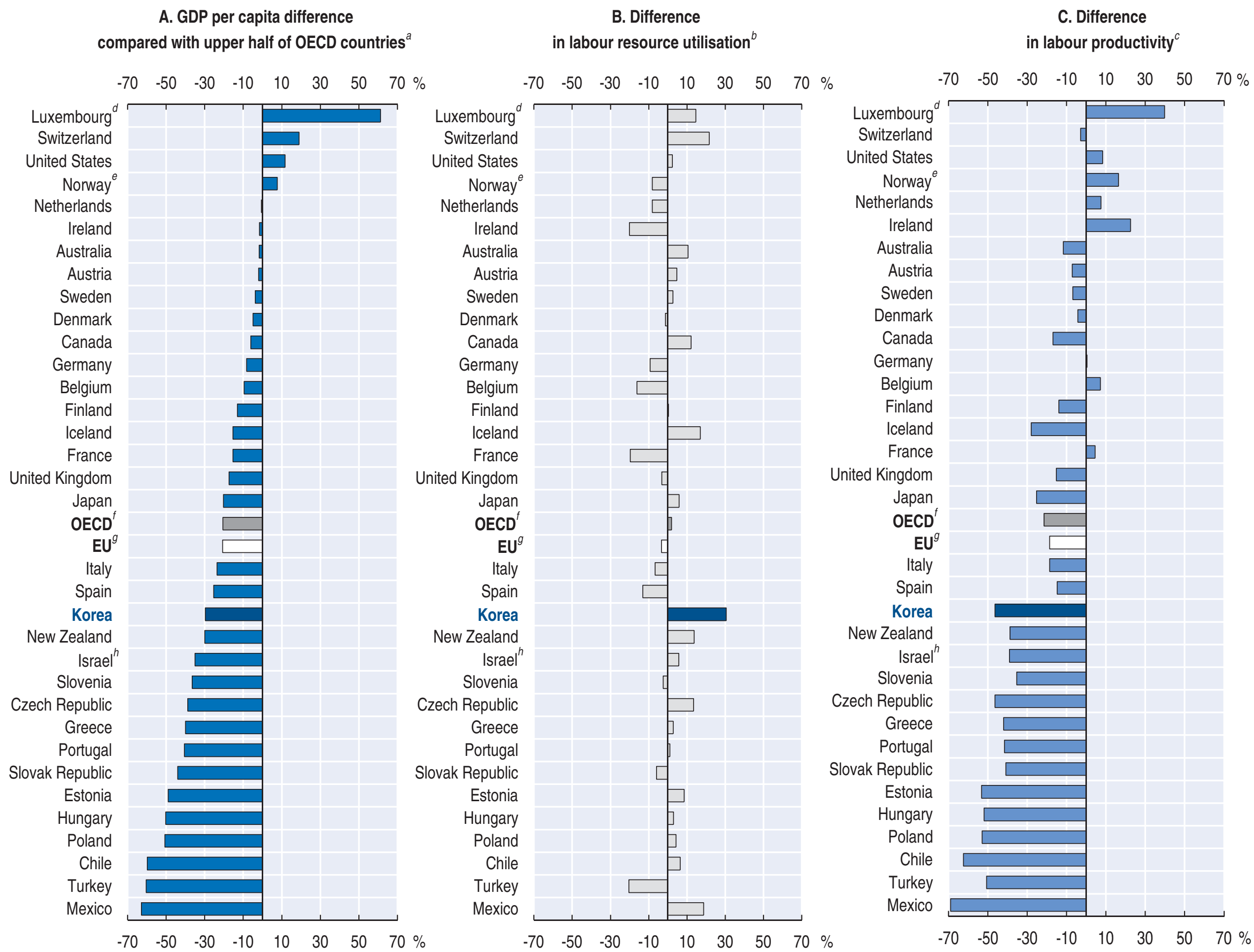
Promoting growth

There is also an important efficiency rationale for the Korean government to take additional policy measures to reduce excessive labour market segmentation. The current structure of the labour market means that a significant share of the potential national workforce is either at risk of becoming trapped in low productivity jobs or is discouraged by that prospect from participating in the labour market. Women and older workers face particular barriers to accessing (or maintaining) high-productivity jobs, a pattern that is especially problematic in the context of rapid population ageing. While the youth labour market has performed very well from an international perspective in most respects, a growing skill mismatch appears to be developing that could prevent many students completing tertiary studies from moving into jobs that take full advantage of their qualifications. A final and closely related concern is that the poor productivity performance of SMEs and service sector firms threatens to hamper the continued convergence of Korean living standards to those in the most advanced economies.

Figure 3.6 shows that output per capita in Korea is 30% below the average for the upper half of OECD countries (based on 2011 PPPs). While still substantial, this represents a remarkably strong convergence in income levels and living standards during recent decades. For example, Korea's per capita GDP was only a little over 10% of the US value in 1970, but has since climbed to 65% of the now higher US level.[21] One of the main economic priorities for Korea is to assure that this convergence continues until these gaps are fully closed. While the strong historic record provides grounds for optimism, important adjustments in the growth model will be required in order to overcome demographic headwinds and the declining scope for large industrial firms, many of which are now at or near the best international benchmarks, to drive national productivity gains.

The second and third columns of Figure 3.6 show that closing the remaining income gap will require a marked improvement in labour productivity. Output per hour worked is currently only about one-half as high in Korea as in the highest income OECD countries. The productivity gap is actually larger than the income gap, since it is partly offset by the high rate of labour utilisation in the OECD area. Average labour utilisation (i.e. the total number of hours worked per capita) in Korea is 38% higher than the average for countries in the upper half of the OECD income distribution, largely due to the long hours that Korean workers put in on their jobs: the annual hours of Korean workers in 2011 averaged 2 090, much higher than the highest value found in any of the highest income OECD countries. This labour utilisation advantage is likely to attenuate, however, as the population ages and "the long hours culture" becomes less pronounced. That prospect further underlines the importance of raising output per hour worked.

Figure 3.6. **Factors behind income variations across OECD countries, 2011**



a) Compared to the average of the 17 OECD countries with highest GDP per capita in 2011, based on 2011 purchasing power parities (PPPs). The sum of the percentage difference in labour resource utilisation and labour productivity do not add up exactly to the GDP per capita difference since the decomposition is multiplicative.

b) Labour resource utilisation is measured as the total number of hours worked per capita.

c) Labour productivity is measured as GDP per hour worked.

d) In the case of Luxembourg, the population is augmented by the number of cross-border workers in order to take into account their contribution to GDP.

e) Data refer to GDP for mainland Norway which excludes petroleum production and shipping. While total GDP overestimates the sustainable income potential, mainland GDP slightly underestimates it since returns on the financial assets held by the petroleum fund abroad are not included.

f) Unweighted average for the 34 OECD countries.

g) The EU category brings together countries that are members of both the European Union and the OECD. Data refer to an unweighted average of the EU15 countries *plus* the Czech Republic, Estonia, Hungary, Poland, the Slovak Republic and Slovenia.

h) Information on data for Israel is available at: *http://dx.doi.org/10.1787/888932315602*.

Source: OECD (2013), *Economic Policy Reforms 2013: Going for Growth*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/growth-2013-en*.

Population ageing is occurring at a rapid pace in Korea and will tend to lower labour supply and hence potential growth in coming decades, unless a higher share of the working-age population can be employed in high-productivity jobs. Due to both strong gains in longevity and a sharp fall in fertility, the age structure of the population has changed dramatically since the mid-1970s and will continue to do so through 2050 (Figure 3.7, Panel A). Between 1975 and 2010, this demographic transformation boosted labour supply and per capita GDP because the share of working-age persons in the total population rose from 46% to 66%.[22] This shift in the age structure of the population resulted in rapid labour force growth, particularly since it was combined with an increase in the total population from 35 million in 1975 to 49 million in 2010. The labour market impact of population ageing will be very different in coming decades; first the share of working-age persons in the total population will begin to fall followed by the total population. If participation rates for men and women remain at their current levels for each age group, then the labour force is projected to begin to decline in 2023 and to be 13% lower in 2050 than in 2010 (Figure 3.7, Panel B). Along with shrinking, the workforce will also become considerably older as entering cohorts of workers shrink relative to older cohorts already in the workforce.[23]

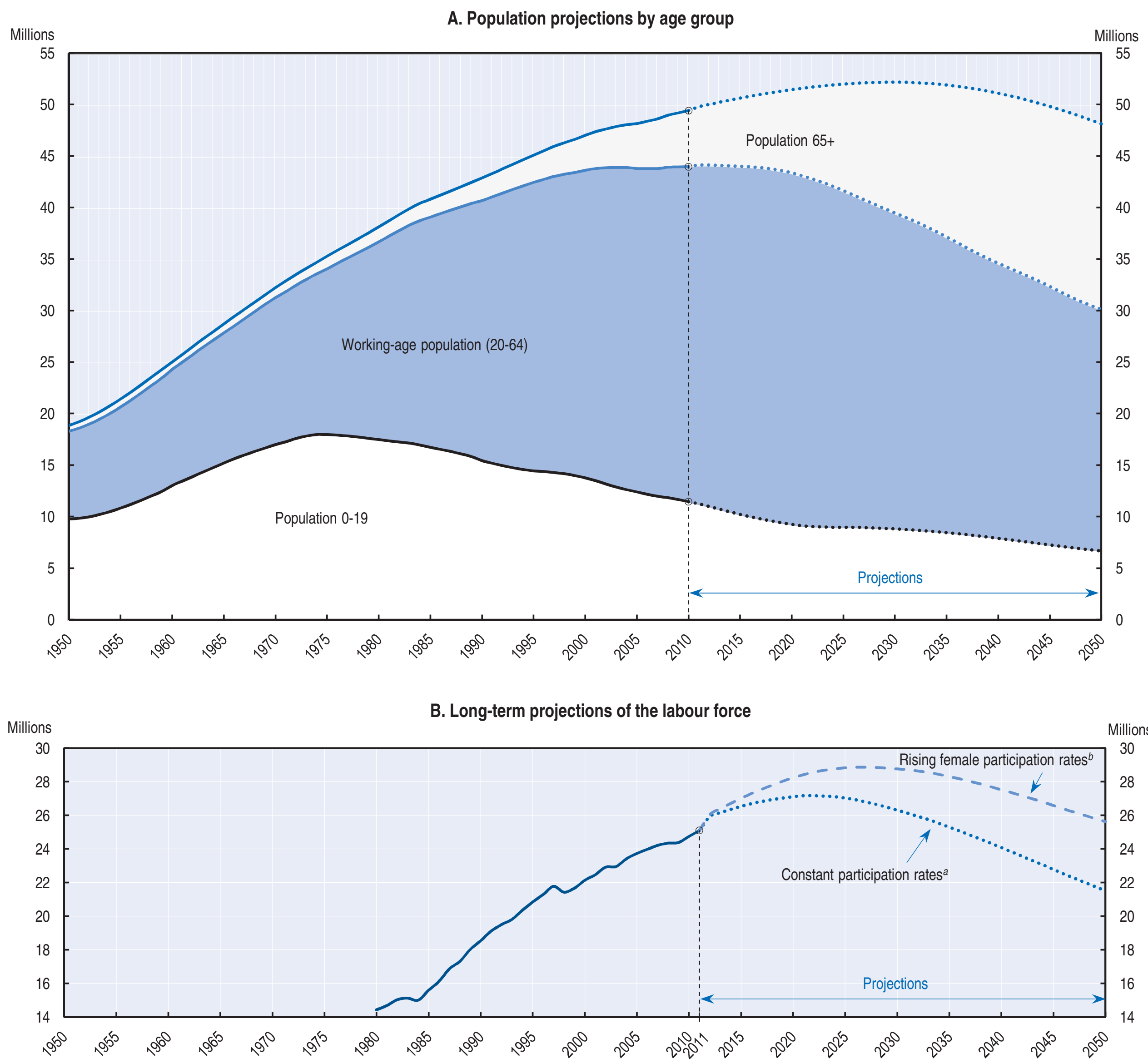
The future impact of these demographic trends on aggregate labour supply would be less negative if participation rates were to increase. Participation rate for Korean women, at 55% in 2010, is substantially below both the OECD average rate for women (62%) and the rate for Korean men (77%). This suggests that there is considerable scope to raise female participation in Korea, provided the necessary steps are taken to make it easier for women to combine their family responsibilities with paid employment. Panel B of Figure 3.7 illustrates this potential by projecting the labour force through 2050 on the assumption that female participation rates converge smoothly to male rates during the projection period. Whereas the labour force falls by 13% between 2010 and 2050 under the constant participation rates scenario, it rises by 4% under the alternative scenario with rising female participation.

The participation rate of youths between the ages of 15 and 24 years is also considerably lower in Korea than in most OECD countries (26% versus an OECD average of 47%), suggesting there is also some room to raise participation for this group. However, higher rates of school enrolment account for a considerable share of the youth participation gap. Since these investments in education contribute to higher quality-adjusted labour supply over the working life, this may not be a problem. However, high inactivity rates for recent tertiary graduates suggest that there is scope for policy measures to better integrate out-of-school youth into the labour market. Since older workers in Korea already have relatively high participation rates, as compared to their counterparts in other OECD countries (63% versus 58%), it may be more difficult to raise participation rates for this age group.

Especially in the context of the strong duality in the Korean labour market, one of the keys to limiting the impact of population ageing on potential growth will be to make it possible for a larger share of the workforce to be employed in jobs that take full advantage of their productive potential. This is especially true for women, which as stressed above represent an important source of under-utilised labour supply that could be drawn into paid work under the right conditions. As is shown in Figure 3.8, the gender wage gap in Korea is substantially larger than in any other OECD country (38% versus an OECD average of 15%). As will be analysed further in Section 3.5, the large gender wage gap in Korea reflects the difficulties that women encounter in combining a career with family life: among workers between the ages of 25 and 44, the gender pay gap is 13% for childless women but

46% for women with one or more children. While wages are not a perfect measure of productivity in the current job, they are likely to be highly correlated.[24] This suggests that a considerable share of the potential economic benefit from raising female participation rates could be lost if the number of high productivity jobs open to qualified women cannot be increased. Reducing the barriers for women to access good jobs would also likely encourage higher participation rates, generating a double dividend.

Figure 3.7. **Changes in the age-structure of the population and the size of the labour force: Historial trends and long-term projections**

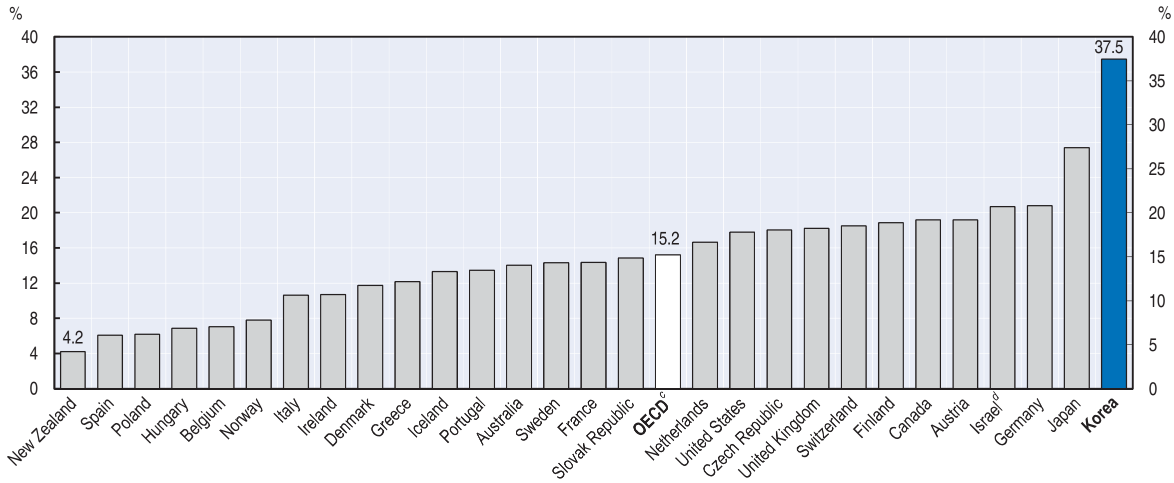


a) The participation rates for men and women are assumed to remain at their current levels for each age group.
b) Female participation rates are assumed to reach current male rates in each age group by 2050.

Source: Statistics Korea, *Population Projection for Korea* (2011 version), Economically Active Population Survey and OECD estimates.

Figure 3.8. **International comparison of gender differences in pay**

Gender wage gap for full-time employees, 2011 or latest year available[a, b]



a) The gender wage gap is unadjusted and is calculated as the difference between median earnings of men and women relative to median earnings of men. Cross-country differences in the gender gap may reflect to some degree cross-country differences in data sources and definitions.

b) Data refer to 2011 for Canada, Hungary, Japan, Korea, New Zealand, Norway, the United Kingdom and the Unites States; to 2010 for Australia, Austria, Belgium, Denmark, Finland, Germany, Greece, Ireland, Israel, Italy, Poland, Portugal, the Slovak Republic, Spain, Sweden and Switzerland; to 2009 for the Czech Republic and France; to 2008 for Iceland; and to 2005 for the Netherlands.

c) Unweighted average for the 24 countries for which data are available in 2010 (i.e. excluding the Czech Republic, France, Iceland and the Netherlands).

d) Information on data for Israel is available at: *http://dx.doi.org/10.1787/888932315602*.

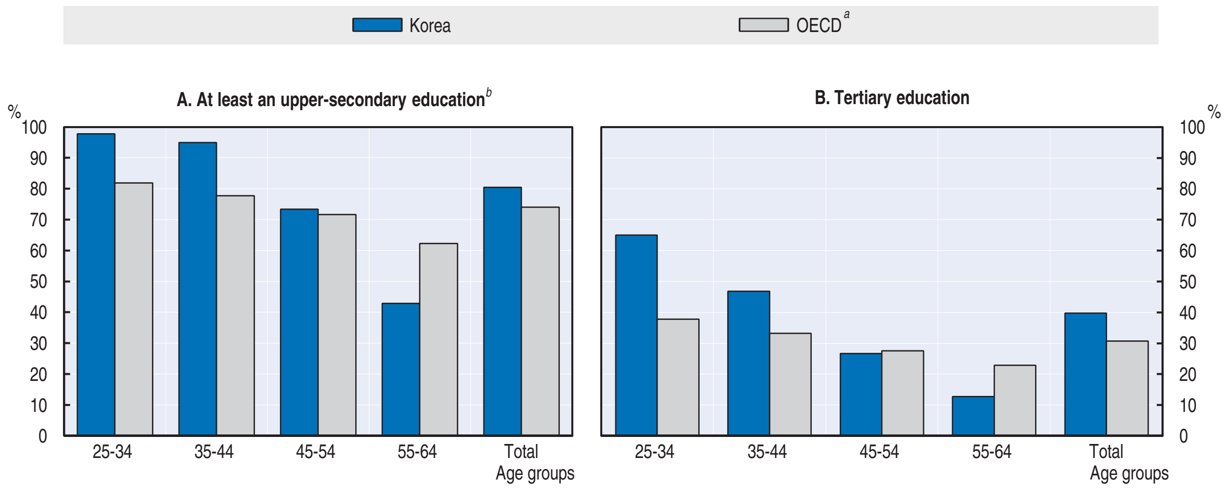
Source: *OECD Earnings Distribution Database*.

The share of older workers in the total labour force will rise in the coming decades and this compositional effect will tend to depress output per worker if this age group continues to have a high incidence of non-regular employment (Table 3.2). Early retirement from regular jobs explains the rapid rise in the share of non-regular workers as well as the steep decline in average wages after age 50 (Figure 3.18). Section p. 165 discusses policy measures to raise productivity and earnings for older workers.

Up until recently, youth have not been among the workforce groups most affected by the dualism of the Korean labour market. However, the very rapid expansion of educational attainment in recent decades has created a danger that an increasing share of recent school leavers will encounter difficulties in finding jobs that make good use of their skills. Figure 3.9 shows that educational attainment has increased much more rapidly in Korea during recent decades than in the rest of the OECD area. Whereas educational attainment for Koreans between the ages of 55 and 64 is significantly below the OECD average in Korea, educational attainment is significantly above the OECD average for Koreans between the ages of 25 and 44. For example, 98% of Korean 25-34 year-olds have completed upper-secondary school and 65% a university-level tertiary degree, as compared with OECD averages of 82% and 38%, respectively.

Figure 3.9. **Educational attainment in Korea by age group**

Percentages in 2010



a) Unweighted average of the 34 OECD countries.
b) Excluding ISCED 3C short programmes.

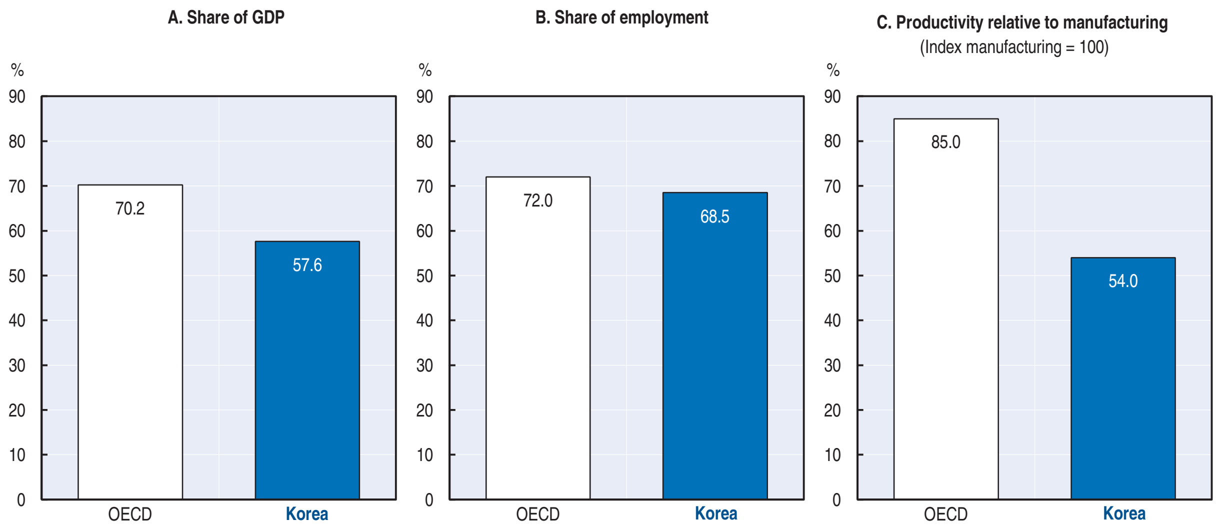
Source: OECD (2012), *Education at a Glance 2012: OECD Indicators*, OECD Publishing, *http://dx.doi.org/10.1787/eag-2012-en*.

A number of studies indicate that a more educated workforce contributes to higher productivity (OECD, 2012c), suggesting that the rapid increase in human capital investment in Korea could help to offset the negative effect of population ageing on economic growth by raising output per hour worked. However, the large differences in the qualifications profiles of the Korean workers who are now retiring and the cohorts who are beginning their working lives suggests a possible serious mismatch between employers' skill recruitments and the skill profile of labour market entrants. The mismatch due to the apparent over-emphasis on higher education among recent labour market entrants relative to employers' recruitment needs could result in a sharp fall in the economic returns to these large investments in tertiary education. Section p. 169 discusses policy measures to better align the educational choices of youth with labour market needs.

If the rapidly growing supply of highly educated workers could be mobilised to upgrade the productivity performance of SMEs and the service sector then the mismatch could be attenuated or even avoided and Korea's large investments in education could provide a stronger boost to national productivity. The service sector in Korea now accounts for two-thirds of all employment, but labour productivity is this sector is only about one-half that in manufacturing (Figure 3.10). OECD (2012a) and Park and Shin (2012) identify a number of policy initiatives that could quicken productivity growth in the service sector. Taking such measures could pay a double dividend by also opening up new career opportunities for highly educated workers.

Figure 3.10. **Performance of Korea's service sector relative to the OECD average**

Percentages[a] in 2010, based on 2005 prices for value added



a) Unweighted averages for OECD of the 34 member countries with the following exceptions: for *Panel A*, Australia, Canada, Chile, Iceland, Japan, Mexico, Turkey and the United States; for *Panel B*, Canada, Iceland and Turkey; and for *Panel C*, Australia, Canada, Chile, Estonia, Greece, Iceland, Ireland, Israel, Japan, Luxembourg, Mexico, New Zealand, Portugal, Poland, the Slovak Republic, Spain, Switzerland, Turkey and the United Kingdom.

Source: *OECD National Accounts Database:* Quarterly National Accounts for Panel A and System of National Accounts for Panel B; *OECD STAN Indicators Database* for Panel C.

Complexity of the policy challenge

The pervasive and multi-faceted nature of labour market duality in Korea suggests that a comprehensive approach is required that encompasses both reforms intended to reduce overall duality (e.g. by reducing the cost advantages associated with employing non-regular workers) and measures intended to help vulnerable workforce groups to access jobs that offer better pay and working conditions, while allowing them to realise their full productive potential. Section 3.4 discusses policies to reduce overall labour market duality and Section 3.5 targeted policies for women, older workers and youth. Since the lagging productivity performance of the service sector and SMEs is also an important source of labour market duality, broader policies to upgrade those enterprises are also required (OECD, 2012a), but are not analysed here.

3.4. Policies to reduce overall labour market duality

Labour market duality has become one of the key issues in the Korean political debate, including in the context of the recent Presidential election. Most of this debate is dominated by issues with social equality, job insecurity and discrimination, amid growing concerns about polarisation in income distribution (Chapter 2). While addressing labour market duality is important for reasons of social equity, a well-designed package of labour and social policies to tackle the dualism of the labour market is also essential to help boosting economic efficiency, especially thanks to the lower level of labour and job turnover that it can induce, and the resulting positive impact on human capital accumulation and, ultimately, the potential for economic growth (Grubb et al., 2007).

The broad challenge of reducing labour market duality in Korea in the long-term requires a multi-pronged approach. This chapter focuses on the role that labour market policies can play, but a comprehensive approach would also need to address lagging productivity in the services sector and SMEs (e.g. through measures to increase product market competition). The key labour market reform priorities for reducing duality are:

- Balancing employment protection legislation (EPL) across different types of employment;
- Narrowing excessive wage differentials;
- Strengthening the role of activation policies to raise employability; and
- Improving the industrial and labour relations framework.

Korea can alter the balance between regular and non-regular jobs by adjusting policies in these areas. Indeed, many reforms intended to improve the employment prospects and working conditions of non-regular workers have already been introduced. These include a series of measures to tackle labour market duality that were adopted between 2011 and 2012, providing confirmation that the government intends to move further ahead on this important issue. However, these measures have been rather fragmented, resulting in few synergy effects. In addition, some reform measures have met with strong objections from trade unions and/or business groups, resulting in certain legislative initiatives – such as the 2007 legislation to reverse the trend towards overuse of temporary employment – being blocked for considerable time in the National Assembly. On the other hand, the strong interconnections between employment protection, activation, informality and labour relations underline the need to make progress on several fronts simultaneously to reap mutually reinforcing effects of different measures. This section reviews the role that key aspects of labour market policies play in reducing duality, focussing on implementation challenges and possible trade-offs. The next and final section complements this discussion by looking into group-specific issues. In the wake of the recent global economic crisis, a number of other OECD countries have engaged themselves in comprehensive labour market reform approaches that are intended to tackle some of the issues that will be discussed in this and the next section (see Box 3.1).

Box 3.1. **Recent examples of comprehensive labour market reforms**

Several OECD countries have recently made important efforts to speed-up long overdue labour market reforms, with Italy, Spain and Mexico being key examples. While the structural labour market characteristics of these three countries are not directly comparable, one common denominator is a high degree of segmentation. As far as Italy and Spain are concerned, comprehensive labour market reforms were introduced as part of a broad effort to restore competitiveness, amid a backdrop of long-lasting difficulties that are closely intertwined and mutually reinforcing: a poor underlying growth rate, high public debts, and limited lending power of financial institutions. For Italy and Spain, these sources of pressure were compounded by the confidence crisis in the European monetary union and the related risk of contagion from the euro area crisis.

Box 3.1. **Recent examples of comprehensive labour market reforms** *(cont.)*

Italy

The comprehensive labour market reform approved by the Parliament in June 2012 is built on four main pillars: *i)* some relaxation and streamlining of employment protection rules for workers with permanent contracts, including the liberalisation of dismissal restrictions and simplification of procedures for dispute resolution; *ii)* the creation of an easier route for the insertion of youth in the labour market, including *via* apprenticeship programmes and the introduction of tax incentives for companies investing in training programmes; *iii)* the reduction of incentives for employers to make use of atypical labour contracts; for example, the cooling-off period between two fixed-term contracts has been extended, the fiscal incentives for some types of non-permanent contracts have been reduced and tests to reclassify independent contractors as employees have been introduced; and *iv)* a step towards a more universal unemployment benefit system, including an extension of the pool of workers eligible for standard unemployment benefits, which will imply a moderate increase in the level of the unemployment benefits.

Mexico

The widespread labour market reforms introduced in November 2012 contain several initiatives aimed at providing incentives for creating formal employment: adding new types of contracts that provide access to social security and other benefits, such as fixed-term contracts for seasonal workers; and provisions for initial training and probationary periods for newly hired workers. The reforms also aim to encourage more women to take up and stay in work: reducing discriminatory hiring and firing practices; outlawing workplace harassment; allowing more flexible use of maternity leave; reducing working time after childbirth for breastfeeding purposes; and introducing the right to request family-friendly arrangements, such as part-time work and teleworking. Moreover, the introduction of paid paternity leave is a step towards a more gender-equal distribution of work and care. The introduction of initial training contracts and probationary periods should improve the hiring prospects of young, inexperienced and low-skilled workers. As another important step, promotions have been linked to skills and competence, rather than seniority.

Spain

The labour market reform of February 2012 increases the flexibility of collective bargaining and provides greater flexibility for individual firms to bargain about working time, wages and employment conditions. New measures also include: clearer economic reasons for fair dismissal and reduced compensation for unfair dismissal; removal of the required government authorisation of collective dismissals; allowing temporary work agencies to act as private employment service providers under contract from the public employment service; and reform of hiring subsidies to boost recruitment of young workers and older unemployed. New financial incentives for firms hiring unemployed youth were also introduced. At the same time, unemployed workers below the age of 30 can now use up to 100% of their accumulated unemployment benefit entitlements, if they opt to capitalise their benefits to create a new business. The system of training for unemployed workers is being transformed through the introduction of vouchers and measures to strengthen competition in the selection of training providers.

These recent initiatives illustrate how comprehensive reform approaches are required to tackle complex labour market problems, such as the need to improve the adaptability of the labour market while reducing its duality. In Italy and Spain, financial pressures related to the euro area crisis have also meant that these reforms must be implemented swiftly. It is also important to support such reforms with permanent monitoring and evaluation systems. Careful monitoring is needed to identify areas for further actions to improve the functioning of the labour market.

Employment protection legislation

Over the past fifteen years, the Korean government has introduced numerous measures revising employment protection legislation (EPL), reflective of a gradualist reform approach. Two essential components are the reforms that took place in 1998 and 2007, this latter following five years of intense discussions between the government and the social partners.[25] A further step in the reform process was achieved in 2012 with the introduction of new measures to better enforce the 2007 provisions requiring equal treatment of non-regular and regular workers.

Non-regular workers

A well-defined regulatory framework establishing clear rules for non-regular work relationships represents an essential – albeit not exclusive – condition for tackling the labour market dualism problem. Firms will benefit in terms of their search for labour flexibility and the effort to contain costs. At the same time, such a framework can help workers by promoting job stability and boosting career prospects (e.g. by promoting greater access to firm-provided training), while also supporting the further development of social insurance systems. Furthermore, it can accommodate the needs of particular groups of workers who may prefer more flexible work arrangements – for instance, women and youth.

In this broad context, one key objective of the reform initiatives undertaken by Korea since the end of the 1990s has been the achievement of a stronger degree of harmonisation between the regulatory regimes governing three types of non-regular employment: workers hired under a fixed-term contract, part-time workers and temporary agency workers.[26] The main common features of today's Korean regulatory framework for these three groups of non-regular workers are as follows:

- *Contractual obligations.* Employers are obliged to establish a written contract when hiring fixed-term workers, part-time workers and temporary agency workers.
- *Discrimination against non-regular workers.* The reforms on non-regular workers introduced in 2007 prohibit "unreasonable" discrimination against fixed-term workers, part-time workers and temporary agency workers. This general principle applies to differences in wages and working conditions between non-regular and regular workers, who work in the same or similar jobs in the same enterprise. This approach is consistent with international best practices – for example, it is roughly equivalent to the approach taken by the European directives on equal treatment for fixed-term, part-time and temporary agency workers.
- *The remedial process to redress discrimination.* Non-regular workers hired under the above three categories can submit complaints to the Labour Relations Commission alleging discriminatory treatment relating to wages and working conditions, with their employers then being required to prove that their treatment is not discriminatory. An employer who fails to comply with a judicial order for remedy can be condemned to pay a civil fine (up to KRW 100 million), as well as a monetary indemnity to the worker. The new bill that was passed by the National Assembly in February 2012 – with effect from August 2012 – empowers the Ministry of Employment and Labor (MOEL) to directly issue a corrective order to an employer who discriminates against fixed-term workers, part-time workers, and/or temporary agency workers, even when the aggrieved worker has not filed a complaint with the Labor Relations Commission. If the employer refuses to

comply, the MOEL can make recourse to the Labor Relations Commission. Following these changes, the ability of MOEL to play an active role in initiating and conducting the audits to investigate possible discriminatory practices in workplaces has become significantly stronger. Before these changes, the decision to file a complaint was left to the discretion of employees. However, some workers facing discrimination reportedly chose not to bring their cases to the Commission for fear of reprisals or other unfavourable treatments. The new revisions to the law also allow supervisors to take corrective measures when discriminatory activities are identified. This is also intended to strengthen the effect of anti-discrimination legislation in improving the employment conditions of non-regular workers.

- *Provisions governing the duration of contracts for fixed-term workers.* The maximum period to hire workers on fixed-term contracts is two years, except that no maximum period is set for older workers (aged 55 and over) and certain categories of professionals. Employers can also request longer periods for other workers provided they can show reasonable cause. In general though, if a worker on a fixed-term contract is still on the job at the end of the two-year period, the fixed-term contract is automatically converted into a permanent contract. This rule, introduced with the 2007 labour market reform bill, is considerably more restrictive than the government's initial proposal. The latter envisaged a longer duration of three years, on the grounds that this would raise job stability by reducing the turnover of fixed-term workers and the concentration of workers in more vulnerable types of non-regular employment.
- *Part-time employment.* For part-time workers, overtime work is limited to no more than 12 hours per week. This provision was introduced in 2007 with a view to expanding job opportunities for workforce groups at risk of exclusion from the labour market, such as housewives and students who cannot work full time.

Despite these reforms, the treatment of the different types of non-regular employment – fixed-term contracts and part-time contracts, on the one hand, and workers dispatched by temporary work agencies (TWAs), on the other – remains unbalanced. In particular, the legislation on TWA employment remains overly restrictive with temporary agency work being automatically allowed only in 32 specified occupations. While this limit is higher than the 26 occupations agreed to at the time of the 2007 reforms, most OECD countries allow TWA employment as a general principle, with only a few specified exceptions. Even though it is possible for Korean employers to apply for permission to make use of TWA workers for a short period of time in other occupations, when they can provide objective reasons to justify doing so, reliance on a limited list of occupations as the basis of regulation risks excessively limiting the use of TWA employment, especially if the list of occupations is not regularly updated to incorporate new occupations where regular use of this type of employment is appropriate.

The idea to abandon the present "positive-list system", which limits TWA workers to certain occupations and industries, in favour of a "negative-list system", which allows them in general – except in certain cases expressly forbidden by law – has featured prominently in the policy discussions between the Korean government and the social partners. However, this option was blocked by the Assembly when it approved the bill in 2007. In the end, the Assembly agreed on a less ambitious approach, under which the list of permitted jobs can be expanded by Presidential Decree. It is the application of this authority that explains the increase from 26 to 32 in the number of specific authorised occupations.

One reason for concern is that the latest amendments to the Korea's labour laws, introduced in August 2012, could have further accentuated the divide between the three groups of temporary workers, rather than reducing it. Under the new rules, employers' obligation to hire illegal dispatch workers arises immediately after the violation is discovered. Specifically, employers who use dispatch workers in inappropriate positions (i.e. act in violation of the list of 32 specific occupations fixed by law, without having received approval to do so from the government), or who make use of the services of a manpower agency not duly licensed to engage in the business of dispatching workers, have to immediately hire such dispatched workers as their employees, regardless of the duration of their engagement as dispatched workers. Adopted without the support of a shift from the "positive list" to a "negative list" approach, the new amendments could lead to an upsurge of court cases against the illicit use of dispatched workers. However, such an increase has not yet been observed and it is possible that the amendments' overall impact will be to reduce the incentive for the illicit use of dispatch workers, as intended.

In order to help gauge the potential effects of the new regulations affecting these three types of non-regular workers, Table 3.8 presents data on the size of in-house subcontracting in Korea. In-house subcontracting refers to the business practice whereby the prime contractor contracts out part of his/her production activities to a subcontractor, whose employees are to work within the prime contractor's premise while being supervised by the subcontractor. Since much of this work potentially could be performed by directly employed workers, there is a concern that employers may in some cases be using in-house subcontracting to avoid the regulations protecting fixed-term and part-time workers or limiting the use of TWA employment. There are two regular surveys of in-house subcontracting in Korea, one undertaken by the MOEL directly and the other, named the Workplace Panel Survey (WPS), run by the Korea Labor Institute. The two surveys produce figures that are not directly comparable due to the fact that in-house subcontracting relationships are complex to detect, and therefore the two definitions may capture certain different features of the same phenomenon. In addition, the size of the sample and the denominator of the indicator describing the relative incidence of in-house subcontracted workers are also different. Furthermore, the two surveys are run at different points in time.

Table 3.8. **In-house subcontracting in firms with more than 300 employees**

		Total number of companies in the sample	Percentage share of companies using in-house subcontracting	Employment intensity[a]
MOEL	May 2008	1 764	54.6	28.0
	August 2010	1 939	41.1	32.2
WPS	December 2007	563	35.0	31.9
	December 2009	525	29.9	31.3

MOEL: Ministry of Employment and Labor.

WPS: Workplace Panel Survey.

a) MOEL data refer to the percentage share of the total number of subcontracted workers relative to the total number of workers directly employed by the prime contractor. WPS data refer to the percentage share of the total number of subcontracted workers relative to the number of regular workers. In both cases, only firms using subcontracted workers are considered.

Source: Lee, B.H. (2012), "The Causes for Use of In-house Subcontract and Its Employment Performances", *Korean Journal of Labor Studies*, Vol. 18, No. 1 (in Korean), Korean Association of Labor Studies; Lee, B.H. (2011), "The Situation of Use of In-house Subcontract and Its Economic Effects", Chapter 2 in *In-house Subcontracting and the Employment Structure of Korea* (in Korean), Korea Labor Institute, 10 June. Data quoted in these two studies are from *ad hoc* surveys conducted by the Ministry of Employment and Labor, and from the Workplace Panel Survey.

Bearing these caveats in mind, Table 3.8 shows that the share of large companies making use of in-house sub-contracted workers is around one-third: 30% according to the WPS for 2009 and 41% in the MOEL Survey of 2010. Both surveys suggest that this share may have declined over the recent past. Both surveys indicate that in-house subcontracting accounts for approximate one-third of total employment in large firms that make use of this type of employment relationship. While the WPS indicator has remained fairly stable over the past few years (at around 31%) the MOEL indicator increased by 4 percentage points between 2008 and 2010, rising to 32.2%.

Table 3.9 presents the decomposition by sectors based on the MOEL Survey for 2010. It suggests that all large Korean employers in cars and shipbuilding make use of in-house subcontracted workers. The share of large employers using this form of employment is also high in other manufacturing sectors, including the steel and machinery (87%), chemical (69%) and electricity/electronic (60%) sectors. Among firms using in-house subcontracted workers, the employment intensity indicator indicates that the share of these workers in total employment is particularly high in the steel and shipbuilding sectors. Indeed, the number of in-house subcontracted workers exceeds the number of workers directly employed by the primary-contracting companies in shipbuilding.

Table 3.9. **Sectoral decomposition of the use of in-house subcontracting in firms with more than 300 employees, 2010**

	Percentage of companies using in-house subcontracting	Employment intensity[a]
Total	**41.1**	**32.2**
Machinery	72.4	24.6
Cars	100.0	19.5
Electricity, electronics	59.9	16.4
Steel	87.1	77.6
Shipbuilding	100.0	126.7
Chemical	68.5	23.1
Sales, services	33.1	26.9
Others	30.0	25.4

a) Data refer to the percentage share of the total number of subcontracted workers relative to the total number of workers directly employed by the prime subcontractors.

Source: Ministry of Employment and Labor, *ad hoc* survey, May 2010.

Only a little more than five years have elapsed since the legislative package of 2007 was enacted and even less time since the latest adjustments to the regulatory framework for non-regular workers. Not surprisingly, there is no consensus about how successful the reforms have been and whether additional reforms should be undertaken. Employers are dissatisfied with what they consider a further reduction in their flexibility of staff use. They complain against those who "seem to believe that in-house subcontracting should not have existed in the first place and it is a wrongful type of contract which is detrimental to the labour market and the labour relations and, therefore, must be suppressed or banned in one way or another in the labour market". They also fear a costly upsurge of court prosecutions against illicit uses of in-house subcontracting at a difficult point in the global economic cycle (Lee, 2012). These fears have been compounded recently following a Supreme Court's ruling in favour of a former sub-contracted worker who was determined to have been dismissed unfairly by Hyundai Motor. At the same time, the trade unions remain dissatisfied with the lack of precision on the equal pay issue and call for a further reduction of the maximum length of fixed-term contracts to one year and for limiting the use of these contracts to cases where a *reasonable cause* can be ascertained.

Regular workers

Employment protection for regular workers should be lowered so that firms can achieve an adequate level of flexibility without depending as much as currently on non-regular workers (Jones, 2012). Indeed, international evidence suggests that the creation of temporary jobs is a common response by firms to the high costs of reducing permanent jobs (Kahn, 2010). In this context, changes to the labour law that would accelerate and simplify the procedures, so as to enhance employment flexibility in the employment of regular workers, also deserve a careful evaluation. Overprotection of regular workers in large firms also reflects the power of unions and the high priority they place on protecting their members' jobs. Accordingly, it should not be expected that reforms to employment protection for regular workers will easily translate into greatly increased numerical flexibility for employers. Nonetheless, the experience with employment protection reforms in countries with strong unions, such as Denmark, suggests that reforms can be effective at reducing excessive rigidity, particularly when workers experiencing layoffs are offered adequate unemployment benefits and re-employment assistance. That is, workers' legitimate concerns about lower employment security need to be addressed by implementing a Korean version of the "flexicurity" (OECD, 2006).

Important measures have been introduced over the past fifteen years to reduce the cost involved in firing regular/permanent workers. For example, labour law was revised in 1998 to allow collective dismissals for "urgent managerial reasons". In 2007, the requirement to provide employee representatives a 60-day notice period in cases of dismissal (in addition to the 30-day advance notice to affected workers) was shortened to 50 days. Recent changes in regulations have also reduced uncertainty for employers by replacing penal provisions for unfair dismissal (imprisonment up to five years) with financial penalties.

Nonetheless, there remains considerable scope to further liberalise employment protection rules for regular workers. Firms are required to exhaust "all means" to avoid dismissals on economic grounds and to turn to previously dismissed workers first in case of new recruitment, rather open-ended requirements that could create disagreements about whether they have been met. Moreover, firms have to prove that during the 50-day notice period they have actively engaged in discussions of proposed dismissals in an effort to avoid them. For dismissals based on "managerial reasons", firms dismissing more than a certain number of workers are required to report to the Ministry of Employment and Labor 30 days in advance, documenting the reason for the dismissal, issues discussed with worker representatives, and a dismissal schedule. These strong requirements and procedural complexities raise the effective cost of collective dismissals.[27]

Severance payments

In nearly all OECD countries, severance pay is an important component of firing costs and therefore a major element of EPL strictness. In Korea, firms are mandated by law (the Employee Retirement Benefit Security Act) to pay a *retirement allowance* which, insofar as it needs to be paid to *all* separating employees with at least one year of tenure, is not, strictly speaking, a *firing cost*. Nevertheless, the Korean retirement allowance interacts with EPL to reinforce labour market dualism. It does this by producing incentives for employers to make heavy use of very low tenure workers, thereby accentuating differences between regular and non-regular workers. It is for this reason that the retirement allowance is discussed in this section.

Clause 8 of the Employee Retirement Benefit Security Act requires firms to pay a lump-sum retirement allowance of at least one month of wages per year of work to all separating workers with a year or more of job tenure, regardless of the reason they leave the firm (i.e. for both firings and voluntary quits). The worker's final wage, including bonuses, is used to calculate the retirement allowance, which was made mandatory in 1961 for companies with over 30 employees and in 1989 for those with over five employees. In some firms, successive rounds of collective bargaining have increased the allowance entitlement for employees with long service to more than one month's salary per year.

The retirement allowance is an inheritance from Korea's early stages of economic development, when only very limited income security was available. In fact, it was conceived to function both as unemployment insurance for the jobless and as old-age income for the retired. The retirement allowance has also long acted as a catalyst to a strong sentiment of loyalty of the employee to the firm, ultimately acting as a factor of trust during the development of a work career.

The retirement allowance has several adverse effects on employers' human resource policies which tend to reinforce the dualism of the labour market. In particular, it encourages firms to employ workers with very short tenures, possibly helping to explain the very high rates of labour turnover documented in Section 3.2. One reason this happens is that workers who leave the firm after less than a year have no entitlement to the retirement allowance. This mostly affects non-regular workers. A second reason is that the seniority-based wage scheme causes wages and hence also the retirement allowance entitlement to increase steeply with tenure. This interaction is a key reason why employers require or induce many regular workers to retire from their career jobs at relatively young ages (see Section 3.5).

Reforms of the retirement allowance system have been debated for a long time in Korea, particularly since the introduction of a national pension scheme in 1988 and the Employment Insurance system in 1995. One important outcome of these discussions was the decision by the government to launch a corporate pension scheme in 2005. This initiative allows retirement allowance schemes to be converted to company pension schemes, provided labour and management agree on the conversion. The key elements are as follows:

- Both a defined-benefit (DB) scheme and a defined-contribution (DC) scheme are possible, again to be decided by labour/management agreement;
- Under the DB scheme, the benefits payable should be equal to the current amount of the retirement allowance;
- Under the DC scheme, the employer's annual contributions should be equal to 1/12 of the employee's total annual wages;
- Employees moving between jobs can accumulate their lump-sum severance payments in an *individual retirement account*.

Important adjustments have been introduced since the creation of the corporate pension scheme. For example, one important limit of the 2005 bill was that the workers employed by firms with fewer than five employees were not entitled to join the corporate pension scheme – the same access requirement as for the retirement allowance. This meant that the scheme was unable to enhance the welfare of the workers in the smallest firms. To correct this unbalance, the entitlement to join the corporate pension scheme was extended to the enterprises with four or fewer employees in 2010.

Since one-quarter of all non-regular workers are employed in establishments with four or fewer employees, the 2010 amendment represents a much needed step towards more equal treatment of non-regular workers.[28] However, there is also a time dimension to consider, with the important point here being that the workers with tenure of less than one year are still not entitled to join the corporate pension scheme. This means that the strong incentives that the employers face to hire workers on short-term contracts and to terminate the contract before the employee's tenure reaches one year may have increased following the introduction of the new amendments.

Reflecting the fact that the decisions to set-up a corporate pension scheme and to establish an "individual retirement account" are voluntary, the government has relied on tax incentives to encourage conversions. For employers, all contributions to the corporate pension scheme are treated as business expenses. Furthermore, the corporate pension scheme transforms more or less unpredictable firing costs into a predictable cost of employment, particularly in the case of the DC scheme. This mitigates employer's financial costs when high-tenure workers leave the firm, thus moderating the disincentive to hiring and retaining regular workers. For employees, income tax is deferred to the time of withdrawal from the pension scheme or retirement account.

Despite these advantages, the new corporate pension scheme has had only limited take up so far. The number of enterprises joining the scheme has remained relatively low since its inception, so that, as of 2011, pension plans had been introduced at only 9% of firms. However, these plans had been adopted largely by large corporations and they covered 36% of employees (OECD, 2012a). At the current pace, it could take more than ten years to cover just one half of regular workers in company pensions. In part, such a slow transition to the company pension plans reflects the fact that the substantial tax advantages associated with company pensions are less favourable than those associated with the retirement allowance, which allow the lump sum payout to be taxed over a number of years at low rates. Moreover, the retirement allowance does not have to be funded outside the company. By contrast, firms that adopt DB schemes must entrust at least 60% of the funds to financial institutions and 100% in the case of DC schemes. In both cases, employers must provide payments at least as large as under the lump-sum retirement allowance.

A package of new measures has been introduced by the government in July 2012 with a view to promoting more rapid adoption of company pensions. The new measures allow firms to adopt both DB and DC schemes and to limit the interim payment of the retirement allowance. Until now, one factor slowing the development of the company pension system has been the requirement that workers and the firm reach a prior agreement about whether to adopt a DB (which is typically favoured by workers) or a DC (typically favoured by firms). Under the new streamlined approach, which applies exclusively to the newly established companies, the employer has a year to set up a corporate pension scheme based on a preliminary consultation with employee representatives, but not requiring a formal and binding agreement with them.

The new provision should enable the new employers to more easily set up a DC scheme, which is both relatively more convenient from the viewpoint of the employer, than a DB, and less risky. Importantly, a stronger role of the DC scheme should also reinforce the portability of company pensions, an important consideration in Korea where average employment tenure is only five years. Insofar as, firms that adopt DC schemes must entrust 100% of the funds to financial institutions, whereas in the case of the DB scheme only 60% of the retirement allowance has to be funded outside the company, the DB system can limit pension portability, which is an important drawback when many careers involve working for multiple employers.

Another problem with the operation of company pension schemes has been the tendency of employees to withdraw savings prematurely, undermining the role of pensions as a vehicle for retirement savings. To address this issue, new measures cap early withdrawals (i.e. those occurring before reaching retirement age) to 50% of savings and limit withdrawals to specific purposes (e.g. the purchase of a home for those not already owning a property).

Link to the OECD indicator of employment protection

A number of the above-discussed provisions are reflected in the OECD indicators of the strictness of employment protection (Figure 3.11). Taken together, the significant efforts undertaken to promote labour market flexibility since the 1997 Asian crisis imply that the overall OECD index of employment protection for regular and non-regular workers in 2008 was 2.1, which is slightly below the OECD average of 2.2. Nevertheless, it is far above the level in countries such as the United States (0.9), Canada (1.0) and the United Kingdom (1.1).

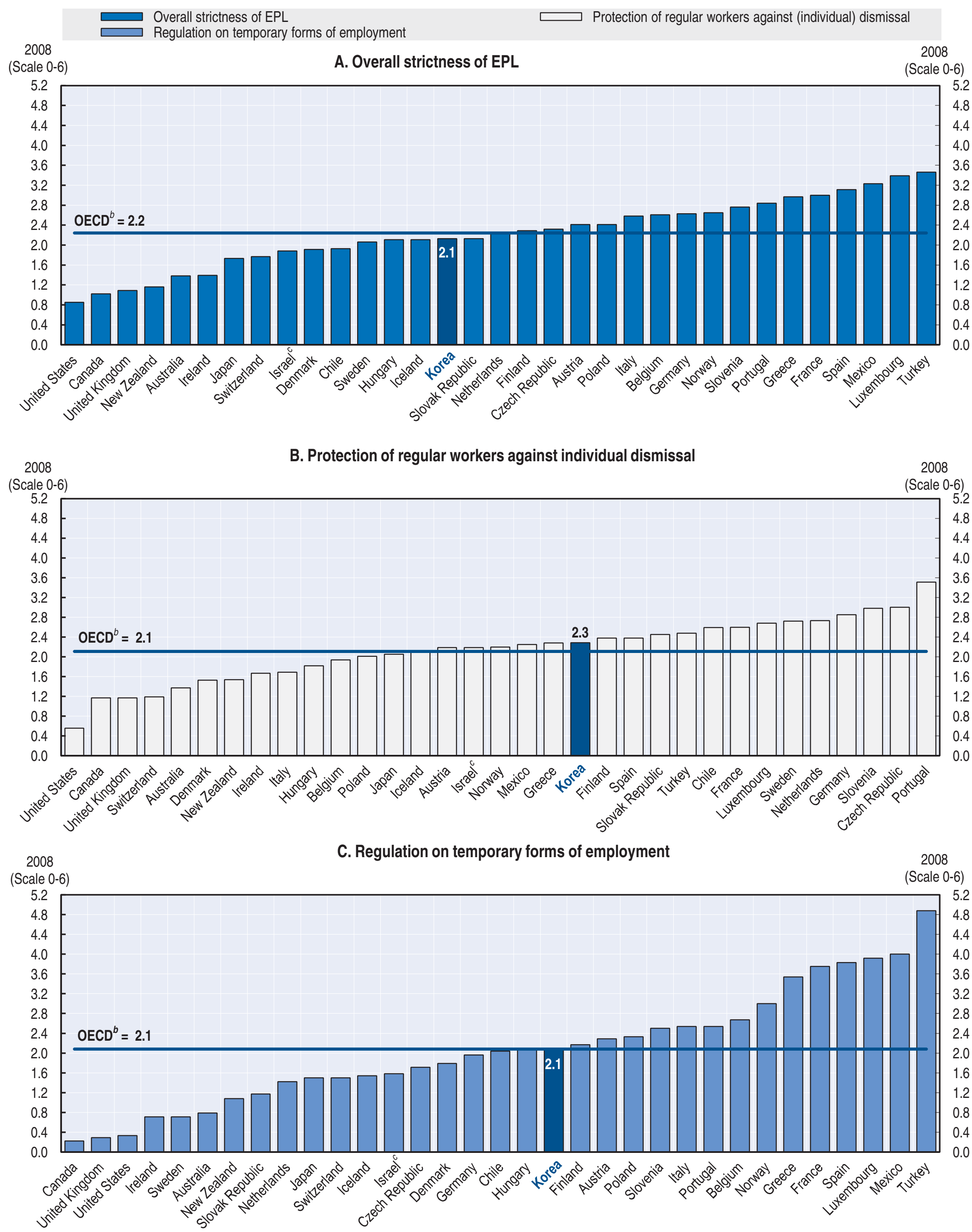
With regard to regular employment, the EPL indicator ranks Korea slightly above average among OECD countries in terms of strictness (2.3 versus 2.1), at about the same level as Austria, Greece and Japan (but below France, Sweden and Germany). Korea's EPL classification reflects a number of relatively strict protective provisions including:

- Relatively strong procedural requirements and long consultation periods with employee representatives;
- The need for employers to make verifiable efforts to avoid dismissal and apply certain standards in selecting employees to be laid off; and
- The relatively high frequency of reinstatement orders in the case the employer is convicted for unfair dismissal.

The reason the overall score is only slightly above the OECD average, despite these provisions in the law, is that Korean EPL is scored as providing no severance pay for dismissed workers. While the retirement allowance acts as relatively generous severance pay in practice, it is not included in the index because it is paid to all separating workers and hence is not strictly speaking a firing cost. As was discussed above, the retirement allowance does reinforce the impact of (strictly defined) EPL in creating incentives for employers to make extensive use of temporary workers and, hence, reinforces labour market dualism.

In terms of EPL strictness for temporary work, Korea was ranked in 2008 at the same level as the OECD average (2.1). The legislative package introduced in 2012, implies both a strengthened protection of fixed-term contracts (reflecting the new MOEL authority to directly issue a corrective order to an employer that discriminates against fixed-term and/or part-time workers, even in the absence of the aggrieved workers' petition to the Labor Relations Commission) and a significant tightening of temporary agency contracts (stemming from the newly introduced rule requiring the employer to hire illegal dispatch workers immediately after the violation concerning their use is discovered and regardless of the duration of their engagement as dispatched workers). Neither of these reforms is reflected in the 2008 values of the OECD indicators of EPL. While they probably will result in a modest increase in the indicator value, they represent a welcome development because they reduce the difference in the protection accorded to non-regular and regular workers and may thus help to prevent overuse of non-regular employment, especially fixed-term employees. The reforms affecting TWA employment may also serve as a disincentive to employers to hire illegal dispatch workers in the form of in-house subcontracting.

Figure 3.11. **Overall strictness of the employment protection legislation and two main components, OECD countries, 2008[a]**



EPL: Employment protection legislation.

a) Data refer to 2009 for France and Portugal.

b) Unweighted average of each indicator for the 30 countries that were members of the OECD in 2008 (i.e. excluding Chile, Israel and Slovenia shown above).

c) Information on data for Israel is available at: *http:/dx.doi.org/10.1787/888932315602*.

Source: *OECD Online Employment Database*, and specifically *www.oecd.org/employment/protection*.

The Korean government is aware of the need for further EPL reform to address important labour market duality challenges. The discussion above underlies the need for a comprehensive approach:

- On the one hand, Korea should further relax EPL for regular workers. Labour law should be changed so as to accelerate and simplify the remedy procedure against unfair dismissal, which often involves an excessively long period of time before the final court decision is reached. The remedial procedure for unfair dismissal allows for the possibility of a settlement in the form of monetary compensation, which has the potential to facilitate the process. However, it appears that the effect of this provision is limited because reinstatement is always offered to the employee and remains the primary remedy.
- At the same time, decisive action towards the liberalisation of the temporary agency work remains needed. Particularly, aligning the regulation of the TWA workers to that of the other OECD countries would require replacing the "positive-list system", which limits such workers to certain authorised occupations and industries, to a "negative-list system", which allows them in general, except in certain cases. Since this issue has been the source of fierce disagreements between management and labour, it will be important to develop greater consensus among stakeholders before moving forward with the implementation of such a reform.
- Although the improvements achieved recently are welcome, the corporate pension scheme has not fully responded to the need for a comprehensive EPL reform and for a reduction in labour market segmentation. Removing existing tax preferences for retirement allowances would be a big step in the direction of a "comprehensive approach" to reducing labour market duality.

Policies to narrow wage differentials

Another important component of a broad effort to reduce the duality of the labour market is the effective implementation of policies to reduce wage discrimination between non-regular and regular workers who perform equivalent jobs, while more closely aligning individual pay with individual productivity. As the other OECD countries, Korea has various mechanisms in place to prevent unjust differences in pay. The most important of these are anti-discrimination and minimum wage legislation.

Anti-discrimination legislation

The two Korean trade union federations argued in favour of explicitly prescribing the principle of "equal pay for work of equal value" within the 2007 Act on the Protection of Fixed-term and Part-time Employees, as is already the case in the Gender Equal Employment Act. However, the bill that was finally approved did not contain this particular language, although some participants argued that the principle was effectively implied by the overall text. Grubb et al. (2007) note that only a few OECD countries (i.e. Belgium, France and Spain) have enacted legislation that explicitly requires temporary workers to be paid the same wages as equivalent permanent workers.

The 2007 anti-discrimination legislation is intended to reduce "*unreasonable*" differences in wages or benefits between permanent and temporary workers. Its application may be relatively straightforward in cases where non-regular workers are, for example, openly denied the fringe benefits that a company provides its regular workforce.

However, the current discrimination redress system is difficult to apply to situations where a comparable worker, performing the same or similar tasks in the same workplace, is lacking. This is often the case in SMEs. To address this particular issue, the government has issued detailed guidelines in 2012 to reduce discrimination in wages and other working conditions, encouraging both labour and management to actively use the new guidelines as a benchmark. Initiatives are also underway, at present, to train labour inspectors, so that they can more effectively and consistently apply the new guidelines.

The fight against wage discrimination is also expected to benefit from recent measures to reduce unpaid wages. From August 2012, the government publicly discloses the names of companies that fail to regularly pay their employees and reports delinquent employers to Credit Information Collection Agencies. Credit-rating penalties have also been introduced along with strengthened personal sanctions against employers who fail to pay their employees.

Another source of difficulties relates to the complex, seniority-based wage structure prevalent in Korean firms. Typically, there are numerous dimensions involved in wage determination: a basic salary, depending largely on seniority, but also various allowances and bonuses, whose entitlement reflect different features, also connected to seniority. Taken together, these factors complicate, even in the presence of anti-discrimination legislation, the identification of unjustifiable wage differentials between employee categories. As was discussed above, the steep increase in pay with seniority and the way it interacts with the retirement allowance also creates strong incentives for employers to require regular workers to retire at relatively young ages. Addressing these problems requires more than a narrowly defined focus on discrimination. It also requires changes in the wage determination system to better align individual pay with productivity. However, this is a complex issue and more tripartite efforts will likely be needed to achieve a consensus about how to reform wage systems.

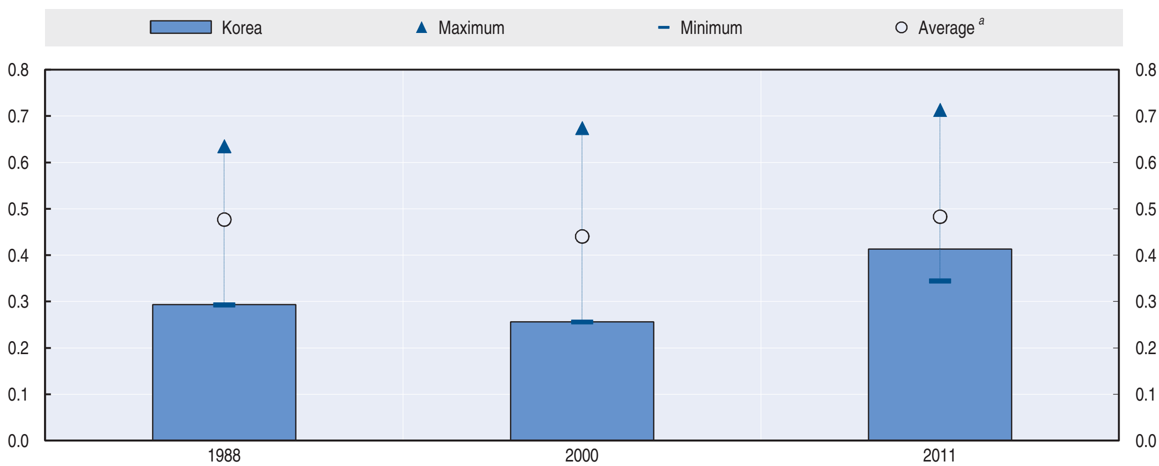
Statutory minimum wage

The minimum wage is a useful tool for ensuring that fair wages are paid, thus potentially helping to reduce the large wage differential between non-regular and regular workers. In Korea, the Minimum Wage Act was introduced in 1988 and its provisions have applied to all workers since November 2000, with only a few exceptions – for instance, family businesses that hire only family members. There is one unified national statutory minimum wage in Korea, which is adjusted annually. Only in the case of security guards and other intermittent workers, a sub-minimum rate of 90% is applied.

Figure 3.12 shows that the minimum wage in Korea was set at 29% of the median wage in 1988, the lowest level in the OECD, but has since been increased to a still relatively low level of 41% of the median wage. While the level of the minimum wage is not high internationally, the high incidence of low-paid employment (Figure 3.4) suggests that the cost implications could be significant for many employers and caution is called for in considering further increases.

The evidence in Korea on the impact of the minimum wage on wage determination is mixed. Recent work by the Korean Labor Institute shows that wages are distributed to some degree also below the minimum wage, rather than being completely truncated at the level of minimum wage. This seems to suggest a limited degree of enforcement (Jeong, 2011). Indeed, the trade unions report that cases of non-compliance have been increasing overtime, with the share of wage earners below the statutory minimum wage having grown from 4.4% in 2001 to 12% in 2011 (Lee, 2012). This amounted to 2 million workers, 95% of whom were in precarious jobs and twice more likely women than men. While 19 518 cases alleging violations of the Minimum Wage Act were filed in 2011, only 11 cases resulted in legal rulings against the employer and most of these concluded with minor, if not symbolic, punitive measures such as the administrative request for "corrective measures". Weak inspection and monitoring, as well as light sanctions, thus appear to be undermine effective enforcement in Korea's minimum wage system. At the same time, Jeong (2011) provides evidence of spill over effects of the minimum wage, with minimum wage policies increasing the wage levels for all workers up to the median of the wage distribution. This finding underlies the potential of the minimum wage to also help non-regular workers earning somewhat more than the statutory minimum.

Figure 3.12. **International comparison of the level of the minimum wage relative to the median full-time wage**



a) Unweighted average for countries with a legal minimum wage.

Source: OECD Minimum Wages Database and *Earnings Distribution Database*.

Reforms undertaken by the Korean government in recent years include expanding coverage of the statutory minimum wage to all wage and salary earners, including workers on probation for less than three months, and applying the full minimum to young workers aged below 18 and employed for less than six months. Additional measures to expand the coverage of the minimum wage were introduced in September 2011, when the government announced that fixed-term worker trainees under contract for less than one year would also be covered by minimum wage law. To some extent, these reforms have reduced the incidence of very low pay among temporary employees, thus supporting the effort against labour market duality.

The OECD's Reassessed Jobs Strategy emphasises that a moderate minimum wage is generally not a problem for employment and can play a positive role within a broader "make-work-pay" strategy, by encouraging higher labour market participation and reducing in-work poverty. In addition to setting a nationwide minimum wage, an increasing number of countries set lower minimum wages in certain sectors and/or for particular groups, such as teenagers. International experience suggests that the case for applying a lower sub-minimum wage to young workers is especially strong when the job requires significant investment in training new recruits (OECD-ILO, 2011a). The rationale for a more differentiated minimum wage is to encourage firms to invest in hiring and training young workers who lack qualifications, while enabling these employers to share the related cost burden with the workers. OECD countries following this practice include Germany and the United Kingdom, where salaries and training allowances are initially set at relatively low levels to account for the lower labour productivity expected during the training period. However, this approach may be of more limited importance for Korea, given the very high educational attainment of youth.

Strengthening the role of activation policies to raise employability

Active labour market policies, such as job-search assistance and public training programmes, play an important role in facilitating the transition from unemployment to employment. Unemployment benefits play an essential complementary role by providing income support during the time when the jobseeker is looking for work. The Reassessed OECD Jobs Strategy of 2006 presents general principles for combining active labour market policies and unemployment benefits into an coherent activation policy that keeps joblessness low while reconciling labour market flexibility with income security for workers (OECD, 2006). The general principles of activation policy apply to all jobseekers, regardless of their previous status as regular workers or non-regular workers. In practice, however, Korean non-regular workers are much more likely to miss out on any kind of activation policy than their regular counterparts. For example, Table 3.6 (above) shows that non-regular workers receive substantially less training than regular workers overall and that this training gap is larger when the comparison is restricted to participation in public training programmes. Along with facing weak coverage by active labour market policies, non-regular workers are also less adequately covered by the social safety net than regular workers. These coverage gaps reinforce inequality insofar as non-coverage is one of the reasons the Korean tax-transfer system does little in comparison with other OECD countries to reduce income inequality (cf. the discussions in Chapter 2). They also reinforce labour market duality by increasing the labour cost advantage of employing non-regular rather than regular workers. This section discusses how the broad framework for activation can be improved in Korea, focussing particularly on how to increase the access of non-regular workers to appropriate re-employment and training measures.

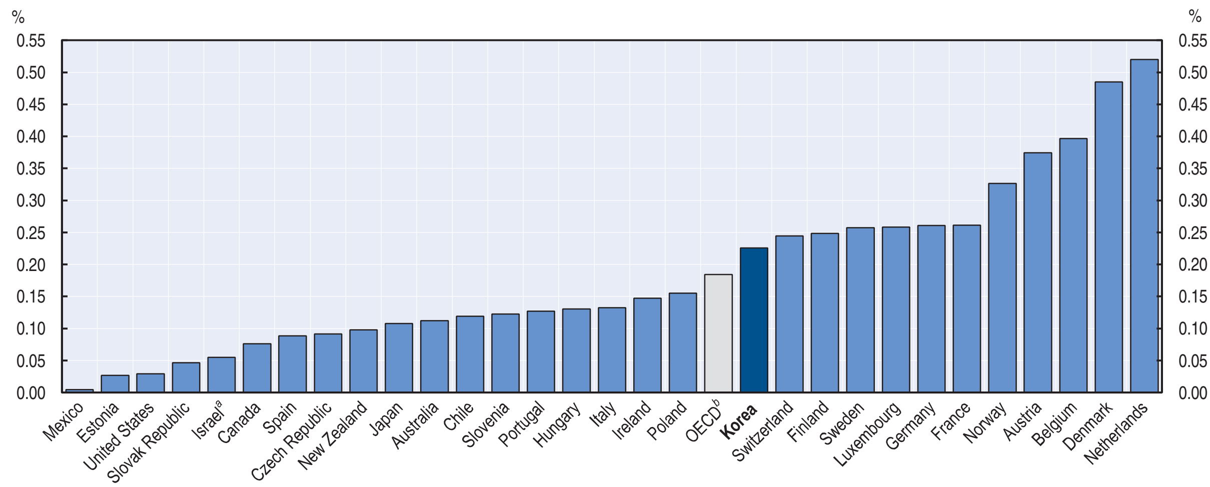
Improving job-search assistance

In response to the steep rise in unemployment following the 1998 financial crisis, the Ministry of Employment and Labor (MOEL) established a new nationwide employment service network called Employment Security Centres (ESCs), replacing the ineffective previous public service, which had long played only a modest role in the job placement market. Over the space of just a few years, the number of Job Centres expanded substantially. In order to enhance the effectiveness of labour market policies, ESCs are set up as a *one-stop service* providers offering: *i)* job brokerage; *ii)* unemployment benefit administration; and *iii)* referral to active labour market programmes. The ESCs also grant foreign worker permits. However, EI premiums, together with Industrial Accident Compensation Insurance premiums, are collected by the Labor Welfare Corporation.

Korea's spending on active labour market programmes is somewhat higher than the OECD average when taking into account the relatively low unemployment rate (Figure 3.13). Although Korea's expenditure on active labour market programmes has increased in recent years, the bulk of spending (almost 70%) is on direct job creation. While these types of measures have some value in a deep recession, when alternative employment opportunities are scarce, in general they have been found to be ineffective at helping unemployed people move into stable jobs in the private sector, and can even hinder future job prospects by distracting jobseekers from searching actively for unsubsidised work (OECD, 2009). This suggests that the mix of active labour market policies in Korea is not well suited to reduce labour market duality by helping non-regular workers to move into unsubsidised regular jobs.

Figure 3.13. **Expenditure on active labour market programmes, 2010**

Total expenditure on active programmes per unemployed person in OECD countries
Percentage of GDP per capita



a) Information on data for Israel is available at: *http:/dx.doi.org/10.1787/888932315602*.
b) Unweighted average of countries shown above.

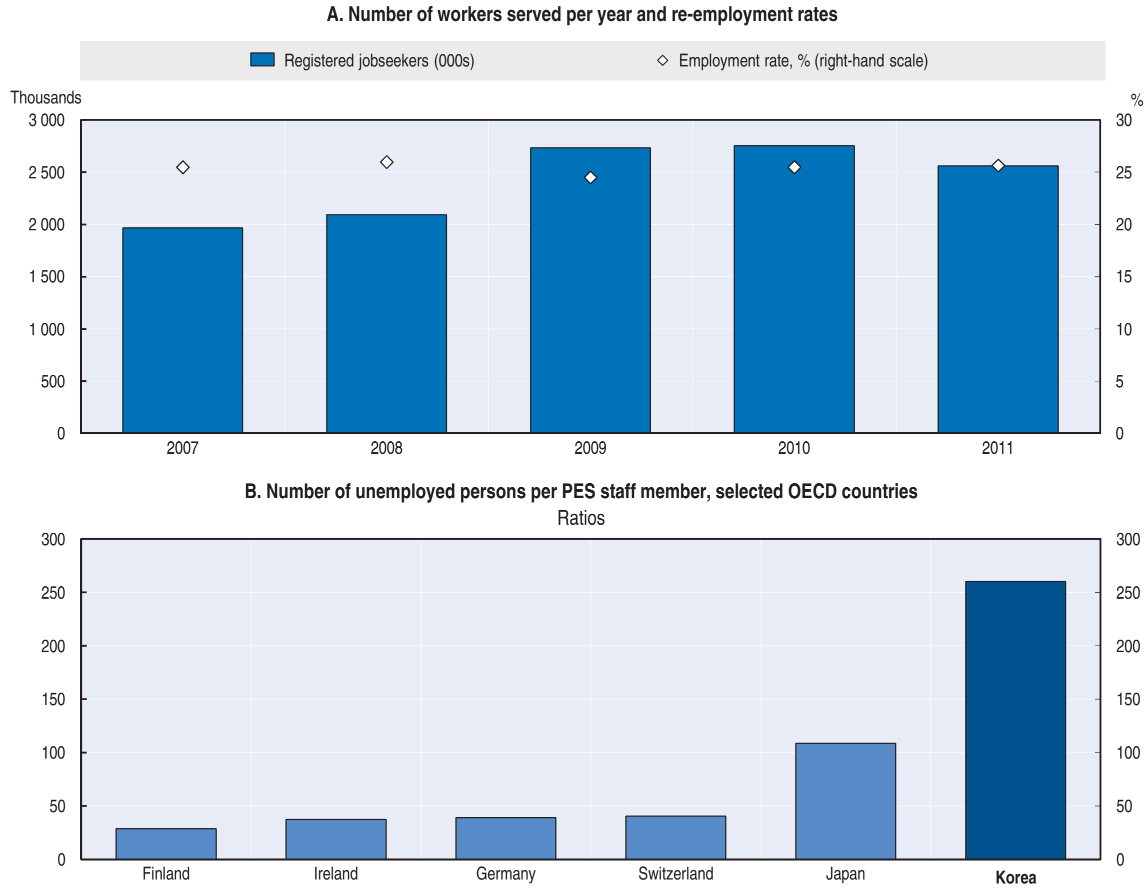
Source: OECD calculations based on *OECD Labour Market Programmes*, *OECD National Accounts* and *OECD Main Economic Indicators Databases* respectively for ALMP expenditure per GDP, population and harmonised unemployment.

Korea spends a relatively small proportion of its active labour market programme budget on job-search assistance and training aimed at improving employment prospects in the long-run. In 2011, Job Centres provided services to around 2.5 million jobseekers (Figure 3.14, Panel A). However, despite their extensive responsibilities and central importance in the delivery of employment services, Job Centres are under-resourced. Only 81 Job Centres are in operation around the country, with around 3 500 staff. The number of Job Centre staff, relative to the client and workloads, appears inadequate by comparison with other OECD countries for which data are available (Figure 3.14, Panel B). The ratio of unemployed persons to Job Centre staff in Korea is more than twice that in Japan and more than six times that in Germany. The resources devoted to job matching and counselling appear even more inadequate considering that less than 40% of total Job Centre staff work on employment or job-search support (MOEL, 2010).[29] Only 25% of registered jobseekers are employed after being referred to a vacancy by the Job Centre (OECD, 2013a).

Some positive steps have been taken in recent years to relax these bottlenecks and gradually shift the focus of Korea's active labour market policies towards devoting more attention to job counselling. Most notably, a restructuring in July 2011 – combined with a change allowing unemployment benefit recipients to file evidence of job-search online – has allowed staff to spend more time providing counselling to jobseekers. For example, the average time spent with clients in the Seoul Job Centre rose from 5 to 15 minutes between 2011 and 2012 and the proportion of jobseekers successfully placed in employment increased from 32 to 36% (OECD, 2013a).[30]

Figure 3.14. **Staffing at and workers served by MOEL Job Centers**

Levels, percentages and ratios



Source: MOEL (2011), *Employment White Paper*, Gwachun, and MOEL (2012), *Employment White Paper*, Seoul, for Panel A. For Panel B, data for Korea are from OECD (2013), *Back to Work Korea – Improving the Re-employment Prospects of Displaced Workers*, while data for the other countries are from Duell, N., D. Grubb, S. Singh and P. Tergeist (2010), "Activation Policies in Japan", *OECD Social, Employment and Migration Working Papers*, No. 113, Table 2A.2, *http://dx.doi.org/10.1787/5km35m63qqvc-en*. "Unemployed persons" refers to the internationally harmonised concept of unemployment, as implemented in the *Online OECD Employment Database*, *www.oecd.org/employment/database*. Data refer to 2011 for Korea, 2006 for Germany and 2007 for other countries.

Recently, these efforts have been further intensified following the introduction by the government of the Successful Employment Package (SEP) project, which is specifically targeted to help the low-income and socially vulnerable individuals get jobs. The SEP is a comprehensive programme providing customised job-placement services for these groups, among whom many formerly occupied non-regular positions, which aim to help individuals find personally suitable positions. In the project's first stage, "choosing a career path", the package provides participants with individual counselling and a four-week course aimed at boosting participants' confidence and desire to work. Participants are also provided with financial support for their actual expenses. In the second stage, "increasing determination & ability", the project provides a salary to participants while they receive vocational training. Participants needing an opportunity to become acclimatised to a working environment and learn necessary job skills are offered work experience. In addition, participants who wish to start a new business can participate in a business start-up course. In the project's third stage, "intensive job placement", Employment Centres and private institutions work together to provide "interview chaperones" in addition to other job-placement services provided by both public Job Centres and contracted-out private employment agencies. In addition to the SEP project, the Korean government is carrying out other measures tailored to individual circumstances of jobseekers – notably, youth, the disabled, Baby Boomers, and women (for discussions of labour market problems encountered by youth and women see Section 3.5 below).

These recent policy initiatives, notably the 2012 expansion of the SEP programme to cover more jobseekers, have shown some good results in helping marginalised people find work, by providing customised, intensive assistance and are welcome. Nonetheless, it is too soon to fully assess the impact of the new measures, as they are still in their infancy. As experience with operating these measures accumulates, their effectiveness should be assessed in terms of the resulting increases in *both* the number and quality of job opportunities; that is, they should seek to promote better paying and more stable employment, as well as more employment. It may also be worth considering offering services equivalent to the first stage of the SEP programme to all jobseekers having been unemployed for more than a certain time, say six months. After drawing up an individual action plan, jobseekers could then be referred to additional assistance as required, such as personalised job placement, job-search training, vocational training and work-experience placements.

Careful targeting may also be required to avoid inefficiency as the programme becomes more widespread. For example, it is not clear that all workers displaced by the recent Free Trade Agreement with the United States will require such an intensive assistance, at least not in the initial stages of unemployment (OECD, 2013a). It may be better to provide less costly assistance – such as job-search training – and allow these workers to search for work for a period of time after job loss and only refer them to the SEP programme if they are unsuccessful.

Furthermore, it may be important to address possible sources of co-ordination failures between service providers operating at different levels of government. Municipalities and local governments are also active providers of employment services, through their Job Information Centres. While the network of local government employment services is more extensive than the MOEL Job Centres, few resources are devoted to these services by each local government. In 2006, a local government survey showed that each local government administration had, on average, 1.2 full-time equivalent staff dealing with employment issues. Nevertheless, local governments play an important role in activating recipients of Basic Livelihood Security (see Chapter 2). Local governments are also responsible for choosing which recipients will take part in the SEP programme, which is run by the MOEL. This suggests that good co-ordination between MOEL Job Centres and local governments will be crucial going forward. To assist this co-operation, the MOEL has recently hired 100 job counsellors to work with local governments and help them to identify appropriate participants.

In addition, Korea has Re-employment Assistance Centres (RACs) managed by the Korea Labor Foundation (KLF), and funded by the MOEL. In a number of locations, the RACs operate in collaboration with the local government. RACs provide job matching, individual counselling, training in resume and interview preparation and networking and provide facilities for jobseekers. These services include computer and internet access, photocopiers and training rooms. Audiovisual equipment allows jobseekers to film mock job interviews and review their performance. There are also special programmes to provide intensive support for jobseekers with mental health problems.[31]

After an expansion in 2007, RACs help around 16 000 jobseekers each year, almost a third of whom use the two Centres in Seoul. While there is some evidence suggesting that the RACs may perform better than MOEL Job Centres in helping jobseekers move back into work, it is difficult to compare their relative effectiveness since they target somewhat different labour force groups and offer a different range of services. Nonetheless, there is considerable overlap between the types of services offered by the two organisations which are both funded by the MOEL. It may thus be desirable to more clearly define the role and target population of the RACs, possibly focusing their efforts on providing more intensive assistance to jobseekers who have not been successful in finding work through MOEL Job Centres, as well as their assistance offered directly to firms.

Expanding social security coverage for non-regular workers

Another priority for reducing labour market duality is to ensure that non-regular workers are more effectively covered by the social insurance system. In principle, the Korean legal framework requires nearly all workers to be covered by the social insurance system, including the Employment Insurance system. In practice, however, there is a sizeable gap between statutory coverage and actual coverage, with many non-regular workers excluded (*Korea Labor Review*, March-April 2009). In part, the problem reflects the relatively recent creation of the Korean social security system and is likely to diminish as time passes. However, there are a number of policy initiatives that can speed the expansion of coverage while maximising the resulting contribution to reducing labour market dualism and these are discussed in the following paragraphs.

As is the case in most other advanced countries, Korea has a two-tier social security system, consisting of a higher social insurance tier and a lower public assistance tier. The social insurance tier covers the majority of the population and is largely funded by contributions paid by employers and employees (also the self-employed in some cases). Public assistance complements the higher tier by providing a basic income floor directly targeted on the lower income population and is mainly funded by general tax revenues accrued by the central government or local governments.

Korea has four major social insurance schemes: *i)* National Health Insurance (NHI, introduced in 1977); *ii)* National Pension (NP introduced in 1988); *iii)* Employment Insurance (EI, introduced in 1995); and, *iv)* Industrial Accident Compensation Insurance (IACI, introduced in 1964). The NHI covers all of the Korean population except the beneficiaries of the Medical Assistance Program. The NP covers all persons with a history of paid employment. Both the EI and IACI principally cover employees, but also cover the self-employed on a voluntary basis. A more detailed discussion of the social security system is provided in Chapter 2.

The statutory coverage of social insurance has expanded rapidly over time and now extends to virtually all employees with very limited exceptions, such as part-time workers working less than 15 hours a week. However, data on *de facto* coverage rates for employees reveal large gaps in coverage. According to the Economically Active Population Survey (EAPS), the actual coverage rates for NHI, NP and EI vary between 67% and 70% of employees entitled to participate (Table 3.10). This is fairly low by the standards of the high-income OECD countries. Importantly, the figures have improved significantly during the past decade. Effective coverage rates in 2012 were 14 percentage points higher for NP than they had been in 2002. Over the same period, effective coverage also rose by 14 percentage points for NHI and by 18 percentage points for EI.

Table 3.10. **Social insurance enrolment rates by type of contract, 2002 and 2012**

Percentages of employees

	2002			2012		
	National Pension	National Health Insurance	Employment Insurance	National Pension	National Health Insurance	Employment Insurance
Total	**52.7**	**55.5**	**48.0**	**66.6**	**69.7**	**66.5**
Regular	62.9	65.6	56.2	79.6	81.3	78.3
Non-regular	25.7	28.8	26.2	40.5	46.5	45.0
Temporary	31.3	34.6	31.8	60.7	69.1	65.5
Fixed-term	*32.1*	*35.3*	*32.9*	*64.4*	*74.2*	*70.0*
Non fixed-term	*29.1*	*32.6*	*29.2*	*49.6*	*53.6*	*51.9*
Part-time	2.0	2.9	3.1	13.2	15.4	15.9
Atypical	24.4	28.4	24.8	22.1	31.0	29.2

Source: Statistics Korea, Economically Active Population Survey (EAPS), Supplementary results of the EAPS by employment type (March each year).

The overall coverage rates for all employees in the first row of Table 3.10 hide large differences between regular and non-regular workers. In 2012, coverage rates are 33 to 39 percentage points higher for regular workers, due to coverage being below 50% for non-regular workers for all three of these social insurance schemes. Nonetheless, coverage rates are up significantly relative to 2002 in all cases. Wide coverage differences are also present between different types of non-regular workers, with enrolment being much lower for part-time and atypical workers than for temporary workers. Company-based coverage rates also differ greatly between large and small firms, as well as between high and low wage firms, but in the case of NHI workers not covered *via* their job typically are covered in another manner, such as *via* another family member (Table 3.11). In short, labour market dualism is strongly echoed in the tight association between holding a non-regular job or being employment in a small and/or low-wage firm, on the one hand, and a high probability of not being enrolled in social insurance schemes on the other. This pattern implies that EI, for instance, fails to provide income security precisely for the workers in the most insecure jobs. Similarly, low-wage workers who likely have difficulty saving for retirement or a period of unemployment, face a high risk of missing out on NP and EI. Further efforts to reduce non-compliance by employers and workers are needed to allow these social insurance schemes to better achieve the risk-sharing purposes. Raising effective coverage would also reduce the financial incentives for employers to employ non-regular workers. Since access to many active labour market programmes is limited to recipients of EI benefits, enrolling more non-regular workers in EI would help to enhance their employability and their chances to move into better jobs in the long run.

Table 3.11. Social insurance enrolment rates by size of firms and wage level

Percentage distribution by classes of subscribers, 2010

	National Pension			National Health Insurance					Employment Insurance		
	Company-based[a]	Individual-based[b]	Unsubscribed	Company-based[a]	Individual-based[b]	Co-beneficiaries[c]	Medical assistance	Unsubscribed	Civil servants, teachers, and special postal workers	Subscribed	Unsubscribed
Total	**65.0**	**6.7**	**28.3**	**67.0**	**17.3**	**11.9**	**1.1**	**2.7**	**7.5**	**58.6**	**33.9**
Firm size (number of employees)											
1-4	24.8	12.5	62.7	26.7	38.4	26.3	2.4	6.2	0.4	25.3	74.3
5-9	49.9	9.8	40.4	52.9	26.1	15.9	1.3	3.8	0.7	51.2	48.1
10-29	68.3	6.5	25.1	71.1	14.8	10.8	1.0	2.3	4.6	65.5	29.9
30-99	80.7	4.9	14.4	83.1	8.7	6.4	0.6	1.1	14.0	68.2	17.8
100-299	91.8	1.5	6.8	92.6	3.2	3.3	0.3	0.7	11.4	80.1	8.5
300+	95.6	0.8	3.6	96.0	1.9	1.7	0.1	0.3	20.2	74.8	5.0
Wage level[d]											
Low	29.2	8.5	62.3	34.3	30.6	26.0	3.0	6.1	0.3	32.5	67.3
Mid	68.5	8.1	23.4	69.8	17.6	9.9	0.6	2.1	3.2	66.3	30.5
High	92.6	2.8	4.6	93.2	4.5	2.0	0.1	0.3	21.2	70.5	8.3

a) "Company-based" refers to enrolment subscribed through the company to which the subscriber belongs (for employees).
b) "Individual-based" refers to enrolment subscribed directly to the authority (for self-employed).
c) "Co-beneficiaries" refers to enrolment not subscribed, but covered due to a family member who subscribed.
d) "Low" refers to less than two-thirds of the median wage, "Mid" to between two-thirds and one-and-a-half of the median wage, and "High" to above one-and-a-half of the median wage.

Source: Lee, B.H. (2012), "Promoting Registration for Social Insurance through Insurance Premium Subsidies", *e-Labor News Issue Paper*, No. 124, Korea Labor Institute, Seoul, 28 September.

Key regulatory improvements have been introduced recently to address these policy challenges. In July 2012, the Korean government introduced a nationwide social insurance contribution subsidy programme – *Duru Nuri Social Insurance Subsidy Programme*. This new initiative followed a pilot programme in 16 local areas, which lasted between February and June of the same year. The subsidy programme applies to EI and NP. IACI and NHI are excluded almost all the people are already covered by NHI, at least as beneficiaries, while for IACI workers and their families can benefit even in the absence of enrolment.

One key feature of the new subsidy programme is that it is set to cover the smallest establishments, with nine workers or less. Both regular and non-regular workers who earn less than KRW 1 250 000 a month on average – corresponding to about 44% the average monthly wage of a regular worker in an establishment with five or more employees – are eligible to receive the subsidy. The subsidy applies to both the employer's and the employee's parts of the contribution, with the amount of the subsidy varying between one-half and one-third of the combined contribution premium. An element of progressivity is applied: the subsidy equals one-half of the contribution premium for employees with income between KRW 350 000 and KRW 1 050 000, but declines to one-third of the contribution for the employees with income between KWR 1 050 000 and KRW 1 250 000.

Since non-regular workers are strongly concentrated in small enterprises and have low enrolment rates in EI and NP, the new *Duru Nuri* approach appears to be well designed to raise social insurance coverage for non-regular workers. Broadening the system to reach out to a wider pool of contributing SMEs is also a declared objective of the government, which hopes that the subsidy will act as an incentive encouraging small firms to comply.[32] The subsidy is funded from general revenues, implying that the government is providing partial support for the contributions of low income workers, thereby insuring that the funding of these two social insurance schemes expands in line with the expansion of future benefit claims, without the burden of being transferred to other contributors.

Although it is too early to fully assess the impact of the new scheme, the results so far have been very encouraging. According to data provided by the Ministry of Employment and Labor (MOEL), 350 000 firms have qualified for the subsidy so far, equalling 70% of all eligible firms (502 000), and are receiving a combined subsidy of KRW 140 billion. Since the launch of the programme, 30 000 firms with less than ten employees have newly enrolled in EI.

The new subsidy policy should be accompanied by careful monitoring, which will be needed to detect remaining coverage gaps and ways to further improve how the system functions. For instance, there could be deadweight losses associated with the expansion of the subsidy, i.e. firms that qualify for the subsidy despite the fact that they would have paid the contribution even without the subsidy. The subsidy might also induce substitution or displacement effects. These possible side effects should be kept in check.

While very useful, a subsidy policy will not be sufficient to generate as broad and stable a base of social security contributions as is desirable. An efficient administration of these schemes is at least equally important for achieving high coverage rates, while minimising compliance costs for employers. In this regard, one important and long debated issue in Korea concerns the integration of the collection of different social insurance contributions. Consolidating the collection process in a single institution has the potential to reduce administrative costs and improve the enforcement of coverage rules, by comparison with separate collection by each social insurance institution, as was practiced until very recently. Historically, there have been wide differences in the income base used for the calculation of premiums. Premiums for NHI and NP insurance have been based on *taxable income* as defined by the Income Tax Act in the previous year, while EI and IACI premiums have been based on the *wage* defined by labour law in the current year. Some deductions are allowed against taxable income under tax law but not against the wage under labour law, and *vice versa*, although the amounts involved are not large.[33] Taken together these differences imply that the NHI and NP insurances have a relative advantage in terms of information exchange with the tax authority. These differences stem from the fact that each social insurance has been designed and implemented by different ministries. Furthermore, they reflect the fact that EI entitlements require a more complex record-keeping, since they are based on records of the individual's monthly contributions up to the month of separation from the last job.

Meaningful steps to improve the administration of the social insurance system have been taken recently. The contribution bases of the four social insurances were unified in 2011, using the taxable income as defined by the Income Tax Act as the common base. This implies that EI and IACI have switched to use the same contribution bases as NP and NHI. Furthermore, EI and IACI have also changed collection system from yearly imposition, based upon total wages paid on a company basis, to monthly impositions based on the individual taxable income of each employee (again like NP and NHI). This reform can be expected to reduce administration costs while allowing individual subscribers to be managed more efficiently.

Since 2011, the Korean government has also allowed NP, NHI, EI, and IACI to integrate the collection of their respective premiums at the National Health Insurance Corporation (NHIC). Combining collection in a single institution is expected to facilitate enforcement because the information about compliance with the different insurance schemes can be compared. For example, it becomes possible to check whether the same employer who is enrolled in one insurance scheme is also enrolled in the other schemes. This should result in less arbitrage between insurances on the part of the contributors – unless the employer does not enrol the employees in any of the four insurances.

The unification of the collection represents a welcome improvement, but more remains to be done to achieve a high degree of integration between four main social insurance schemes. Many tasks and responsibilities continue to be performed separately by each governing body. These include the right to decide upon contribution premiums, for example. More closely integrating the functioning of the four insurance schemes could enhance the efficiency of their administration and the monitoring of compliance.

The Earned Income Tax Credit (EITC) system (see Chapter 2) can also contribute to improving the administration of the social insurance system. In order to administer the EITC, the tax authority must collect full information about the income sources of many low income workers, including those who have remained beyond the reach of the insurance authorities, so far. The information available to the tax administration might thus be very helpful for detecting noncompliance with the rules defining social insurance coverage and hence useful in fostering higher coverage. Allowing the authorities to compare the EITC database on incomes with the wage bill on which social insurance contributions have been paid could help to target compliance enforcement activities by allowing insurance authorities to detect workers who are not enrolled in the social insurance schemes.

That said, a major problem in Korea is that the tax authority itself still lacks a complete set of data on earnings. Specifically, it lacks wage information for over a quarter of wage and salary earners. Income information for most of the self-employed is also not available or is estimated without book-keeping. Reforms to improve income reporting should therefore be given a higher priority.

Spill over effects on the efforts to reduce the size of the informal economy

Enrolling more non-regular workers in social insurance schemes *via* their employers can be expected to support efforts to reduce the size of the informal sector. Although there is no simple and reliable way to measure the incidence of informal employment, several methods can be used to estimate it. According to results from survey-based and national accounts-based estimates, the incidence of informal employment in many high-income OECD countries is around 5% or less, while in other OECD countries including Korea, Mexico, Southern European countries, and some transition countries in Eastern Europe, it is several times higher. As regards wage and salary workers, the observed extent of the gap between the theoretical liability for social security contributions based on wages and salaries in the national accounts and the amount of actual contributions collected reveals a shortfall in receipts for Korea and Mexico of between 25% and 30%.

Older and less educated workers, along with social benefit recipients, are particularly likely to be hired informally. The current Korean benefit system tends to encourage informal work, because many benefits are withdrawn as soon as a household's income (i.e. the sum of benefits and earnings) exceeds a threshold tied to the minimum cost of living. While informal employment may provide a buffer for some people with few labour market options, it also leaves workers with little protection against old age, unemployment or work accidents. Informal employment is also generally associated with tax evasion. The resulting shortfall in tax revenues hinders the government's capacity to provide necessary public services. The long-term effects of informality also include a lower aggregate economic growth potential since informality goes hand-in-hands with unfair competition, lower training rates and inefficient production methods.

Improving the industrial and labour relations framework

The labour market reforms discussed above have been complemented by important recent measures to improve the Korean framework for industrial and labour relations. These reforms address two issues:

i) The rules governing the remuneration of union officials for time taken away from their duties as employees in order to accomplish their duties as trade union representatives; and

ii) The replacement of the single union system at the level of the individual firm with a multiple union system.

These two issues have been a recurring topic of discussion in Korea since the first Trade Union and Labor Relations Adjustment Act (TULRAA) was approved in 1997. Consistent with international norms supporting the right of workers to be represented by the unions of their choice, that act recognised the multiple union principle. More specific to Korea, it also terminated employers' obligation to remunerate all time-off hours for union officials, a practice that threatened to become increasingly expensive for firms with the shift to a multiple union system. However, trade unions expressed concerns that banning employers' support for union officials would severely undermine their financial situation and hence their ability to represent their members effectively. As a result, implementation of these two provisions of the TULRAA was delayed by a series of moratoriums, allowing more time to reach agreement about how to implement them.

After years of intense negotiations between the government and the social partners, a compromise plan was reached in 2010 for implementing a multiple union system and reducing employers' responsibility for the remuneration of union representatives. The revised Trade Union and Labor Relations Adjustment Act (TULRAA) of January 2010 incorporates this compromise while confirming the key principles of the 1997 Act.

The first pillar of the reform establishes new rules defining employers' responsibility to remunerate union representatives for the off-work time they require to accomplish their union responsibilities (in vigour since July 2010). Prior to the reform, it was a deeply rooted practice in Korea for union officials to receive full remuneration from their employers for the time spent on union affairs. Rather than abolishing time-off remuneration altogether, the new TULRAA includes a compromise solution. Under the new rules, workers are allowed to take time off work to fill certain union duties, such as engaging in bargaining and consultation activities with the employer, handling grievances, and promoting workplace safety. These activities can be performed without any loss of pay, provided that they do not exceed the maximum time-off limits prescribed by the law, or higher limits agreed to with the employer. Union representatives remain free to engage in other union activities, but cannot be paid for time spent on openly antagonist actions (e.g. strikes and picketing). The statutory caps limiting the overall number of paid time-off hours for covered union activities vary depending on the number of union members in the firm. These caps range from 1 000 hours annually for companies with fewer than 50 union members up to 36 000 hours a year for companies with 15 000 or more union members.

The second pillar is the formal introduction of a multiple union system and it has been fully in vigour since July 2011. Before the reform, there were very strong restrictions on workers' rights to establish new unions of their choice within firms where a union was already present. For example, even a temporary overlapping in membership coverage was not permitted, thus implying a strong bias in favour of the incumbent union.

The new amendment to the TULRAA sets out the framework governing the establishment and operation of multiple unions at the level of each firm. To keep the system manageable and avoid employers having to deal with many excessively small trade unions, the amendment introduces a bargaining representative mechanism. The bargaining representative mechanism is also intended to assure appropriate working conditions for workers by increasing the bargaining power of labour unions. If two or more trade unions come to exist in the same firm, they are generally required to appoint their bargaining representative before a new bargaining process is launched. However, it is possible for each union to bargain separately, provided that the employer accepts to deal with multiple bargaining unions. Should the trade unions be unable to achieve a consensus on the choice of the bargaining representative, the trade union garnering a majority of members will act as bargaining representative. If no union garners a majority, then a joint bargaining representative team will be established. In order to prevent discrimination against members of trade unions that are not the representative union, the revised act sets out a remedy mechanism, which can be invoked by appealing to the Labor Relation Commission.

Although these recent industrial relation reforms do not address the dualism problem directly, there are grounds to hope that the effort to create a more pluralistic industrial relations framework will prove to be helpful. Labour market dualism in Korea tends to create conflicts of interest between regular workers (the "insiders") and non-regular workers (the "outsiders"), which have tended to be reflected in the organisation and operation of collective bargaining. Many unions operating in large companies do not accept non-regular workers as members and few seek to represent their interests. As a result, enterprise-based collective bargaining agreements generally do not cover non-regular workers. This pattern tends to reinforce inequalities in the treatment of regular and non-regular workers. However, it may also pose a long-run risk to trade unions and the job security of their members, because non-regular workers are potential substitutes for regular workers (Kim, 2010).

In this context, reforms that promote the inclusion of non-regular workers in unions may help reduce inequality between regular and non-regular workers (Choi et al., 2012). Provided the revised TULRAA is fully implemented as planned, the system of multiple unions it promotes could open the way to a trade union movement that better represents the interests of the entire workforce. By lowering employers' costs, the new limits on employers' responsibility to remunerate trade union representatives for off-job time could also reduce a barrier to the expansion of the trade union system among the small and medium-sized enterprises. If so, this could also contribute to a reduction of labour market duality in Korea.

There are encouraging signs that some of these desirable effects may already have begun to materialise. According to a recent survey prepared by the Korean Labor Relations Academy, the number of union officials who are paid by their employer for off-job time has decreased in large firms since the revised TULRAA entered into force in July 2010 (Lee, 2012), even as there has been an increase in the number of enterprises with fewer than 500 employees remunerating one or more union officials. Despite the new limits on employers' responsibility to remunerate union representatives, evidence that union fees increased was found in only 5% of the firms reviewed by the survey. More generally, the survey concluded that there has been no significant change in labour relations or union activities so far.

As many as 842 new firm-based unions were created in the year following the launch of the new multiple-union approach (July 2011-June 2012), although the pace of union creation has subsequently decelerated (KLF, 2012).[34] Nearly two-thirds of the new unions (64.4%) were established within enterprises where the existing union belonged to one of the two major national umbrella unions, the *Federation of Korean Trade Unions* and the *Korean Confederation of Trade Unions*. A large majority of the new unions (85.6%) did not join either of the national umbrella unions, preferring to remain independent. Among new unions, 28.1% have obtained the status of representative union.

Taken together, these results are encouraging because they suggest that some progress is being made to make the industrial relations system more inclusive in Korea, even while somewhat allaying concerns that the new time-off system could undermine the effectiveness of trade unions. However, it is much too soon to be confident that the reforms to date are sufficient to insure that the industrial relations system will evolve so as to make an important contribution to reducing duality.

3.5. Policies targeted on groups particularly disadvantaged by labour market dualism

A comprehensive policy to tackle labour market duality in Korea also needs to encompass measures to reduce the specific barriers that make it difficult for certain workforce groups to find high quality jobs which allow them to realise their full productive potential. Women and older workers are clearly two such groups, since both are overrepresented in non-regular employment and earn substantially less than, respectively, men and somewhat younger workers. In the case of women, relatively low participation rates are also a concern, especially in the context of population ageing. This section also reviews policies to reduce the skill mismatch that has developed in the youth labour market. Policies intended to reduce overall duality, which were discussed in Section 3.4, should make it easier to improve the labour market prospects of these three groups. However, the more targeted measures discussed in this section also have an important role to play.

Women

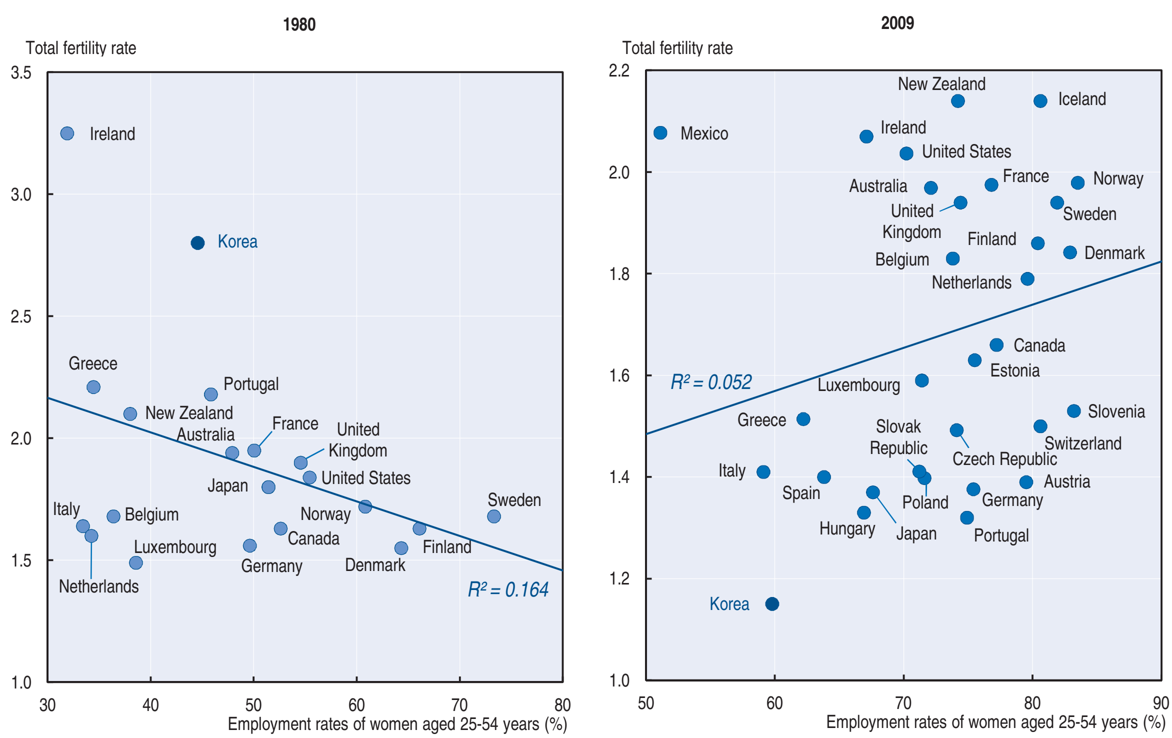
Labour market barriers confronting women

It is difficult for Korean women to combine their family responsibilities with good careers. These difficulties are reflected in the high gender pay gap of 38% (Figure 3.8). They also help to explain why one-third of women hold temporary work contracts and only 8% have supervisory responsibilities. The difficulties women encounter in accessing good jobs also discourages their participation in the labour market, although this effect is somewhat masked in the overall employment rate due to later retirement in Korea than in most other OECD countries. As a result, the 53% overall employment rate for Korean women is only moderately below the OECD average value of 57%. The barriers preventing many women from realising their full productive potential at work appear to have a particularly large impact on the participation decisions of the most educated women. Whereas the 2010 employment rate for Korean women who have not finished upper secondary education is 12 percentage points *above* the OECD average (58% versus 46%), it is 17 percentage points *below* the OECD average for women who have a tertiary degree (62% versus 79%).[35] This represents a costly underutilisation of human capital which could become a major drag on economic growth as population ageing causes potential labour supply to shrink.

Labour market duality is an important source of the difficulties that women face in reconciling working and family life. The human resource practices of large Korean employers *vis-à-vis* their regular workers provide little flexibility for workers attempting to combine active involvement in parenting and other family care responsibilities with successful careers. In particular, career progression is typically dependent on maintaining an uninterrupted employment relationship and being available to work long hours. A woman wishing to temporarily drop out of the labour force following childbirth is likely to pay a large price in terms of lost earnings capacity and opportunities for career advancement. Indeed, she may be able to return only to low-paid, non-regular employment. Since this is not a very attractive prospect, women who wish to pursue a career often decide to remain in regular employment and have no children. Another way many mothers reconcile parental responsibilities and careers in other OECD countries is to temporarily switch to a part-time schedule on the same job and then to return to full-time work when their children are older. This solution typically has not been available to Korean women, since part-time work is almost *de facto* non-regular work that pays poorly and offers little opportunity for career advancement. Breaking down labour market dualism – for example, by making the remuneration system more performance-based and work schedules more flexible for regular workers – would make it possible for many more women to meet their families' needs while enjoying successful careers and contributing more fully to the national economy.

Figure 3.15 shows that the trend increase in female employment since 1980 has been associated with a very steep decline in fertility in Korea. While the 15 percentage point increase in the female employment rate (ages 25-54) between 1980 and 2009 was fairly typical of the increases observed among the 21 OECD countries with data for both years, the decline in the Korean fertility rate from 2.8 to 1.2 was larger than in any other country. The only country that came close to seeing such a large decrease in fertility was Ireland (a 1.2 percentage point decrease versus the 1.7 percentage point decrease in Korea), but this left Ireland still having one of the highest fertility rates in the OECD area (2.1), whereas Korea now has the lowest fertility rate (1.2). The 1980-2009 increase in the female employment rate was also more than twice as large in Ireland as in Korea. Another indication that rising female employment appears to have proven particularly difficult to combine with fertility in Korea is that a number of countries, including Australia, Sweden, the United Kingdom and the United States, have actually experienced *increases* in fertility since 1980, even as female employment increased. The difficulty Korean women encounter in reconciling motherhood and work is also underlined by recent work by the Hyundai Research Institute (2010) which shows that Korean parents have on average 0.76 fewer children than they would like to have.

Figure 3.15. **Female employment and total fertility rates, 1980 and 2009**[a]

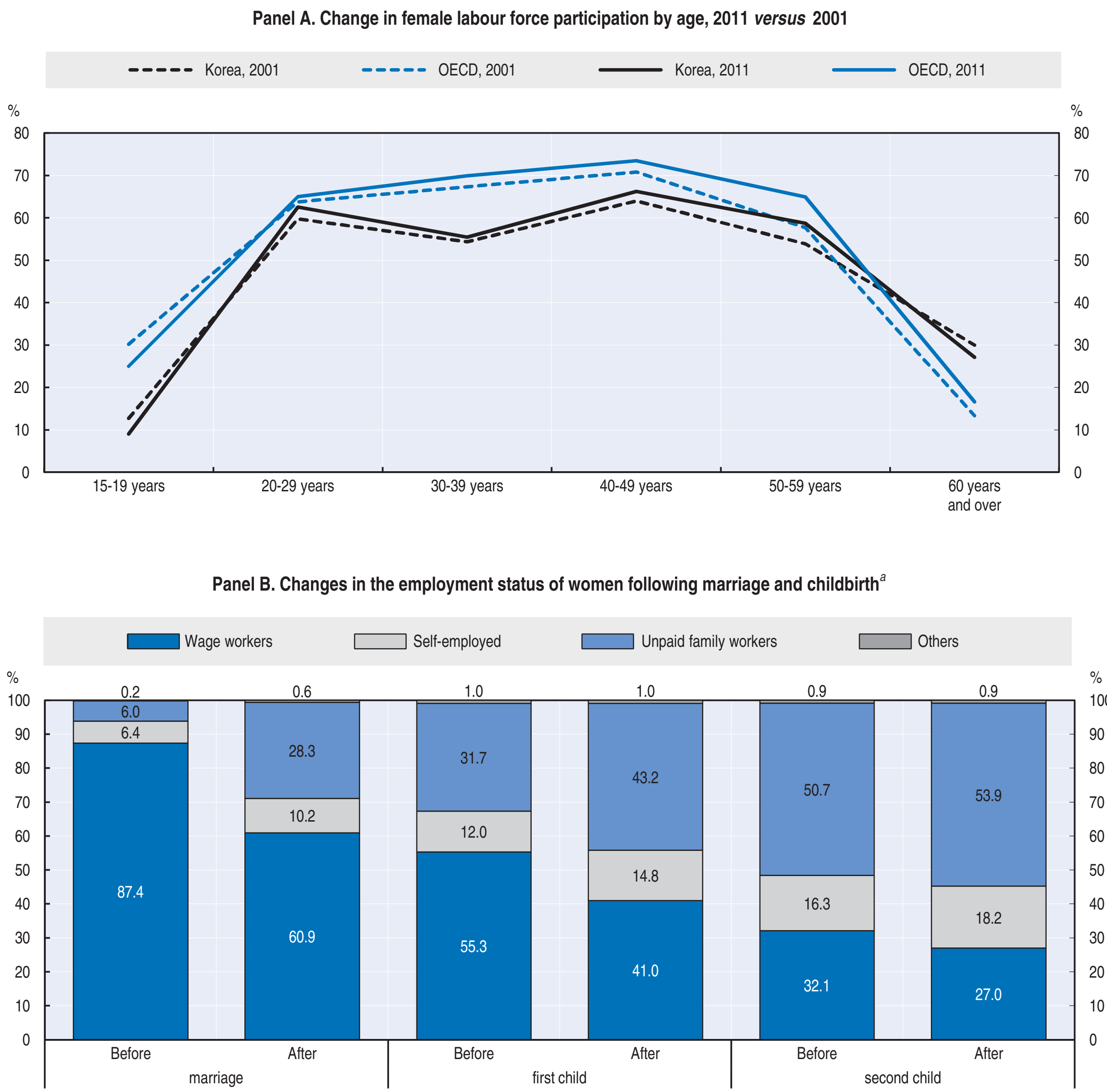


a) The Y-axis scale is 1.0 to 3.5 for total fertility rate in 1980, and 1.0 to 2.2 in 2009. The X-axis scale is 30 to 80% for female employment rate in 1980, and 50 to 90% in 2009.

Source: OECD Family Database 2012, www.oecd.org/els/social/family/database.

Figure 3.16 provides more direct evidence that the family responsibilities borne by Korean women limit their participation in paid employment. Panel A of this figure shows that – charting participation rates by age for Korean women generates an M-shaped profile: participation rises to a first peak as the school-to-work transition is completed, declines during the main child rearing years, rises to a second peak as the children become older and women return to the labour market, and then declines a second time as women retire. No other OECD country shows this pattern because mothers in the prime child-bearing years do not withdraw from the labour market in sufficient numbers to cause participation rates for women in their thirties to fall below those for women in their twenties. Panel B of Figure 3.16 provides a more detailed look at how marriage and childbirth affect the labour market status of Korean women. Prior to marriage, 87% of women are employed, but the employment rate falls to 61% after marriage. Significant additional declines are registered after the births of the first and second child.

Figure 3.16. **Changes in labour market status of women with age and family status**



a) The 2007 survey samples for marriage, birth of a first child and a second child are not necessarily identical.

Source: *OECD Online Employment Database* (*www.oecd.org/employment/database*), for Panel A; and Kim, J. (2011, Table 4), "Women's Career Disconnect and Reentry into the Labor Market", in K. Bae (ed.), *Labor Issues in Korea 2010*, Korea Labor Institute, Seoul, for Panel B.

Policies to promote "family friendly" workplaces

Korea is confronted with the complex challenge of promoting women's labour force participation and career opportunities, while also boosting fertility rates. Recent experience in other OECD countries suggests that a number of policies can help to reconcile working with family life. Indeed, a comparison of Panels A and B of Figure 3.15 shows that female employment and fertility have become more compatible since 1980 in the OECD area, as institutions and attitudes have changed in many countries so as to better accommodate the increasingly common desire of women to combine careers with motherhood (see Box 3.2 for a discussion of several notable national experiences). Comprehensive and well-co-ordinated policies for reconciling work and family life have turned out to be particularly successful in achieving both relatively high birth rates and relatively high female employment rates in the Nordic countries.

Box 3.2. **International examples of policies promoting both higher female labour market participation and higher fertility rates**

A number of OECD countries have achieved higher than average rates of fertility and female employment as a result of good parental-leave arrangements and child care policies.

- **Promoting shared parental leave reduces barriers to female employment and fertility**. Shared leave encourages men to participate more in caring activities and reduces the length of leave taken by women relative to men. In *Sweden* and *Iceland* parental leave policies have been adapted to encourage shared rights and responsibilities in parenting. Overall, across the OECD, there tends to be fewer working women in countries with longer parental leaves.
- **Ensuring quality in child care settings**. If parents are confident about the quality of child care services, they are more likely to take them up, and return to work when their children are young. A number of countries take steps to promote high-quality child care. *Australia*, *France*, the *United Kingdom* have strict licensing and regulatory systems, and *Denmark*, *Norway* and *Sweden* have integrated systems of education and care, facilitating standard setting and monitoring. To meet the demand for child care services, *Canada*, the *Netherlands*, and the *United Kingdom* rely on closely supervised private provision, as does *Australia*, where voucher payments for private provision are linked to quality standards.
- **Providing for the care of older children**. Out-of-school-hours care (OSHC) supports families by providing a variety of centre-based activities for school-aged children whilst their parents are at work. In *Denmark*, *Sweden*, *Hungary* and *Australia* 50-70% of 6-11 year-olds benefit from OSHC. In *Denmark* and *Sweden* low-cost OSHC is frequently provided in school facilities, including during school holidays.
- **Encouraging family-friendly workplaces**. Workplaces that are mindful of their employees parenting responsibilities can facilitate the work family balance, and in doing so promote women's work and reduce the barriers to family formation. Family-friendly workplaces are encouraged in the *Nordic countries*, *Australia*, *Japan*, *New Zealand*, the *Netherlands*, and the *United Kingdom* using policies such as flexible working hours, part-time options for mothers returning to work, and incentives to provide workplace care facilities for the children of employees.
- **Building consensus on the value of family friendly policies**. Promoting the importance of family friendly policies is central to their take-up by families, the business community and broader society. In ***Finland***, prior to childbirth, every pregnant woman receives an information pack on the rights they will get once the child is born. Closer involvement of employers is also possible, as in ***France***, where an "observatory" is used to disseminate information on best practices regarding the work-life balance for businesses (*www.parenthood-observatory.com*).

Source: For supporting evidence and further reading see: OECD (2011), *Doing Better for Families*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264098732-en*.

A considerable range of "family friendly" policies have helped to reconcile working and family life in other OECD countries, with the details of the different policy types and their relative importance varying considerably across countries. Laws mandating maternity, parental and family care leave are one example. Another is public measures to increase the availability, quality and affordability of child care. A third area has been for governments to promote work practices that provide workers with greater flexibility about how much, where and when they work, while also assuring that workers availing themselves of this flexibility are not shunted into low quality, dead-end jobs. For example, some countries require employers to make a good faith effort to accommodate request for full-time employees to temporarily switch to a part-time work schedule following the birth of a child. Similarly, working time flexibility and teleworking have been promoted.

In this spirit, the government's second plan (2011-15) in response to an ageing population and a low fertility rate includes measures to promote family-friendly workplaces, including provisions for parental leave, shorter work hours for parents and expanded public financial support for child care and education. These measures are promising, but more should be done to help women to match job and family responsibilities.

One important measure in Korea has been to lengthen paid maternity leave, from 60 to 90 days. This increase brought the duration of paid maternity leave up to two-thirds of the average of other OECD countries where, in 2008, the average length of paid maternity leave was only 19 weeks. In order to reduce the cost to employers of maternity leave, the Employment Insurance (EI) system has expanded its financial contribution to meeting the cost of paid maternity leave. In the case of big enterprises, the initial 60 days are paid for by the employer and the additional 30 days are paid for by the EI; by contrast, the EI pays the complete duration of the leave in the case of SMEs. However, as in the case of unemployment compensation, women need to have been insured for at least 180 days in order to qualify for these benefits. Both mothers and fathers can also take child care leave for up to one year while receiving 40% of their regular pay (subject to a floor of KRW 500 000 and a ceiling of KRW 1 million) and retaining the right to return to their job.

As from 2008, Korea also has introduced paternity leave. Further measures to encourage fathers to make greater use of parental leave could also serve as a catalyst to encourage Korean employers to develop more flexible working time practices for regular workers.

The Korean government also supports the establishment of public and private child-care facilities (see Chapter 4 for a detailed discussion). Furthermore, since 2008 Korea has a system allowing workers to request Family Care Leave or shortened work hours for child rearing. Workers raising children under the age of 6 who are not yet attending elementary school are eligible to request shortened work hours for child rearing. As an alternative to taking child care leave, workers can request to reduce their work hours, so that they can both care for their children and maintain employment. However, as initially established, the mechanism had limited impact on leave practices as most employers ignored it reflecting the fact that it was voluntarily. Therefore the government decided to reinforce the system more recently, by mandating all employers to accept requests for shortened work hours for child rearing, barring exceptional circumstances. The pay for shortened work hours is proportional to the reduction in the number of hours worked. Although workers taking shortened work hours for child rearing will see a decrease in income, it is less than the income decrease experienced during child care leave. Shortened work hours for mothers on their existing jobs also have the advantage of preventing career interruptions. The revised Family Care Leave system is effective since August 2012 for companies employing 300 or more workers and will take effect on 2 February 2012 for companies employing fewer than 300 workers. The provisions related to childbirth and young children apply retroactively to cover all children born after January 2008.

Under the revised Family Care Leave system, workers can also take unpaid leave to care for family members – defined broadly to include, parents, children, spouses, and in-laws suffering from chronic disease, accidental injury, or old age. Workers can take up to 90 days of unpaid Family Care Leave per year. Up until now, workers who have had to care for sick family members have only been able to use their annual vacation days.

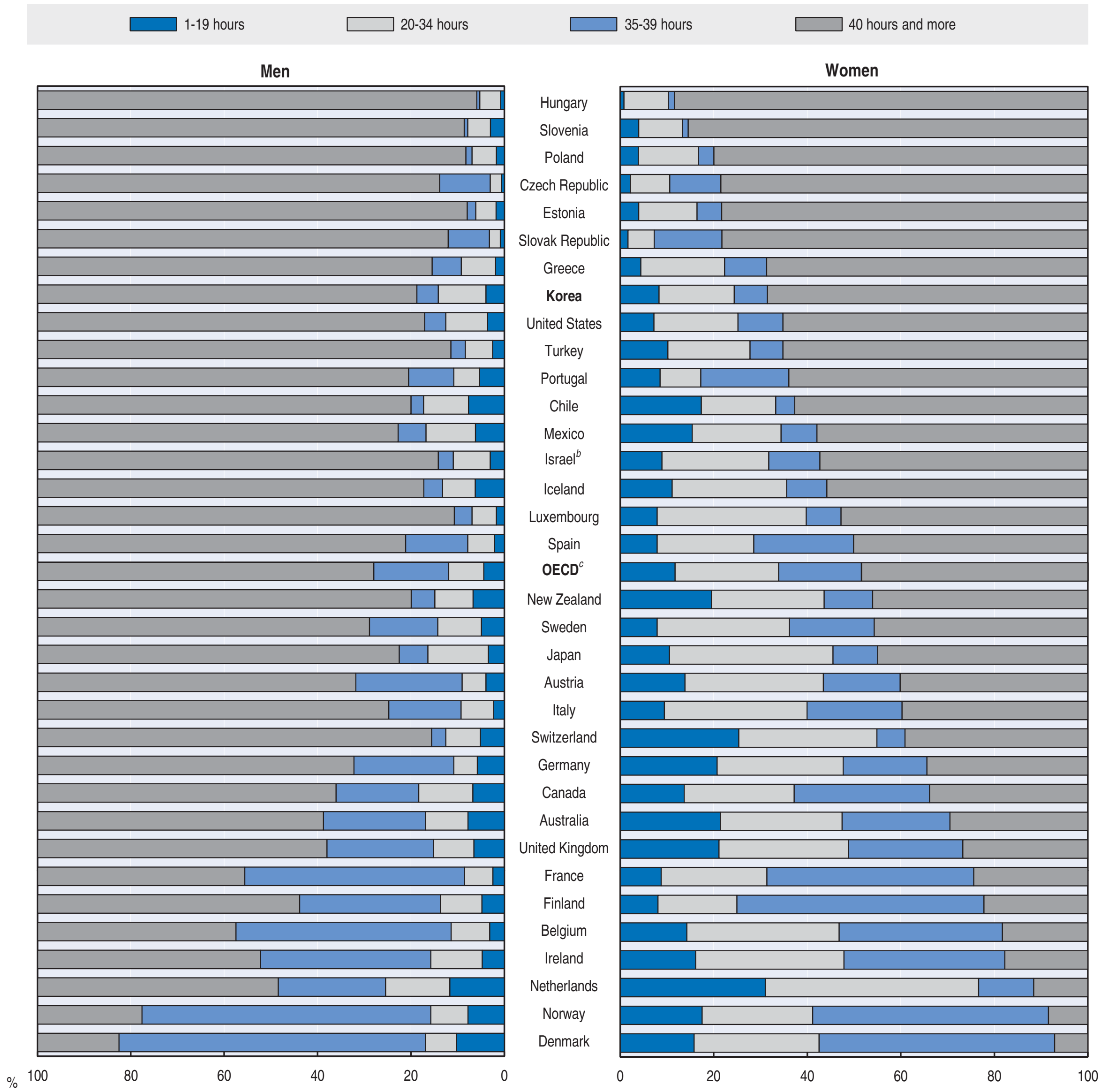
Another important part of work/family reconciliation strategies is informal care provided by grandparents. Some countries have started to make care supports and/or leave entitlements available to grandparents. Parental benefits can be taken by Czech and Slovenian grandparents if they provide child care and the parents agree to transfer their entitlement. More generally, family-friendly measures for intensive informal care can yield high returns, provided that they foster participation in the labour market. Flexibility in the use of cash benefits could be a viable option, as long as the relatives who qualify as family carers are not trapped in low-paid employment. Another risk with cash benefits is the emergence of a grey market, where families use allowances to hire untrained non-family members to the detriment of formal care services. Respite care and counselling services for carers can help reduce stress levels and increase the well-being of carers.

As concerns funding households' care expenses, one model could be Italy, which is considering the introduction of a new social card that entitles low income families with care needs a small amount of income support. A complementary option could be to provide a tax incentive in the form of a tax deduction for care expenditures, as done in France, for example. An alternative option is tax-incentives to support family caregivers (e.g. tax-exemptions for carer's allowance, as in the Czech Republic and Ireland, or tax-credits, as in Canada and the United States).

Since the long hours culture represents a particular barrier to combining motherhood with good careers, it is also important to achieve the tripartite Economic and Social Development Commission's target of cutting annual work hours to less than 1 900 by 2020. Regular workers (especially white-collar occupations) are often expected to signal of their commitment to their firms by working long hours, often including unpaid overtime, and using less leave than they are entitled to. While annual working hours have fallen from more than 2 500 hours in 2000 to around 2 074, they remain the highest in the OECD area and are still well above the average of 1 736 hours.

In Korea, 69% of women work 40 or more hours per week (Figure 3.17). This is well above the OECD average of 48%, but below the level in Greece and several formerly centrally planned countries in Central and Eastern Europe, where part-time work remains rare. Of the Korean women working 40 or more hours weekly, 60% report working 45 or more hours and nearly half of that group work 54 or more hours. Long commuting times in urban areas and a culture of socialising after work lengthen further the working day, forcing working parents to find child care services for up to nine to ten hours per day. Indeed, the average length of child care services for a household with a working mother is 8 hours and 38 minutes per day. In addition to securing affordable and reliable child care and out-of-school-hours care, family-friendly solutions, such as flexible working hours and part-time employment opportunities, should become more widespread.

Figure 3.17. **Share of workers by usual weekly hours of work[a] and gender, 2011**



Note: Countries are ranked in decreasing order of the share of women working 40 or more hours per week.

a) Data refer to *usual* weekly hours on the main job for all employed persons, except that data for Japan and Korea refer to *actual* hours worked.

b) Information on data for Israel is available at: *http:/dx.doi.org/10.1787/888932315602*.

c) Unweighted average of the 34 countries shown above.

Source: OECD Online Employment Database available at: *www.oecd.org/employment/database*.

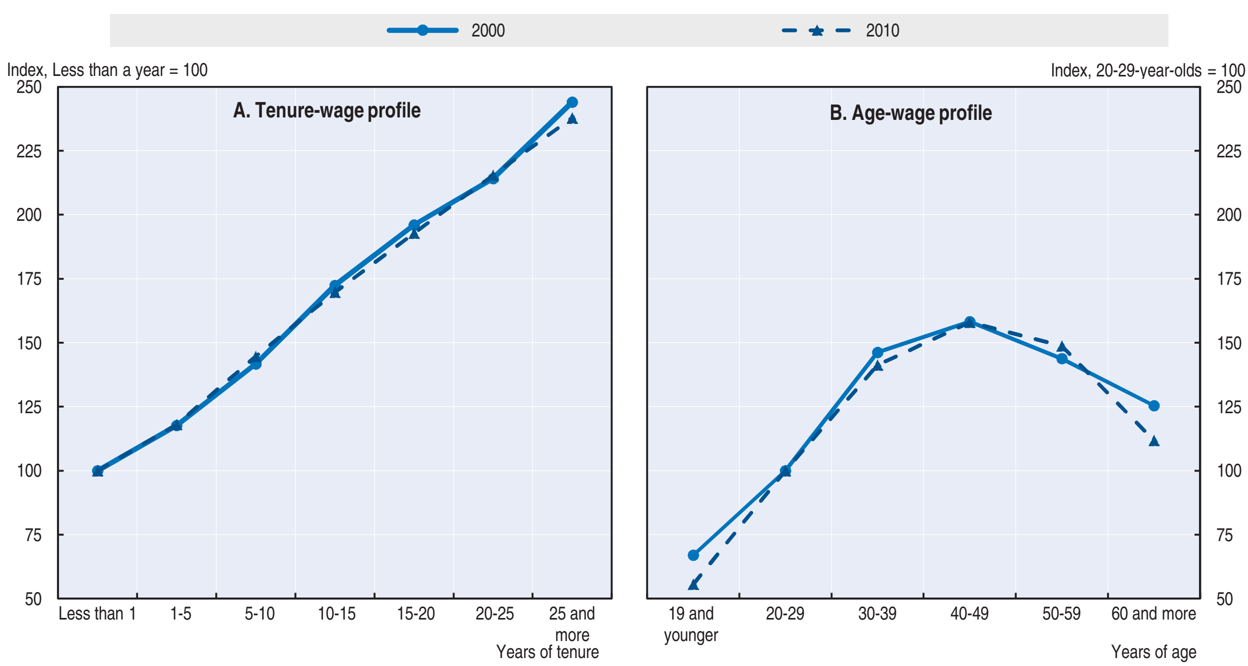
Older workers

Early retirement results in underemployment for many senior workers

While older workers in Korea are likely to remain in the labour force longer than many of their OECD counterparts, they tend to retire early from their main career jobs, beginning at around age 50. They then move into "second careers" that often represent an extended period of underemployment. This pattern explains why average employment tenure peaks at 11 years in the 45-49 age group and then falls sharply, whereas the tenure peak in most other OECD countries occurs in the 55-64 age group (Jones and Tsutsumi, 2009). Early retirement for career jobs also explains why more than two-thirds of workers over age 50 worked in firms with less than 100 employees in 2007 and fewer than two-fifths were regular workers. Similarly, 34% of workers over 50 are self-employed, as against 13% of those under that age. Indeed, a study of early retirees found that about three-quarters of departing employees become self-employed, primarily in services with low productivity.

These second careers typically last numerous years, as underscored by the fact that the average effective age of retirement for men in Korea is 71, the second highest level among OECD countries. During this period, workers earn much less than during their earlier career job (Figure 3.18, Panel B) and a recent work by the Korean Labor Institute (Phang, 2010) shows that there is also a strong deterioration of working conditions for self-employed workers after retiring from wage work. These patterns raise concerns about both the risk that older workers will fall into poverty and the unnecessary loss of productive potential the economy suffers. The sharp increase in household debt during second careers provides another indication of the financial difficulties confronting many middle-aged and older workers in Korea, both during their second careers and after they retire from the labour market.[36]

Figure 3.18. **Wage profiles in Korea,[a] 2000 and 2010**



a) Wages for "20-29 year-olds" and for "Less than a year" equals 100 in 2000 and 2010.

Source: Ministry of Employment and Labor, Wage Structure Survey.

While early retirement of regular workers from the career jobs has many adverse consequences for both the workers and the overall productive potential of the economy, it is firmly entrenched in the human resources strategies of large firms and industrial relations practices. As can be seen in Panel A of Figure 3.18, the compensation practices of Korean employers result in wages that increase sharply with job tenure. Since other benefits, such as the retirement allowance, also increase strongly with seniority, the costs of employing workers begins to exceed their productivity well before the age at which most workers retire from the labour market. This provides strong incentives for employers to induce early retirement and explains why that is one of the main ways that large firms adjust their workforce (OECD, 2013a). One key to reducing the incidence of early retirement is thus to tie wages more closely to productivity and less closely to seniority. Another factor encouraging widespread use of early retirement is the strong employment protection that regular workers enjoy, especially in large firms where unions have stronger presence. Relaxing EPL on regular workers could also contribute to phasing our early retirement by offering employers other ways to adjust to declines in labour demand for regular workers (see Section 3.4 above).

Table 3.12 summarises the obstacles that employers identify to employing older workers. Consistent with the notion that linking compensation to seniority creates a disincentive to employ workers beyond a certain age, 43% of the firms surveyed cite high wages relative to productivity. However, employers also cite a large number of beliefs about ways in which older workers are less productive or more difficult to manage. For example, the most frequently cited barrier to employing older workers was that they have ability to adapt to change (57% of firms). It is difficult to judge the validity of these beliefs, but comparison with employment practices in other OECD countries where most workers remain in their career job until they retire from the labour force altogether, suggests that Korean employers may underestimate the ability of older workers to continue to be highly productive when given the necessary support to do so.

Table 3.12. **Reasons given by firms as obstacles to employing older workers**

In 2008[a]

	Percentages
Low adaptability to change	57.3
Lower work ability and capacity	44.8
High wages relative to productivity	43.1
Difficulty in assigning to posts	39.7
Unable to perform difficult tasks	32.9
Little motivation or enthusiasm for new work	25.8
Difficulty in accepting instructions	19.9
Frequent accidents	8.2
Lack of ability to co-operate with other workers	6.3

a) The survey included 648 firms. Firms were allowed to give three answers.

Source: Korea Labor Institute (2008), Survey on Firms Implementing the Wage Peak Compensation Scheme 2008.

Policies to improve the position of older workers in the labour market

The government's efforts to counteract discrimination against old-age workers have considerably intensified since the mid-2000s. The "Basic Plan to Promote Employment of the Aged" aimed at increasing the employment rate of the 55-64 age group from 59% in 2005 to at least 63%, the 2004 level in Japan. In 2008, the government enacted a law to prevent unjustified discrimination against older persons in recruitment or employment (effective from 2009) and age discrimination with regard to working conditions, such as wages and welfare (from 2010).

Recent policy measures also include offering different subsidies to encourage firms to hire and retain workers after retirement age and/or above the age of 50. However, real estate service firms account for about two-thirds of the recipient companies and the concentration of the subsidies in this one sector raises doubts about the effectiveness of this scheme in boosting the overall employment of older workers (Jones and Tsutsumi, 2009). Since 2006, the government also provides a subsidy to promote the introduction of the *peak-wage system*, which allows for the wages of older workers, who remain on their career jobs, to decline after reaching an agreed-upon age, in exchange for guaranteed employment up to a specified higher age. The subsidy is offered to older workers who agree to join the system by the EI system.[37] However, the take-up of this subsidy has been relatively limited, so far.

Further "Measures to Promote the Creation of New Opportunities and Win-Win Jobs for the Baby Boom Generation" were issued by the government in July 2012, following a 2011 survey of Korean Baby Boomers – persons born between 1955 and 1963, who are nearing retirement age – that was conducted by the Ministry of Health and Welfare (MOHW). This survey revealed that 54% of this cohort had not made any preparations for retirement. The government has identified 35 key tasks in five areas. These include the provision of job placement services, assistance to start a business, support services for customised retirement planning and encouraging seniors to take part in retirement planning education programmes. Workers aged 50 and over also will be given the right to request "shortened work hours." This should help them to stay in their current jobs longer and better plan for life after retirement. A new employment subsidy will allow companies to hire socially vulnerable workers to fill new positions created by shortened work hours.

The new measures are a welcome step towards reducing the negative impact of labour market duality on older workers. They can be expected to provide baby boomers with increased opportunities to extend their period of "continuous employment" with their career firm, rather than being forced to move into self-employment or non-regular work for the final stage of their working lives. However, these measures alone may not be sufficient to induce sufficient changes in the firmly entrenched practices of large employers. This consideration suggests that the introduction of wage subsidies to reduce the cost of employing older workers relative to younger ones, should be combined with additional measures to promote greater wage flexibility, so that older workers remain affordable (Lee and Lee, 2011). Requiring companies to set mandatory retirement at an age closer to the pension eligibility age – or forbidding the use of mandatory retirement altogether – could also provide an important impetus for changing the seniority-based wage system. Firms agree to steep seniority-based wage profiles on the condition that they can force older workers to leave. Without mandatory retirement, firms would insist on wage systems that more closely reflect productivity. Accelerating the transition to company pensions, as an alternative to the retirement allowance system, could also reduce firms' incentives to retire older workers and enhance labour mobility.

Factors contributing to the weak employability of older workers in many OECD countries also include the obsolescence of skills and a lack of suitable employment services. In Korea, the low educational attainment level of older people may be a factor leading to reduced employability, explaining why many older persons work in non-regular jobs with low pay. However, training has to be carefully targeted to be effective (Lee, 2008). By the end of the 2010s, government expenditures on lifelong learning, including vocational training, amounted to only 0.1% of GDP and the participation rate of adults in lifelong education was about 30%. The rate rises with the level of education, making it important to target less-educated persons (Lee, 2008). The amount of firm-specific and ICT training provided at an enterprise level is negatively correlated to its hiring of older workers. This suggests that a lack of ICT skills is an impediment to hiring older workers. The inclusion of older workers in training or lifelong learning schemes could contribute to improving their employment prospects.

Youth

Labour market difficulties affecting youth

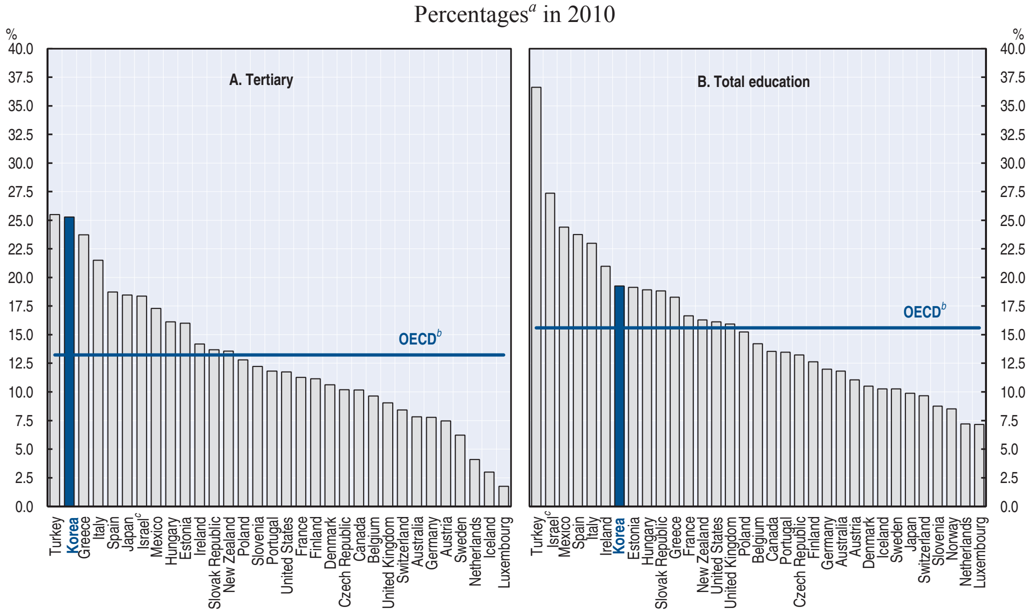
Korea has a remarkable record of expanding enrolments at the tertiary education level of education. Indeed, the number of students enrolled at this level has quadrupled during the past 25 years and almost two-thirds of persons between the ages of 25 and 34 now have a tertiary degree, while the OECD average is only a little above one-third (Figure 3.9). While these are remarkable achievements, there are reasons to believe that an economically costly mismatch had developed between the qualifications profile of recent school leavers and labour market requirements.

Concerns that an over-emphasis on higher education has become a problem in the Korean labour market appears to be borne out by statistics on the number of youth who are neither in employment nor in education or training, the so-called NEETs. Figure 3.19 shows that the share of NEETs among Korean youth with a tertiary education is about double the OECD average (25% versus 13%), while the rate among all youth is only moderately above average (19% versus 16%). By contrast, only 5% of the least educated out of school youth in Korea (i.e. those not having finished upper-secondary schooling) are neither employed nor in training, well below the OECD average of 16%. This pattern is consistent with the widespread perception that the Korean youth labour market is characterised by an over-supply of highly educated workers, with employers unable to offer all of the university graduates jobs which match their qualifications. It should be noted, however, that the NEET statistics tend to overstate the extent to which young adults in Korea are neither working nor studying, because some of the youth classified as NEET are taking courses equivalent to regular school education, such as private academic courses that serve as preparation for entry to certain jobs. This type of informal study is particularly common among youth with a tertiary degree. The Ministry of Employment and Labor estimates that a corrected NEET rate for this group would 15%, rather than the 25% shown in Figure 3.19.

The relatively high rate of NEETs among tertiary graduates, combined with the low incidence of non-regular employment among this group, suggests that educated youth in Korea prefer to stay out of the labour market rather than to accept non-regular jobs that do not meet their aspirations. This could reflect a correct perception that accepting a non-regular job would more strongly compromise their chances of later accessing a good job than remaining unemployed. The analysis of mobility patterns in Section 3.2 suggests that this is likely to be a correct perception in many cases.

Figure 3.19. **International comparison of the share of youth neither in employment nor in education or training**

Percentages[a] in 2010



a) Percentages of 15-29 year-olds who are NEET (neither in employment nor in education or training), relating to graduates of tertiary education in Panel A and to all school leavers in Panel B. A significant share of Korean youth who are classified as being NEET according to the OECD definition are engaged is some form of study. For example, data on the category ISCED 4, which captures programmes that straddle the boundary between upper secondary and post-secondary education, are not available in Korea and 11 other OECD countries. This category could potentially include persons in an apprenticeship or in training outside of school. The numbers in the chart therefore overestimate the number of youth who are inactive in these countries.

b) Unweighted average of the countries shown on the chart, respectively for each panel.

c) Information on data for Israel is available at: *http://dx.doi.org/10.1787/888932315602*.

Source: OECD (2012), *Education at a Glance 2012: OECD Indicators*, OECD Publishing, *http://dx.doi.org/10.1787/eag-2012-en*; and Statistics Korea, Economically Active Population Survey.

Figure 3.20 sheds further light on the nature of the skill mismatch in the youth labour market by documenting the labour market status of 2007 graduates of tertiary programmes. Recent graduates of colleges, that is, of professional universities, were significantly more likely to be employed than the graduates of general universities. Most employed graduates from both types of universities had regular employment, but significant minorities had non-regular employment, suggesting that the latter sometimes may serve as a stepping stone to better jobs. The NEET rates were twice as high for recent graduates of general universities as for graduates of colleges (27 and 18%, respectively). These differences strongly suggest that the mismatch in Korea is as much about too great a focus on academic subjects, as it is about too much education overall.

As was noted above, many of the non-employed youth with a general university education are preparing for job entrance exams in the public or private sector. This probably makes sense for many of them insofar as it maximises their chances of obtaining a good economic return on the large investments they have made in obtaining an advanced education. However, this form of study may be largely a zero-sum competition from the point of view of society. There would be large efficiency gains if policies could be found to either expand the number of jobs that make productive use of workers with degrees from a general university or adjust schooling patterns, so as to bring education supply into better balance with the demand for workers with different qualifications.

Figure 3.20. **Employment outcomes for university graduates in 2007**

Percentages

a) Includes those continuing to advanced studies and men fulfilling their military service obligation.

Source: Ministry of Education, Science and Technology.

Policies to reduce mismatch by improving vocational education and training

One way to boost youth employment and obtain higher economic returns on investments in human capital formation is through policies that adapt the education system to better reflect labour market needs. While the rapid expansion of higher education has raised concerns about an over-emphasis on higher education in general, it is probably at least as important to assess how well the fields of study chosen by students match with labour market requirements. The fact that the rise in the number of students in engineering, the natural sciences, medical fields and education has been below average, while enrolment in social science, the humanities, arts and athletics has grown faster than average suggests a possible mismatch. New graduates from the latter disciplines typically experience the most acute school-to-work transition difficulties. The origin of this mismatch is that education is excessively supply-driven and therefore does not adequately reflect changing labour market requirements. There has been an excessive shift away from vocational education, despite the evidence that students with a VET education tend to access a regular employment more smoothly than students choosing more academic courses. This probably reflects the lower status of vocational education. Limited opportunities for students to combine study with work experience are another source of difficulties.

It is widely accepted among policy makers and academics in Korea that the mismatches between labour supply and demand associated with the massive expansion of tertiary education are one of the major causes of current youth labour market problems. This diagnosis is reflected in the new Policy for Implementation of Open Employment, which was launched in July 2012 with the broad objective of strengthening vocational education in Korea. The main components of this ambitious strategy are as follows:

- *Expanding the role played by VET at the high school level, including by expanding the Meister High Schools.* Meister High Schools are special purpose schools that provide technically focused education to foster young craftsmen. At the moment, Korea counts 28 such schools. In addition Korea has several specialised high schools which provide education in design, animation, computers, cooking, tourism, and other special fields. Taken together there are over 50 vocational high schools in the country.

- *Supporting the delivery of vocational education programmes by supporting private partnerships in vocational education.* This primarily involves government support for Non-degree Corporate Universities. These are educational institutions established and operated by companies for the purpose of training their workers to master the highly skilled tasks that are necessary to adapt to a rapidly changing technological environment. In-house corporate universities were created as a way to circumvent the rigidity of the curricula offered by degree-granting institutions. The non-degree universities are flexible structures that operate with considerable managerial and teaching autonomy, with regard to curriculum, class size and the choice of pedagogical approaches. Experience with these institutions shows that they can achieve educational quality in professional courses on par with that of regular universities. The government currently provides subsidies for corporate universities ranging across a broad spectrum of areas, including management and organisational design, curricula development, technical assistance with personnel and wage policies, infrastructure facilities and equipment, and other miscellaneous educational expenses. Supporting Non-degree Corporate Universities is seen to be a particularly valuable way to promote co-operation between large enterprises and SMEs in raising workforce skill levels. Both types of firms send their personnel to participate in their joint educational programmes. Box 3.3 provides a review of experiences with industry-led bodies engaged in VET programmes in selected other OECD countries.
- *Improving career path guidance services from the stage of middle school.* The career guidance potential is far from being fully realised, presently. Websites designed to guide students in their choice of postsecondary education (e.g. *www.ipsi.kcce.or.kr*) focus on explaining admission requirements and procedures at different institutions, with little or no attention to the outcomes of different programmes within each institution.
- *Linking curricula in high school VET more closely to national technical standards and qualifications to increase efficiency and improve responsiveness to industry needs.*

Box 3.3. **Selected national examples of industry-led bodies engaged in VET policy**[1]

Denmark

The Council of Academy Profession Programmes and Professional Bachelor Programmes (i.e. short- and medium-cycle post-secondary VET) was set up in 2008. The board has up to 21 members, including those appointed by the Minister of Science, Innovation and Higher Education after nomination by various employer organisations (8 members), trade unions (2), the organisation of Danish regions (1), organisation of local governments (2), student organisations (2), University Colleges (1) and Academies of Professional Higher Education (1). The Council meets six times a year and advises the Minister about the development of new programmes, the mix of provision, quality assurance and improvement. It also provides a yearly report, which reviews existing programmes and describes new initiatives.

Source: Danish Agency for Higher Education and Educational Support (2012), *Skills beyond School: OECD Review of Post-Secondary Vocational Education and Training – National Background Report for Denmark, http://en.fivu.dk/publications/2012/oecdreview-skills-beyond-school/oecd-review-skills-beyond-school-denmark.pdf.*

Box 3.3. **Selected national examples of industry-led bodies engaged in VET policy[1]** *(cont.)*

Switzerland

The involvement of professional organisations in VET policy making is required by law. The term "professional organisations" in Switzerland refers to trade associations, employer association and trade unions, and include both companies and business persons. Professional organisations have the leading role in the content and examination process of both secondary post-secondary VET programmes (in Switzerland post-secondary VET is referred to as "professional education and training", PET).

Professional organisations in post-secondary VET, as in secondary level VET, draft core curricula for PET college degree programmes, which are then approved by the Swiss authorities (Confederation). National examinations leading to a federal diploma are also led by professional organisations. They ensure those federal PET diplomas are relevant to the needs of the profession and the labour market. Professional organisations draft examination rules, which cover admission requirements, occupational profiles, the knowledge and skills to be acquired, qualification procedures and the legally protected title. They also conduct examinations. The role of Swiss authorities (at Confederation level) includes approving examination rules, supervising examinations and issuing federal diploma.

Source: OPET – Federal Office for Professional Education and Technology (2011), *Skills beyond School. The OECD Policy Review of Post-Secondary Vocational Education and Training. Swiss Background Report,* Bern; OPET (2012), Federal Office for Professional Education and Technology website, *www.bbt.admin.ch*, accessed January 2012.

United Kingdom

The UK Commission for Employment and Skills (UKCES) was launched in April 2008 with the aim of increasing the employer voice in the United Kingdom's VET system and promoting investment in skills to drive enterprise, jobs and growth. It is led by commissioners from large and small employers, trade unions and the voluntary sector. It also includes representatives of further and higher education institutions and from the Devolved Administrations.

Its strategic objectives are:

- To provide world-class labour market intelligence which helps businesses and people make the best choices for them.
- To work with sectors and business leaders to develop and deliver the best solutions to generate greater employer investment in skills.
- To maximise the impact of changed employment and skills policies and employer behaviour to help drive jobs, growth and an internationally competitive skills base.

UKCES works with government departments and agencies, as well as with researchers across the United Kingdom to develop an evidence base, to pool expertise and maximise the influence of research and labour market intelligence over policy and practice. The UKCES also funds and manages the Sector Skills Councils and oversees their relicensing process. As a UK-wide body, it helps ensure a strategic approach to skills development that overarches all four nations (with devolved administrations for education and training policy) of the United Kingdom.

A recent shift in the approach to employer engagement advocates that employers should own their skills agenda and develop their own initiatives, rather than relying on a policy agenda set by government with incentives for employers to join in. In 2011, the Prime Minister announced a fund of up to GBP 250 million to test out approaches that empower employers to take control of skills development. The UKCES is working closely with government to follow this approach.

Source: UKCES (2011), UK Commission for Employment and Skills website, *www.ukces.org.uk*, accessed December 2011.

1. This box is derived from Kis, V. and E. Park (2012), *A Skills beyond School Review of Korea*, OECD Publishing, Paris.

Taken together, the above initiatives represent welcome progress towards meeting the recommendations of recent works done at the OECD to review VET issues in Korea (Kis and Park, 2012; Kuczera et al., 2009; and OECD, 2007b). All these works recognize various government initiatives to encourage vocational education (e.g. creation of specialised high schools) and improve the performance of universities and colleges (e.g. promoting mergers and helping them specialise in certain fields of study). At the same time, they identify a number of areas for further improvements. First, links between junior colleges and universities and the labour market should be strengthened (e.g. by including internships in the curriculum, linking government funding to the employment outcomes of graduates). Second, all students should have access to career guidance services so that they can make well-informed choices. Third, to reduce the risk of mismatch between the skills of tertiary graduates and labour market requirements, prospective students and their parents should receive high-quality information on the labour market outcomes of graduates by institution and field of study. Also, before launching new study programmes institutions could be required to prove that the proposed programme would respond to unmet labour demand. Moreover, to promote VET at high school level, all students should have access to workplace training as part of their programme. Furthermore, these studies recommend the creation of better pathways between high school VET and tertiary education, and short-cycle tertiary programmes should be developed in close connection with business. Finally, it is also important to consider whether additional measures are called for to improve equity of access to VET and higher education, in light of the high out-of-pocket costs of education in Korea (see Box 3.4 for national examples of such initiatives).

Moreover, as noted in Section 3.2 above, non-regular workers have significantly less access to employer-provided training programmes than regular workers, and government provided training does not take up the slack. Thus, there is also a need to monitor closely whether financial incentives are sufficient to induce employers to provide training for non-regular workers. Efficient career guidance services and the provision of higher-quality information on training courses could also play an important role in stimulating the demand for training and facilitating a better match between workers' demand for training and the courses offered by training providers.

Due to the high turnover rate of non-regular workers, it may be appropriate to focus training incentives on the individuals themselves, rather than on their employers. OECD research has shown that training subsidies directed at individuals can be an appropriate instrument when the policy goal is to increase training access for groups of workers who tend to receive little or no continuing training from their employers. The Korean government has expanded financial incentives and grants for non-regular workers to engage in training, targeting workers on fixed-term contracts for less than one year, temporary agency workers, part-time workers and daily workers. From 2008, the Labor and Employment Ministry plans to implement a "Skill Development Card System" to raise participation in adult learning among the same target group: under this scheme, the government plans to pay training expenses of up to KRW 1 million per person per year. The ministry has also established a taskforce consisting of union, management and related experts who have been charged with preparing a more advanced action plan to facilitate training for non-regular workers, and setting up a loan programme for living costs during the training.

Box 3.4. **International examples of policies improving equity in VET and higher education**

Countries typically take a multi-faceted approach to addressing equity in education, although the challenges they face vary as does the relationship between general policy approaches that also promote a more equitable system and tailored or targeted measures to address particular equity concerns.

- **Raising the performance of Vocational Education and Training programmes**. Countries such as *Denmark*, *Germany* and *Switzerland* have VET programmes that combine employer engagement, workplace and classroom learning designed to provide vocational students with skills that lead to good labour market outcomes. Maintaining core academic standards in vocational programmes has been tackled in the *United States*, *Belgium (Flanders)* and *Germany* through initiatives that integrate basic skills with vocational content and are adapted to the more practical learning style of most vocational students.

- **Facilitating access to tertiary education**. Countries such as *Australia*, *Canada*, *Chile*, *China*, *Iceland*, *New Zealand* and the *United Kingdom* provide income-contingent student loans, while almost all OECD countries offer some means-tested grants. Some institutions are developing special programmes and initiatives to promote more equitable access. For example, in ***France***, the prestigious Institut des Études Politiques (SciencesPo) operates a partnership with high schools in disadvantaged areas that has significantly improved the intake of very able students who would otherwise not have applied due to lack of self-confidence and material constraints.

Source: OECD (2010), *Learning for Jobs*, OECD Publishing, *www.oecd.org/education/vet*; OECD (2008), *Tertiary Education for the Knowledge Society, Volume 1 – Special Features: Governance, Funding, Quality*, OECD Publishing, and OECD (2008), *Tertiary Education for the Knowledge Society, Volume 2 – Special Features: Equity, Innovation, Labour Market, Internationalisation*, OECD Publishing, *www.oecd.org/edu/tertiary/review*.

Notes

1. There is considerable debate in Korea concerning the definition of non-regular work and this chapter does not attempt to identify one best definition. It makes use of several different definitions as dictated by data availability and the different questions that are addressed. The main qualitative conclusions of the empirical analysis appear to be quite robust to the choice of definition used, although quantitative results would of course differ.
2. This definition of temporary workers differs significantly from the internationally harmonised definition used by the OECD. The second and third types of temporary employment shown in Table 3.1 are not included in the international definition, whereas several of the categories of atypical workers shown in the table are included (daily, on-call and dispatched workers). Note that daily workers may have contracts somewhat longer than a single day, while dispatched workers typically would be called temporary agency workers in most other OECD countries.
3. These percentage shares sum to 126% due to considerable overlap between the three forms of non-regular employment.
4. By providing additional protection for workers on fixed-term contracts these reforms, together with related reforms for dispatched and part-time workers, may have reduced the incidence of non-regular work, as measured in the EAPS by inducing employers to replace some of these workers via expanded use of in-house outsourced worker (Lee, 2011 and 2012). This latter type of employment may not show up as non-regular employment in Table 3.1, but raises many of the same issues about low job quality and limited career prospects.
5. Ahn (2006) makes a similar argument using data for 2005.
6. This emphasis is also consistent with the conclusion in Kim (2010) that non-regular workers in Korea most typically perform similar tasks to those performed by regular workers ("substitution-type" non-regular work), whereas non-regular workers in Japan more often perform distinct tasks ("complementary-type" non-regular work).
7. A number of researchers have used the Oaxaca decomposition methodology to assess how much of the pay penalty associated with non-regular work can be attributed to differences in worker and job characteristics, which may reflect differences in efficiency, and how much to discriminatory treatment. For example, Ahn (2006) and KDI (2009) conclude that both factors are important, while Nam (2007) finds that wages are equivalent once standardised for worker and job characteristics. Using a different methodology, KEF (2006) concludes that productivity differences account for one-half of the total differential in pay.
8. The classification of non-regular workers in Table 3.4, between those who are "voluntary non-regular workers" and those who are "involuntary" needs to be interpreted with caution, since this is a subjective assessment and different workers may have described similar situations differently. For example, 19% of respondents said they are voluntary non-regular workers because that allows them "to balance work with other activities" while 8% say they are involuntary non-regular workers for the same reason.
9. Non-regular workers employed in firms employing more than 300 workers are paid nearly two and one-half times as much as non-regular workers in the smallest firms, while the corresponding size premium for regular workers is a smaller but still sizeable doubling of pay.

10. The KLIPS sample covers only metropolitan areas as of 1997 and therefore does not reflect households who moved to cities amidst rapid economic growth after 1998. Farming and fishing households are also omitted from the sample.

11. Most of the mobility analysis of non-regular workers reported in this section is based on the procedure suggested by MOEL for implementing, as accurately as possible, the official definition of non-regular employment (i.e. as implemented in the Supplement on Employment Types to the Economically Active Population Survey) using the information available in the KLIPS. These results are compared with those obtained using workers' self-assessment of whether they are regular or non-regular workers.

12. The age and education effects probably overlap to a considerable extent because younger cohorts have considerably more education than older cohorts.

13. This is a surprising result since mobility rates typically fall with job tenure. The usual pattern holds if workers' self-assessment of employment type is used: non-regular workers with less than two years of job tenure have the highest probability of moving into regular employment.

14. Again, a number of these mobility patterns change when using workers' self-assessment of employment types. For example, the estimated probability that a non-regular worker in public administration moves to a regular job is then much lower.

15. KDI (2009) finds that non-regular jobs are rarely a stepping stone to regular jobs, but that this is more frequently the case for non-regular workers receiving training.

16. According to the internationally harmonised definition of the OECD, temporary work includes workers with fixed-term contracts, temporary agency workers (dispatched workers), and daily and on-call workers (after accounting for possible double counting). This differs from the national definition used in Table 3.1 above.

17. Some of the high level of turnover could be the result of unintended incentives created by labour market policies. OECD (2012a) argues that the requirement to convert fixed term workers into regular workers once they have accumulated two years of tenure with the firm, which was introduced in 2007, has led to a greater churning of fixed-term workers. Similarly, the fact that workers with less than one year of tenure are not entitled to the retirement allowance might also induce some additional churning.

18. There is considerable overlap between temporary and part-time employment in Korea. Note too that the internationally harmonised definitions of these two types of employment differ significantly from the official definitions used in Korea (e.g. as reported in Table 3.1).

19. In order to make valid international comparisons, Table 3.7 makes use of the OECD harmonised definition of temporary employment which differs from the national definition used in Korea (e.g. as shown in Table 3.1). Mobility from temporary to permanent employment is much more common when this national definition is used. For example, the 1-year probability rises from 11% to 43%. As discussed above, much of this mobility appears to reflect an inability to accurately identify the second and third types of temporary employment tabulated in Table 3.1 when using the information available in the KLIPS.

20. The mobility rates shown for Korea in Panel B of Table 3.7 differ slightly from those presented in Tables 3.5 and 3.A1.1 because all persons ever self-employed are omitted from the sample when calculating mobility rates in Table 3.7. This was done to be consistent with the results available for other OECD countries.

21. Over the same period, per capita GDP in Korea rose from approximately 20% of the Japanese value to 90%.

22. The sharp fall in the share of the population under 20 years of age from 51% in 1975 to 23% in 2010 considerably exceeded the still sizeable increase in the share of persons aged 65 years and older (from 3% to 11%).

23. The ageing of the workforce will be even stronger if there is a tendency for retirement ages to rise as longevity and health improve.

24. The question about whether the gender pay gap corresponds to a productivity gap is closely related to regression-based decomposition analyses that are commonly undertaken to differentiate between the part of the pay differential that is attributable to gender differences in characteristics likely to influence individual productive capacity (e.g. education and experience) and residual differences that are often interpreted as reflecting discrimination. Keum (2012) is a recent example of such an analysis for Korea. A decomposition based on KLIPS data for 1999-2008 indicates that 54% of the unadjusted gender pay gap can be attributed to gender differences in the average values of an extensive list of control variables. However, some of these “explained” differences in the productivity of women reflect labour market outcomes that are arguably more a reflection of labour market duality than of the inherent productive capacity of women relative to men (e.g. the relative concentration of women in low-paid service industries and smaller firms, as well as the large impact of less stable employment in an economy where wages are strongly tied to seniority).

25. The reforms of 2007, which enacted the Fixed-Term and Part-Time Employment Act and revised the Act on the Protection, etc. of Temporary Agency Workers, were approved in December 2006 and took effect in July 2007.

26. Temporary agency workers are workers who are assigned to work for a particular user employer by a dispatching employer in the context of a tripartite relation.

27. As was mentioned above, EPL rules for regular workers are only one of the factors limiting employers’ flexibility to adjust staffing levels. Employers are also sometimes reluctant to lay off regular workers because it could be bad for their reputation, workforce moral or lead to industrial disputes, especially where trade unions are strong. For all of these reasons, the long-run goal should be to move toward a flexicurity model where the costs of flexibility for workers are both lower and more equitably distributed than in Korea’s highly dualistic labour market.

28. The 2011 supplementary tesults of the Economically Active Population Survey (EAPS) by employment type indicate that 25.8% of all non-regular workers are employed in establishments with four or fewer employees. Non-regular workers account for 46.1% of all employees working in these very small establishments.

29. Data from KEIS (2010a) show that 32.8% of Job Center staff in 2010 worked on employment support and 6.1% on job-search courses.

30. This information was provided by the Seoul Job Centre during the OECD mission to Korea in February 2012.

31. As well as services for jobseekers, the KLF provides training for career counsellors and since 2012 has had responsibility for monitoring the MOEL’s contracted-out outplacement services programme.

32. See press release by the Ministry of Employment and Labor and the Ministry of Health and Welfare, dated 18 June 2012.

33. Allowances which are treated differently for taxable income and the wage include the performance-based bonus, which is included in taxable income under tax law, but is not included in the wage under labour law. The Korean government estimates that the wage represents on average 95.8% of the taxable wage (i.e. the wage component of taxable income) However, the gap is different by size of enterprises. In large enterprises, the wage is smaller than the taxable wage due to the performance-based bonus, but in small enterprises, the wage is larger.

34. In July of 2011, 10.4 unions per day were established. But 3.5 unions per day were established in August, 2.3 per day in September, 1.7 per day in October, and 0.8 per day in June of 2012.

35. Korean women with an intermediate level of education (i.e. who stopped after finishing upper-secondary education) have an employment rate that is 8 percentage points below the OECD average. All of these figures are for women between the ages of 25 and 64 years and are taken from OECD (2012b).

36. The average poverty rate for retired households in OECD member nations is 15.1%, compared with Korea's rate of 45.1% (see also Korean Labor Foundation, 2012).

37. The government can provide up to 50% of the reduced wage, up to a pre-determined wage ceiling.

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Annex 3.A1

Mobility of non-regular workers based on self-assessment of employment type

Table 3.A1.1. **One-year and three-year mobility of non-regular workers compared with that for other workers**[a, b]

Percentages

A. One-year transition rates

Labour force status in initial year	Current labour force status by status one year earlier (percentage distribution): Regular employment	Non-regular employment	Self-employment	Unemployment	Inactive or unpaid family worker
Regular employment	84.4	4.8	2.4	2.2	6.3
Non-regular employment	12.1	67.8	2.9	3.3	14.0
Self-employment	2.3	1.9	88.5	1.0	6.3
Unemployment	22.9	16.9	5.0	18.0	37.3
Inactive or unpaid family worker	4.0	4.1	1.7	2.2	88.0

B. Three-year transition rates

Labour force status in initial year	Current labour force status by status three years earlier (percentage distribution): Regular employment	Non-regular employment	Self-employment	Unemployment	Inactive or unpaid family worker
Regular employment	69.1	10.3	6.5	2.6	11.5
Non-regular employment	18.1	50.2	6.5	3.1	22.1
Self-employment	4.7	4.7	78.4	1.2	11.0
Unemployment	27.4	22.4	6.6	9.3	34.3
Inactive or unpaid family worker	8.2	6.6	3.1	2.3	79.9

a) Average rates for 1999-2009.

b) Non-regular workers identified using the workers' own assessment of their employment relationship as regular or non-regular.

Source: OECD calculations using microdata from the Korean Labor and Income Panel Study (KLIPS), waves 2-12 (1999-2009).

Chapter 4

Combined early childhood education and care measures to ensure social cohesion

This chapter assesses the current early childhood education and care (ECEC) programmes in Korea. Korea should carefully consider the priorities among its ECEC policy goals: i) *ensuring equity for children in disadvantaged families;* ii) *raising maternal labour force participation, as well as work-life balance, especially in a manner more equitable for women;* iii) *boosting the fertility rate, and* iv) *regarding ECEC as public responsibility. To meet these goals, Korea should first and foremost ease the financial burden on parents for having children and for meeting the associated education cost. Channelling more public spending is required. ECEC is crucial for improving the educational development of children, but its effects will depend on the quality of provision. Good quality and affordable ECEC services can influence parents' decisions, such as whether to go back to work after starting a family or to have more children.*

4.1. Introduction

Education played a key role in Korea's transformation from one of the poorest countries in the world to a leading industrial nation by promoting the development of human resources and technological change. Each phase of investment in education fuelled economic growth, successively developing primary education in the 1960s, then expanding secondary education and finally shifting the focus to expanding tertiary education in the 1990s. The exceptionally rapid development of education in Korea is illustrated by differences in the level of educational attainment for different age cohorts. The share of the population with at least a secondary education ranges from 98%, the highest in the OECD area, for young adults (25-34) to only 40% for older adults (55-64) in 2009. Moreover, 58% of young adults have completed tertiary education, the highest share in the OECD, compared to only 12% of older adults. In addition to these quantitative measures, Korea has consistently ranked near the top in the OECD in the Programme for International Student Assessment (PISA).

Nevertheless, the *OECD Economic Survey of Korea* published in 2012 recognised that improving the quality of education further would promote productivity gains that would sustain growth in the face of challenging demographic trends. The survey's recommendations pointed to a need to upgrade the quality of early childhood education and care, improve the quality of primary and secondary schools through greater autonomy and diversity, upgrade the tertiary sector and improve vocational education in order to address the overemphasis on tertiary education.

As well as boosting economic growth, the universal access to primary and secondary school in Korea also promoted social mobility and income equality. However, the review noted that some aspects of the education system were in need of improvement to further address income inequalities. In particular, recommendations were made for improving access for low-income children to high-quality early childhood education and care; reducing reliance on private tutoring, notably in private institutions known as *hagwons*; and expanding income-contingent loans to tertiary students.

The dual presence in these recommendations of early childhood education and care is argument itself for focusing this chapter on that theme. In doing so, this report recognises the far reaching impact that improvements to the quality of ECEC provision and the equity of access to it can have on the social and economic well being of Korea.

In recent years, the principles underpinning policy intervention are shifting from a current-income, social-welfare model to a life-cycle, human capital development model. In the life-cycle model, early childhood education and care (ECEC) is considered to play a critical role. A large body of empirical work, as well as neurological science research, has established that fundamental cognitive and non-cognitive abilities are created well before the age of five. ECEC thus generates a higher rate of return on public intervention than later stages of education, and even more so for disadvantaged children who receive much less cognitive and emotional stimulation at home (Heckman and Masterov, 2007). It argues that ECEC lays the foundation for subsequent stages in life, such as better student performance, less poverty, more equitable outcomes, fewer dropouts and greater labour market success.

From a labour market perspective, it is argued that access to affordable, quality ECEC permits mothers to take an equal place in the workforce, boosting household income and giving some families vital help out of poverty. It is also argued that this will improve female workforce participation, increasing the tax base for the society in general. From a demographic perspective, some OECD countries are experiencing falling fertility, like Korea and Japan. Surveys in these countries have shown that the substantial costs of raising children and ensuring high-quality learning opportunities are among the key factors that affect a woman's decision on whether to give birth to a child.

While ECEC policy can address a broad scope of socio-economic and demographic challenges, this in-depth analysis will focus on how ECEC policy can promote social cohesion and equity in education opportunities and outcomes of children, while broadly addressing other issues. In this context, the key recommendations of the chapter are as follows.

- Prioritise extending public support for ECEC to all 3- and 4-year-olds starting in 2013, as planned. One option is to ensure implementation of the Act to increase the capacity of public kindergartens.[1] The extent of free provision could be either half-days or full-days. Infants and toddlers should be also supported but possibly through a different combination of ECEC policy measures.

- Improve the quality of child care services such as by relaxing the price ceilings and entry barriers for child care to promote quality through competition, while ensuring the affordability of child care by increasing some subsidies as well as introducing a well-established information and accreditation system. The providers should be formally accredited to become eligible for the public subsidies. Given that accredited care may be more expensive to provide than informal child care settings, the subsidy should be sufficient to allow parents to access high-quality child care.

- Set up an integrated systems for accreditation, monitoring and information common to both kindergartens and child care services so that parents can make an informed decision about their choice for an ECEC provider. The system should be common to both child care and kindergartens to ensure transparency for users and streamline administrative procedures.[2]

- Ensure effective implementation of the common curriculum for 5-year-olds in child care and kindergarten as planned in 2012 and continue the harmonisation for 3- and 4-year-olds. Additionally, upgrade the programmes for younger children in alignment with the common curriculum. This will ensure continuous child development from birth to compulsory schooling. In doing so, caution is required to focus on "play-based learning" despite the strong academic-orientation in Korea.

- Set out common regulations and standards (e.g. staff qualifications, staff-child ratio) for all children aged 3-5, regardless of whether they attend kindergarten or child care. One option is to consider a gradual integration of administration of kindergarten and child care, at least for children aged three to five. This could promote more even quality among staff by raising qualifications of child care staff and enhance pedagogy by providing common teacher education and professional development for child care and kindergarten staff. Greater integration could also help reduce costs by streamlining administration as well as establish a coherent financing system that is fair.

Clarifying ECEC policy goals

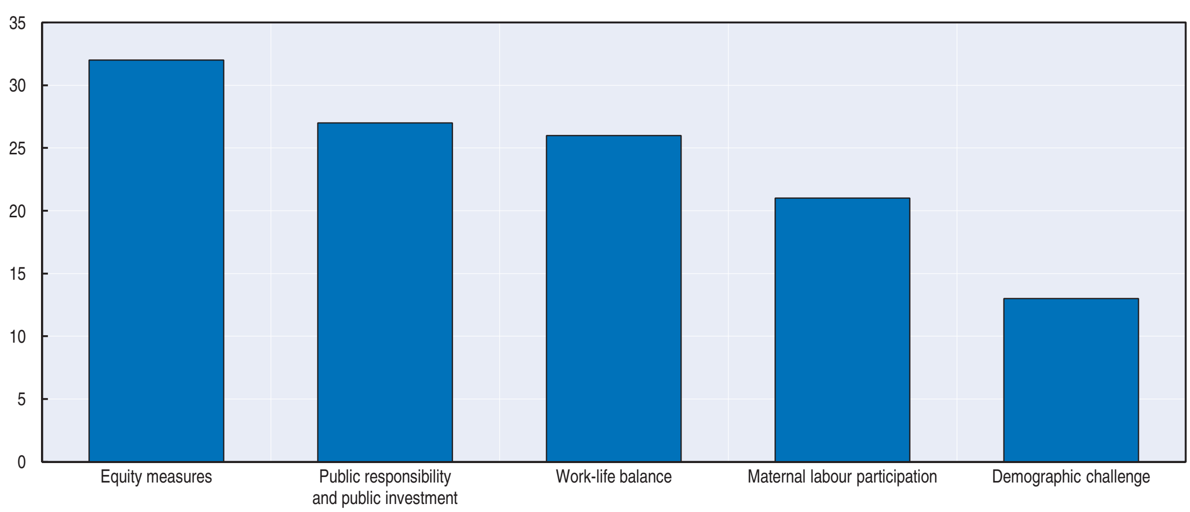
Explicit policy goals should be set to give ECEC programmes their purpose and orientation. Research has shown that setting policy goals can: *i)* help consolidate political will and strategically align resources with prioritised areas; *ii)* anchor discussions between ministries for better leadership in ECEC; *iii)* promote more consistent, co-ordinated and child-centred services with shared social and pedagogical objectives; *iv)* and provide guidance for providers, direction for practitioners and clarity for parents (OECD, 2006 and 2012). The goals should be specific but flexible enough for application (NIEER, 2004; and OECD, 2006).

A recent survey of OECD countries found that their aims and expected outcomes of ECEC policies can be categorised into five types, ranked by their order of importance (Figure 4.1). Broadly speaking, goals which countries refer to as the aims and expected outcomes of ECEC policies can be categorised into five types (OECD, 2006):

1. *Equity measures:* addresses child poverty and educational disadvantage by establishing fair and inclusive ECEC systems, accessible for all children;
2. *Public responsibility and investment*: recognises ECEC as a public investment;
3. *Work-life balance*: reconciles work and family responsibilities, especially in a manner more equitable for women;
4. *Maternal labour participation*: responds to the rise of the service economy and the influx of women into salaried employment; and
5. *Demographic challenges*: responds to changes in fertility rates and continuing migration/immigration.

Figure 4.1. **Overall policy goals for ECEC**[a]

Number of times cited as policy goal



a) Thirty-one jurisdictions responded; they were given a list of example policy goals to choose from based on *Starting Strong II* (2006). Respondents may list more than one policy goal.

Source: OECD Network on Early Childhood Education and Care's Survey for the Quality Toolbox and ECEC Portal, June 2011.

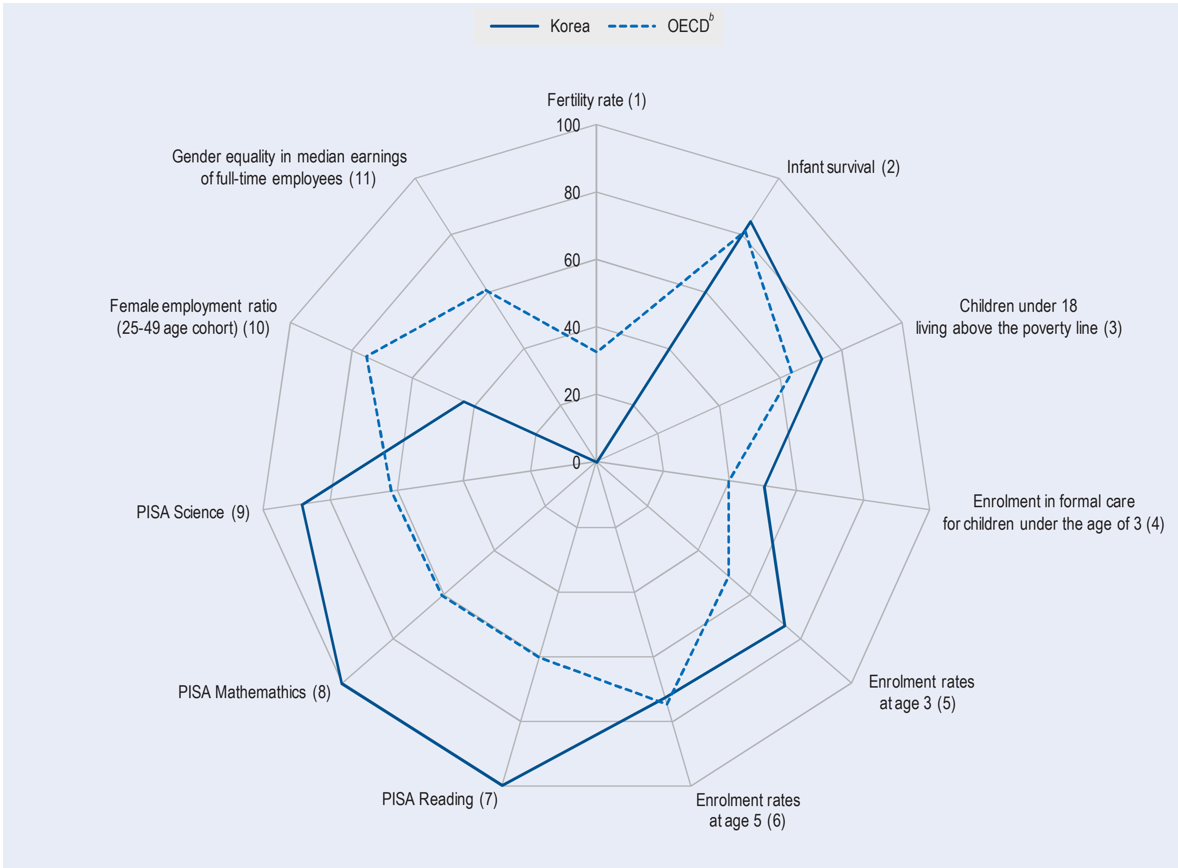
The majority of the countries participating in the survey selected three or four goals (21 jurisdictions in total), while four were able to prioritise two. Seven jurisdictions, including Korea, selected all five. To ensure the optimal allocation of Korea's government budget, which is under pressure in particular due to growing social spending, it is important to review to what extent these goals have been met and which areas need targeted policy intervention. This would help to better align the government's strategic budget planning with its ECEC goals.

An overview of expected outcomes of ECEC policy for Korea

Figure 4.2 presents performance indicators that are selected in accordance for Korea and the OECD area as a whole that have been selected in accordance with the five ECEC policy goals.[3] The choice of the 11 indicators depends on currently available data as well as the agreement of the Korean Ministry of Education, Science and Technology for this exercise (Taguma et al., 2012). The following sections discuss ECEC policy issues by reviewing the selected indicators in these areas. In line with the agreed focus of this chapter on "social equity for young children and ECEC policy", equity measures account for five of the indicators, while socio-demographic outcomes of ECEC policies (e.g. female labour force participation, gender equality, fertility) are also included.

1. *Equity measures*
   - Infant survival (per 1 000 live births)
   - Children under 18 living above the poverty line (%)
   - Enrolment in formal care for children under the age of 3 (%)
   - Enrolment rates at age 3 (%)
   - Enrolment rates at age 5 (%)
   - PISA (Programme for International Student Assessment) Reading (score)
   - PISA Mathematics (score)
   - PISA Science (score)
2. *Maternal labour participation and work/life balance*
   - Female employment ratio (25-49 age cohort)
   - Gender equality in median earnings of full-time employees
3. *Demographic challenges*
   - Fertility rate
4. *Public responsibility and investment*
   - Public spending on ECEC (this will be included as a "policy input indicator" in the next section).

Figure 4.2. **An overview of policy outcomes across sectors**[a]



a) For each indicator, the absolute performance is standardised (normalised) using a normative score ranging from 0 to 100, where 100 was set at the maximum value and 0 was set at the minimum value, taking into account all OECD countries with available data in each case.

b) *Unweighted* average of the 34 OECD countries with available data for Fertility rate *(1)*, Infant survival *(2)*, Children under 18 living above the poverty line *(3)* and Gender equality in median earnings of full-time employees *(11)*. *Weighted* average of the 34 OECD countries with available data for Enrolment in formal care for children under the age of 3 *(4)*, Enrolment rates at age 3 *(5)*, Enrolment rates at age 5 *(6)*, PISA Reading *(7)*, PISA Mathematics *(8)*, PISA Science *(9)* and Female employment ratio *(10)*. Countries missing in the average calculation are: for *(4)*, Turkey and Switzerland; for *(5)*, Canada and Greece; for *(6)*, Canada; for *(10)*, Chile, Israel and Norway; and for *(11)*, Chile, Estonia, Israel, Luxembourg, Mexico, the Slovak Republic, Slovenia and Turkey. See Table 1.1 for maximum and minimum value countries.

Source: See Annex 4.A1 for sources.

Table 4.1. **Maximum and minimum value on policy outcomes**

Indicator on child outcomes	Minimum value	Maximum value
Fertility rate	**Korea (1.15)**	Israel* (2.96)
Infant survival (per 1 000 live births)	Turkey (983)	Luxembourg (998.2)
Children under 18 living above the poverty line (%)	Israel (73.4)	Denmark (96.3)
Enrolment in formal care for children under the age of 3 (%)	Czech Republic (2.2)	Denmark (65.7)
Enrolment rates at age 3 (%)	Netherlands (0.05)	France (100.00)
Enrolment rates at age 5 (%)	Turkey (50.9)	Australia, France, Ireland, Mexico, New Zealand (100.0)
PISA Reading (score)	Mexico (425)	**Korea (539)**
PISA Mathematics (score)	Mexico (418)	**Korea (546)**
PISA Science (score)	Mexico (415)	Finland (554)
Female employment ratio (25-49 age cohort)	Turkey (27.4)	Slovenia (86.7)
Gender equality in median earnings of full-time employees	**Korea (61.2)**	Italy (98.7)

PISA: Programme for International Student Assessment.

* Information on data for Israel is available at: *http://dx.doi.org/10.1787/888932315602*.

Source: See Annex 4.A1 for sources.

4.2. Reviewing equity measures outcomes and identifying policy issues

Korea cited ensuring equity for children as one of its ECEC policy goals. Korea performs above the OECD average on several child outcome indicators; infant survival rates are high, and child poverty is below the OECD average. However, careful monitoring of child poverty is required, particularly for children whose parents have non-regular jobs, given that their hourly wages are much lower than those of regular workers (see Chapter 1). Income inequality in Korea is currently close to the OECD average, although it has increased in recent years (see Chapter 2).

On learning outcomes at age 15, Korea is among the top performers across PISA assessments on reading, mathematics and science. However, like ECEC, financial burden on parents continues for older children in Korea, particularly due to private tutoring in *hagwons*. The high level of household spending on education raises the issues of affordability and equity, especially for disadvantaged families, as the relationship between family background and student outcomes is becoming stronger. As many of the inequalities exist even before children enter school, it is important that early interventions are designed as an equity measure for inclusive growth. To help achieve this, areas for reform include: easing the financial burden on households; revisiting curriculum and pedagogy; and reviewing standards and regulations for better staff quality.

Financial burden on parents for better ECEC outcomes

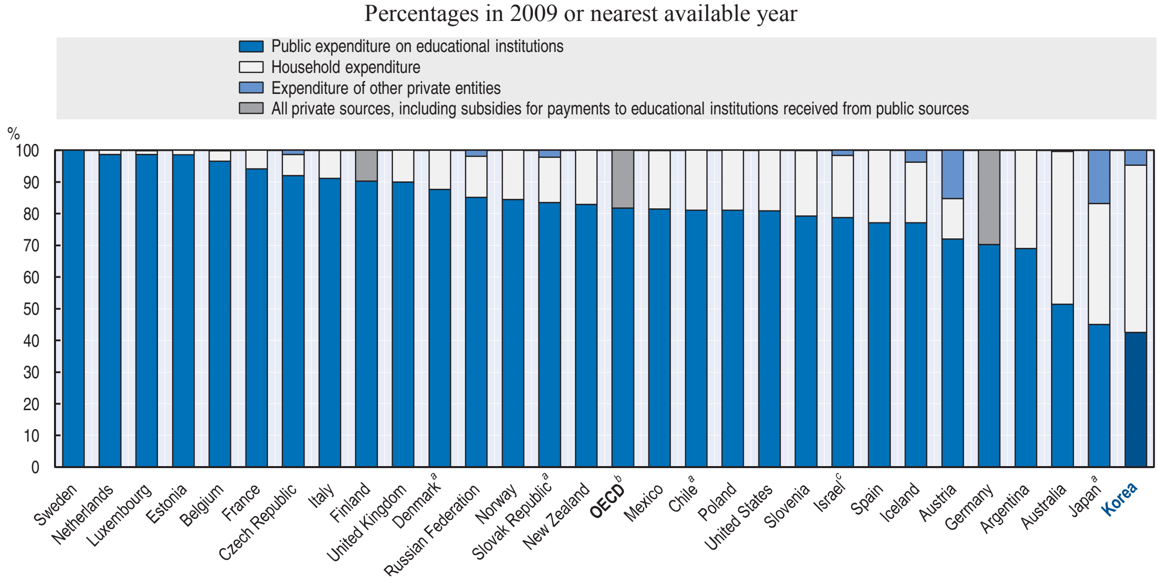
For children under the age of 3, Korea's enrolment rates in formal child care services are higher than the OECD average. The enrolment rate for children aged 5 is slightly below the OECD average.

Although ECEC enrolment rates are close to or higher than the OECD average, the sector is predominantly private, raising issues of affordability and equity. Private kindergartens, which have the autonomy to set their own fees, tend to charge much higher than public institutions (KICCE, 2011a). Consequently, there are concerns that economically advantaged families have access to high-quality ECEC, while disadvantaged families are limited to low-quality or can access no ECEC provision.

Investment in ECEC is essential for establishing a stronger foundation and ensuring equity in education and later life chances. In pre-primary education, the share of total payments to educational institutions from private sources, primarily household expenditure, which averages 18.3% in OECD countries. With the latest internationally comparable data from 2009, it ranged from 0% in Sweden to more than 35% in Australia, Japan and Korea, which was the highest at 52.7%. Conversely, the proportion of public spending also varies widely among countries, ranging from 100% in Sweden to less than 50% in Japan and Korea; with Korea the lowest at 42.6%. The distribution of spending on early education in Korea was the most skewed towards private spending (Figure 4.3). With the increased public funding in 2012 and with the planned further increase in 2013, however, the estimates of the proportions of public spending are 64.7% and 78.0% accordingly (Park and Shin, 2012). The international comparable data for 2012 are not currently available.[4]

Figure 4.3. **Distribution of public and private spending on early educational institutions**

Percentages in 2009 or nearest available year



Note: Countries are ranked in descending order of the proportion of public expenditure on educational institutions in pre-primary education.

a) Some levels of education are included with others.

b) Unweighted average of the 27 member countries shown in the chart above for "Public expenditure on educational institutions"; "All private sources, including subsidies for payments to educational institutions received from public sources" equals 100 *minus* the average previously described.

c) Information on data for Israel is available at: *http://dx.doi.org/10.1787/888932315602*.

Source: OECD (2012), *Education at a Glance 2012: OECD Indicators*, Tables B3.2a and B3.2b. UNESCO Institute for Statistics (World Education Indicators Programme) for Argentina. See Annex 3 to *Education at a Glance 2012* for notes (*www.oecd.org/edu/eag2012*).

In an education market that strongly depends on private fee-paying services, it is rarely possible to secure access, affordability and quality for all children. A large private provision paired with relatively low levels of public spending on pre-primary education places heavy financial burdens on families.

Stronger relationship between family background and student outcomes

Korea is among the top performers regarding children's academic achievements at age 15 across all PISA assessments on reading, mathematics and science. However, the level of private household spending on primary and secondary education continues to be substantial, imposing a financial burden on parents that has been growing over the years. Furthermore, Korean students heavily rely on private tutoring, particularly in *hagwons* (private tutoring); this starts from ECEC with some *hagwons-type* kindergartens, teaching subjects such as English to children aged 3 to 5. This is not the case in kindergartens.

The high level of private spending on education is partly due to the fact that parents have fewer children and are increasingly willing to invest in the education of their children to ensure the best educational opportunities. This is mostly driven and fuelled by the university entrance examination for which students fiercely compete. Entering into a prestigious university has been traditionally regarded as an important factor that is strongly associated with better labour market prospects and sequencing life chances in Korea (OECD, 2013, forthcoming).

The high level of private education spending, as mentioned earlier, raises issues of affordability and equity for children from ECEC to university. Although the percentage of top performing students on the PISA assessment in reading increased from 5.7% of all students in 2000 to 12.9% in 2009, the share of students below proficiency Level 2 has remained constant at 5.8%.[5] Overall, the variation in student performance in reading has increased in Korea between 2000 and 2009 (OECD, 2010, Figure V.4.1).

PISA results indicate that socio-economically disadvantaged students in the OECD area on average fare less well than their socio-economically advantaged peers. The strength of the relationship between socio-economic background and student performance varies across countries, ranging from 8% or below in Estonia, Finland and Iceland to 19% or above in Belgium, Hungary and Turkey. The association is weaker in Korea (11%) than the OECD average of 18%.[6] However, PISA suggests that the relationship became stronger between 2000 and 2009 (Figure 4.4; and OECD, 2013, forthcoming).

A growing body of research suggests that many of the inequalities exist even before the children enter school. Therefore, it is of critical importance that children, in particular those from disadvantaged backgrounds, have access to high-quality ECEC to lay a strong foundation for later successes in life (Schweinhart, 2006; Heckmann et al., 2009).

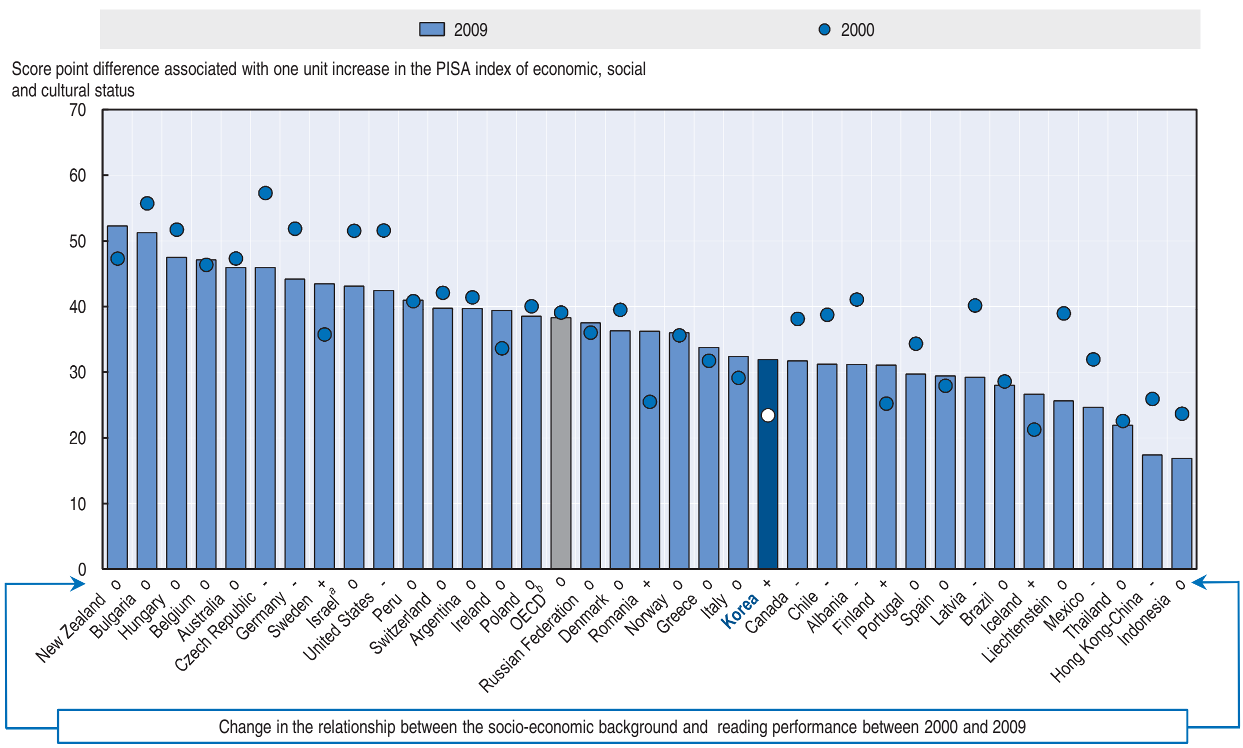
Different standards for staff quality

A consolidated body of research points to the factors that are strongly associated with staff quality and motivation, leading to better child outcomes. The main factors include:

1. *Evidence-based ECEC curricula* (Pianta et al., 2009; NIEER, 2004);
2. *Level with relevance of qualification* (Elliott, 2006; Sheridan et al., 2009; Shonkoff and Philips, 2000; Sheridan et al., 2011);[7]
3. *Staff salaries* (Chetty et al., 2011; NIEER, 2003; CCL, 2006); and
4. *Staff-child ratio* (Pianta et al., 2009; OECD, 2011b).[8]

Figure 4.4. **Relationship between students' socio-economic background and their reading performance in 2000 and 2009**

	2009 higher than 2000	2009 lower than 2000	No statistically significant difference
95% confidence level	+	-	o



Note: Countries are ranked in descending order of the overall association of the socio-economic background in 2009.

a) Information on data for Israel is available at: *http:/dx.doi.org/10.1787/888932315602*.

b) Unweighted average for 24 member countries shown in the chart above (excluding Austria, Estonia, France, Japan, Luxembourg, the Netherlands, the Slovak Republic, Slovenia, Turkey and the United Kingdom).

Source: OECD (2010), *PISA 2009 Results: Learning Trends – Changes in Student Performance Since 2000*, Vol. V, Figure V.4.4, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264091580-en.*

In Korea, the ECEC sector is fragmented with different objectives, regulations and curricula with separate facilities (Rhee et al., 2008), including standards for ECEC staff quality. The responsibilities for the ECEC sector are split between two ministries: kindergarten is administered by the Ministry of Education, Science and Technology (MEST) and child care by the Ministry of Health and Welfare (MHW).

Kindergartens are considered to focus on educational contents while child care has a more social-welfare orientation. According to a parental survey, Korean parents consider educational content to be most important (OECD, 2011a; OECD, 2012a; Yoo et al., 2008). The issue of "quality" is strongly associated with maternal labour market participation. Parents need to trust the quality of an ECEC institution, besides the cost issue, before deciding to send their child to the institution and join the labour force. A new monitoring and information system is introduced for kindergartens, with an aim to enhance transparency of quality for parents using kindergartens. However, in Korea the quality of ECEC services (not only for kindergartens but also child care services) is often not well defined or communicated to parents. The split administrative system further hinders the transparency of ECEC in Korea. The monitoring and reporting system about quality and costs is of particular importance.

Curriculum and pedagogy

Almost all OECD countries or regions have some form of a curriculum framework or learning standards for ECEC. The age groups, for which curricula are defined, differ among countries (Figure 4.5). In "split" system countries, the majority of countries and jurisdictions have created a learning framework for children in the older age bracket of ECEC from around age 2½ or 3 to compulsory schooling. Korea and Japan have been the only exceptions with parallel frameworks for child care (from age 0 to compulsory schooling) and for early education (from age 3 to compulsory schooling). In recent years, Korea started to harmonise curricula for kindergarten and child care for aged 3-5 through the Nuri Curriculum. However, the administration still remains "split" between the MEST and the MHW.

There is an international trend toward providing "integrated" services based on a common framework covering ages 0 or 1 to compulsory schooling [e.g. Australia, New Zealand, Nordic countries and Prince Edward Island (Canada)]. Furthermore, several countries aim to capture continuous child development in early childhood and beyond. This is reflected in the age coverage of the framework in, for example, Hesse (Germany), where there is a curriculum for children from ages 0 to 10, and in Scotland (United Kingdom), where the *Curriculum for Excellence* covers ages 3 to 18 – with age-appropriate content for different age groups.

It is not only the framework of the curriculum that matters – content is also important. A growing body of research points to the importance of "play" and a mixture of "child-initiated and educator-initiated activities and free choice". This is important to note, in particular, in the Korean context where the understanding of quality in ECEC services is rather skewed towards intensive education, such as "differentiated programmes" that can be found in *hagwon* (Lee et al., 2009). However, research suggests that children's main sensory, cognitive, linguistic and social growth develops through play, exploration and interactions with others. In contrast, systematic instruction does not have the same positive effect on early development (NICHD, 2000).

Children in mainly teacher-initiated activities also show more evidence of stress, e.g. nail-biting and turning away from tasks (Shonkoff and Philips, 2000). On the other hand, activities that include acts of scaffolding by ECEC staff members, interacting with peers and stimulation of independent thinking and self-regulation, have been found to positively impact children's IQ and language competences as well as their social skills (Shonkoff and Philips, 2000).[9] Data from pre-primary programmes in ten countries[10] has shown how classroom practices and approaches towards children aged 4 are related to social and cognitive competences at age 7. In all countries, children in ECEC programmes with dedicated time for child-initiated, free-choice activities in addition to practitioner-related activities scored significantly higher on language tests at age 7 than children in programmes with merely didactical practices. Free choice activities provide opportunities for the child to verbally interact with peers and for practitioners to introduce new vocabulary (Montie et al., 2006).

Figure 4.5. **Coverage of ECEC curriculum frameworks or guidelines by age group**[a]

(light blue)	Standards/curriculum for Care
(blue)	Standards/curriculum for Education and/or Education and Care
(white)	No standard curriculum is in place for the specified age group
(dotted)	Compulsory schooling

Age	0	1	2	3	4	5	6	7
Australia	Belonging, Being, Becoming - Early Years Learning Framework for Australia							
Austria								
Belgium (Flemish Comm.)			2.5y Ontwikkelingsdoelen					
Belgium (French Comm.)			2.5y					
Canada (British Columbia)	British Columbia Early Learning Framework for 0-5 year olds					British Columbia Early Learning Framework for 5-6 year olds		
Canada (Manitoba)		Early Returns Curriculum						
						Manitoba Kindergarten Curriculum		
Canada (Prince Edward Island)	Early Learning Framework							
Czech Republic				Framework Educational Programme for Pre-school Education				
Denmark	Preschool curriculum Læreplaner							
Estonia		1.5y Framework Curriculum of Preschool Education						
Finland	National curriculum guidelines on early childhood education						Core Curriculum for Pre-primary education	
France			2.5y National curriculum for école maternelle					
Germany (Baden-Württemberg)	Orientierungsplan für Bildung und Erziehung für die baden-württembergischen Kindergärten							up to 10
Germany (Bavaria)	Bildung, Erziehung und Betreuung von Kindern in den ersten drei Lebensjahren			Der Bayerische Bildungs- und Erziehungsplan für Kinder in Tageseinrichtungen bis zur Einschulung				
Germany (Berlin)	Berliner Bildungsprogramm für die Bildung, Erziehung und Betreuung von kindern in Tageseinrichtungen bis zu ihrem Schuleintritt							
Germany (Brandenburg)	Grundsätze der Förderung elementarer Bildung in Einrichtungen der Kindertagesbetreuung in Brandenburg							
Germany (Bremen)	Rahmenplan für Bildung und Erziehung im Elementarbereich							
Germany (Hamburg)	Hamburger Bildungsempfehlungen für die Bildung und Erziehung von Kindern in Tageseinrichtungen							up to 15
Germany (Hesse)	Bildungs- und Erziehungsplans für Kinder von 0 bis 10 Jahren in Hessen							up to 10
Germany (Mecklenburg-Western Pomerania)	Bildungskonzeption für 0- bis 10-jährige Kinder in Mecklenburg-Vorpommern							up to 10
Germany (Lower Saxony)	Orientierungsplan für Bildung und Erziehung im Elementarbereich niedersächsischer Tageseinrichtungen für Kinder							
Germany (North Rhine-Westphalia)	Mehr Chancen durch Bildung von Anfang an - Grundsätze zur Bildungsförderung für Kinder von 0 bis 10 Jahren in Kindertageseinrichtungen und Schulen im Primarbereich in Nordrhein-Westfalen							up to 10
Germany (Rhineland-Palatinate)	Bildungs- und Erziehungsempfehlungen für Kindertagesstätten in Rheinland-Pfalz							up to 15
Germany (Saarland)	Bildungsprogramm für saarländische Kindergärten							
Germany (Saxony)	Sächsischer Bildungsplan - ein Leitfaden für pädagogische Fachkräfte in Krippen, Kindergärten und Horten sowie für Kinderttagespflege							up to 10
Germany (Saxony-Anhalt)	Bildungsprogramm für Kindertageseinrichtungen in Sachsen-Anhalt							
Germany (Schleswig-Holstein)	Erfolgreich starten: Leitlinien zum Bildungsauftrag in Kindertageseinrichtungen							up to 15
Germany (Thuringia)	Thüringer Bildingsplan für Kinder bis 10 Jahre							up to 10

Figure 4.5. **Coverage of ECEC curriculum frameworks or guidelines by age group** *(cont.)*

Age	0	1	2	3	4	5	6	7
Hungary				National Core Programme of Kindergarten				
Ireland	Early Childhood Curriculum Framework: Aistear							
Israel				Framework Programme for preschool education				
Italy	3 months			Guidelines for the curriculum				
Japan				Course of Study for Kindergarten				
	National curriculum of day care centers							
Korea				National curriculum for kindergarten		Nuri Curriculum		
	Standardized childcare curriculum							
Luxembourg				Le plan d'études				
Mexico	Childcare curriculum			Early childhood education curriculum				
Netherlands			2.5y	Development goals/competences				
New Zealand	Te Whāriki							
Norway	Framework Plan for the Content and Tasks of Kindergartens							
Poland				Core Curriculum for Preschool Education				
Portugal				The Curriculum Guidelines for Pre-School Education				
Slovak Republic				The National Education Programme				
Slovenia		National Curriculum for Pre-school Institutions						
Spain	Early Childhood Curriculum							
Sweden		Läroplan för förskolan Lpfö 98					Läroplan för grundskolan, förskoleklassen och fritidshemmet Lgr 11	
Turkey				Pre-school education programme				
United Kingdom (England)	Statutory Framework for the Early Years Foundation Stage							
United Kingdom (Scotland)	Pre-birth to three - staff guidelines			Curriculum for Excellence				up to 18
United States (Georgia)			Georgia's Pre-K Content Standards					
United States (Massachusetts)				Guidelines for Preschool Learning Experiences				
United States (North Carolina)				Early Learning Standards for North Carolina Preschoolers and Strategies to Guide Their				
United States (Oklahoma)				Priority Academic Student Skills				

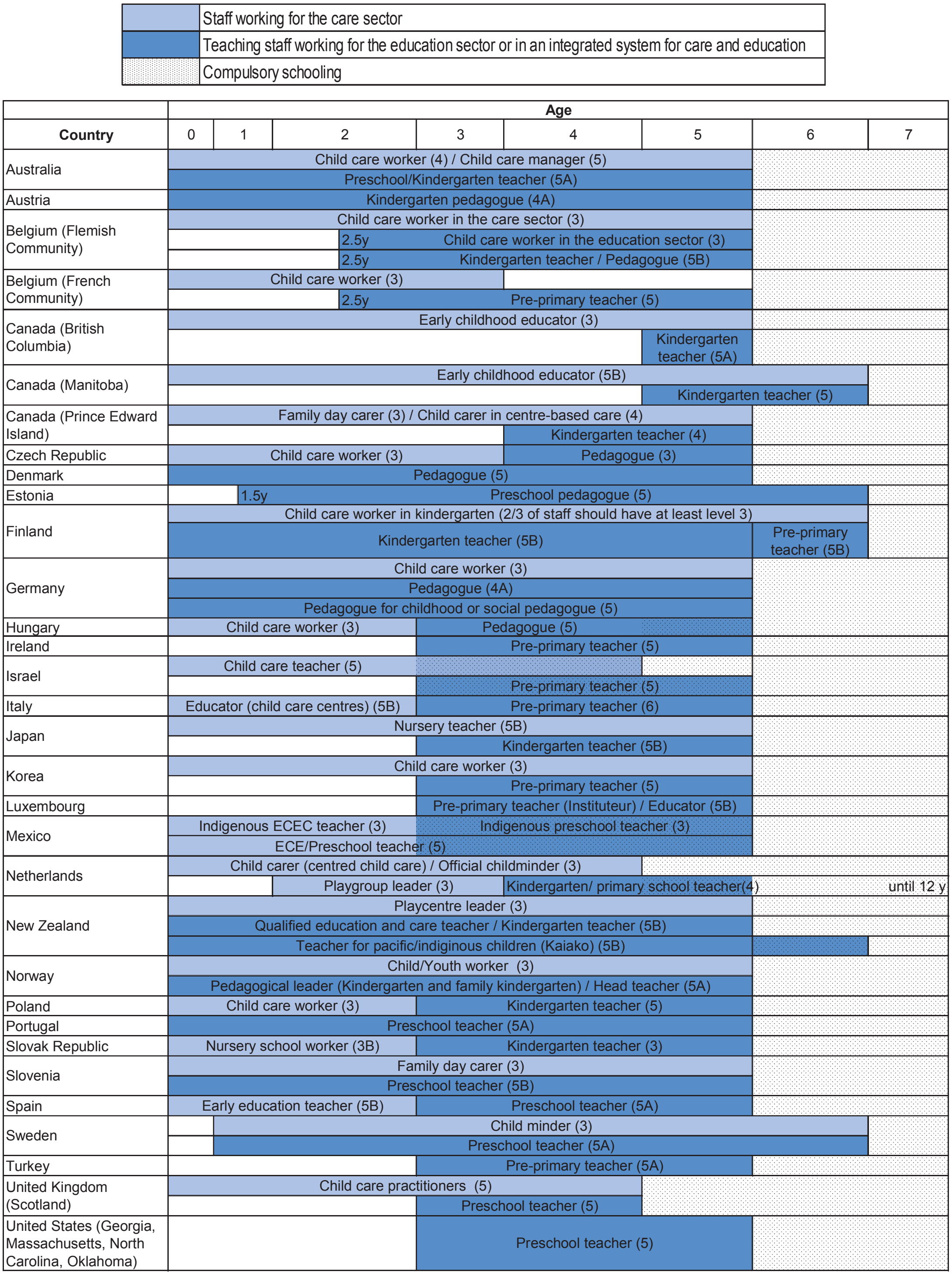
a) For Poland, the compulsory school age was lowered from 7 to 6 in 2009 with a transition period of three years (until 2012), during which time parents can choose if their child starts school at age 6 or 7. For Sweden, *Läroplan för förskolan* is the curriculum for the preschool; *Läroplan för grundskolan, förskoleklassen och fritidshemmet* regards the curriculum for the preschool class, compulsory school and out-of-school centres. For Korea, the Nuri Curriculum was created for age 5 and will cover ages 3 and 4 from 2013. Standardised child care curriculum covers ages 0 to 5.

Source: OECD Network on Early Childhood Education and Care's Survey for the Quality Toolbox and ECEC Portal, June 2011.

Staff qualification and education contents

In Korea, kindergarten teachers are required to have a qualification equal to ISCED 5, while child care workers need a minimum qualification equal to ISCED 3. This is similar to many other OECD countries (Figure 4.6). Children aged 3 to 6 in Korea, however, may experience different levels of staff quality depending on whether they go to kindergarten or child care. The children in child care may still be cared for by staff with ISCED 3 based on a curriculum with less educational focus. Also, private kindergartens that are considered high-quality often demand a high level of fees. Thus, the parallel system raises equity as well as quality issues.

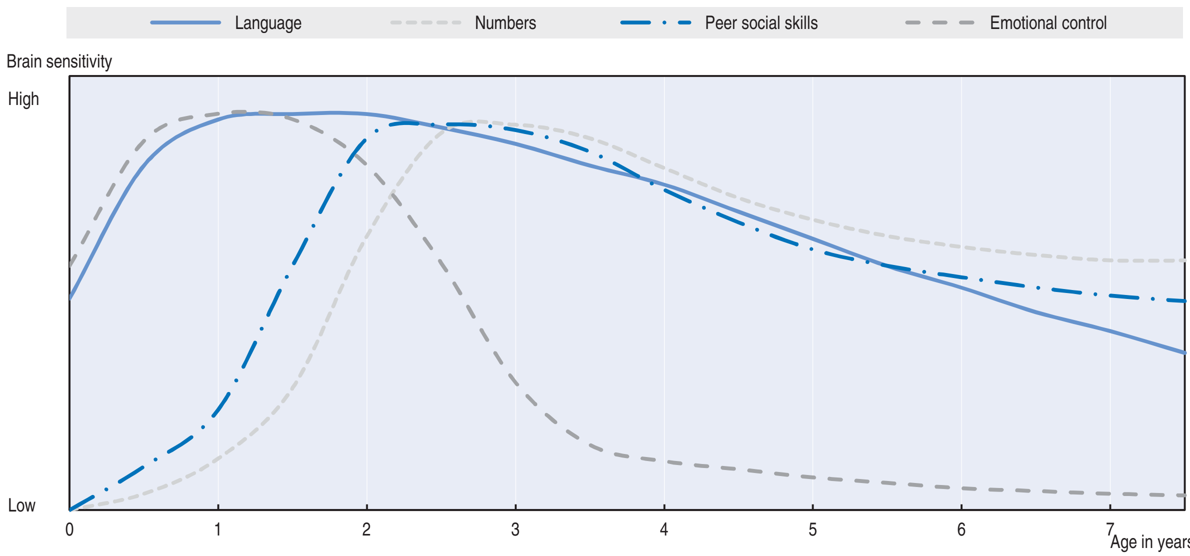
Figure 4.6. **Minimum required ISCED level for different types of ECEC staff**



Source: OECD Network on Early Childhood Education and Care's Survey for the Quality Toolbox and ECEC Portal, June 2011.

Furthermore, raising the quality of staff working with children under 3-years old is a growing ECEC policy interest in many countries, as neurological research has shown that the foundation of fundamental cognitive and non-cognitive abilities is created before ages 3 or 4. Cognitive developmental science has indicated that children learn certain things at particular ages, in a certain sequence (Council Early Child Development, 2010). The "peaks" of brain sensitivity may vary across functions/skills (Figure 4.7).

Figure 4.7. **Sensitive periods in early brain development**



Source: Council for Early Child Development (2010).

For emotional control, the brain sensitivity starts from a middle level at birth, increases to a high level around age 1 and declines to a low level where it stays from age 4. Peer social skills start at a low level, increase rapidly from ages 1 to 2, gradually decrease and remain at a medium level from age 4. For language, the brain sensitivity starts at a middle level, increases to a high level between ages 1 and 2, slightly decreases towards age 4, and will continue to decrease towards the middle and low levels from then on. Numeracy starts with a low level, increases rapidly from ages 1 to 3, gradually decreases but will be maintained at a high level from age 4. Based on these patterns, there are simple and effective ways for families and caregivers to ensure optimal child development.

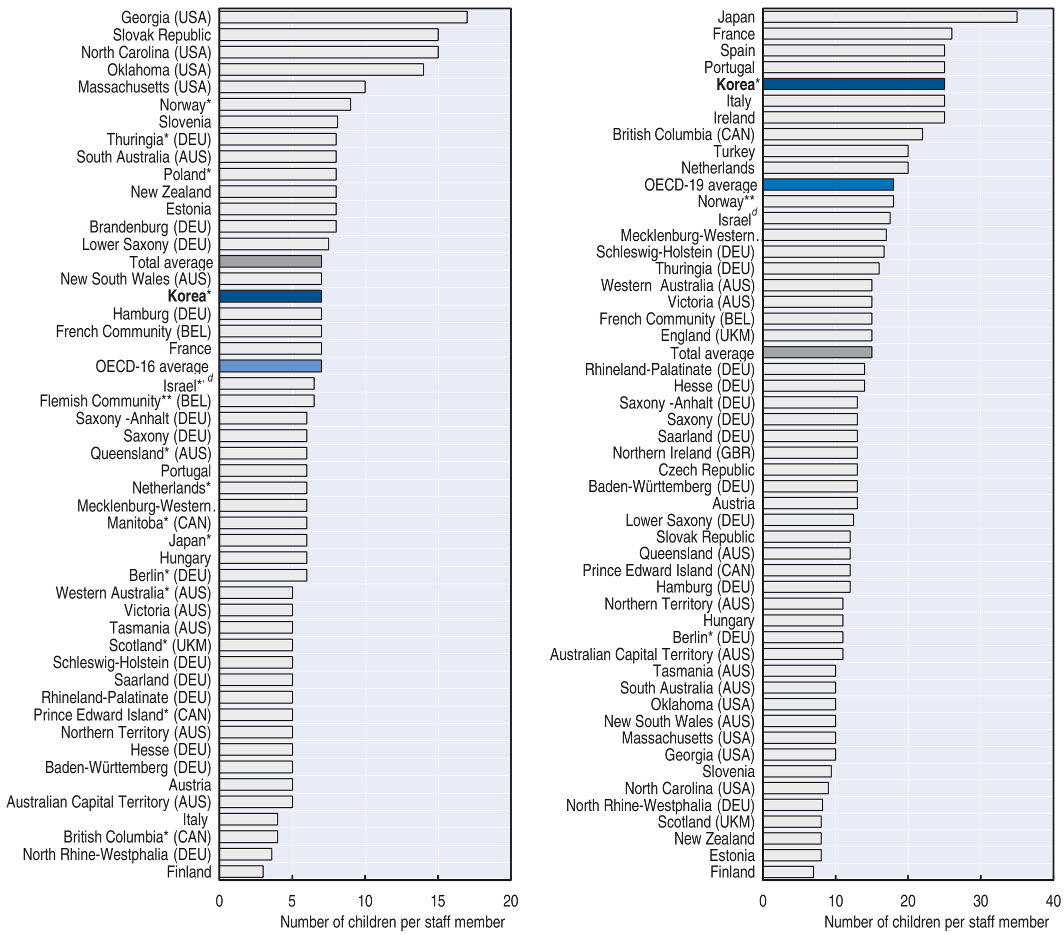
Staff-child ratio

Infants and toddlers need more intensive care than other young children. Therefore, countries often set different minimum standards for young children in the age category 0-3 years than for older children in preschool. The average staff-child ratio for the 0-3 year-old age group is one caregiver for seven children in formal child care services; the average for the 4-5 year-old age group is one teacher for eighteen children in kindergartens. Korea has the same ratio as the OECD average for child care centres, while the ratio is well above the OECD average for kindergartens (one teacher for 25 children) (Figure 4.8). The Korean authority reports that the average *de-facto* ratio for kindergartens was 1:14.6 in 2011, while still pointing out an issue that there are large variations between public and private kindergartens.

Figure 4.8. **Regulated maximum number of children per staff member in ECEC[a]**

Panel A. In child care (0-3-year-olds for integrated system)[b]

Panel B. In kindergarten or preschool (3-year-olds to compulsory schooling age for integrated system)[c]



* Jurisdictions with separate regulations for different age groups, the data given is based on: Berlin (DEU), 2-3 year-olds (attending 5-7 hours per day); British Columbia (CAN), 0-3 year-olds; Israel, 2-3 year-olds; Japan, 1-2 year-olds (while the country has different ratios in place for different ages: the ratio for age 0 is 1:3; age 1-2, 1:6; age 3, 1:20; and age 4, 1:30 – only data regarding 1-2 year-olds are included in the figure); Korea, 2-year-olds; Manitoba (CAN), 2-3 year-olds; Netherlands, 2-3 year-olds; Norway, 0-3 year-olds; Prince Edward Island (CAN), 2-3 year-olds; Queensland (AUS) 2-3 year-olds; Scotland (GBR), 2-3 year-olds; Thuringia (DEU), 2-3 year-olds; Western Australia (AUS), 2-3 year-olds. For Poland, when there is a disabled child in the playroom, the ratio is set at 1:5.

** Subsidised facilities only.

* Jurisdictions with separate regulations for staff-child ratio for different age groups, data are based on: 3-6 year-olds attending for 5-7 hours per day regarding Berlin; and 4-year-olds regarding Korea.

** The figure for Norway applies only to qualified kindergarten teachers, whereas regulation stipulates that if other staff will also be present in the kindergarten setting, the number of children per staff member is effectively lower. The figure for Norway is based on regulation for 3-6 year-olds.

a) "Total average" is based on data for all countries and jurisdictions included in the respective figures.

b) "OECD-19 average" is only based on data reported for OECD countries, excluding regions and territories, and is calculated based on data from: Austria, the Czech Republic, Estonia, Finland, France, Hungary, Ireland, Israel, Italy, Japan, Korea, Netherlands, New Zealand, Norway, Portugal, the Slovak Republic, Slovenia, Spain and Turkey.

c) "OECD-16 average" is only based on data reported for OECD countries, excluding regions and territories, and is calculated based on data from: Austria, Estonia, Finland, France, Hungary, Israel, Italy, Japan, Korea, Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic and Slovenia.

d) Information on data for Israel is available at: *http:/dx.doi.org/10.1787/888932315602*.

Source: OECD Network on Early Childhood Education and Care's Survey for the Quality Toolbox and ECEC Portal, June 2011.

Box 4.1. **Case Study: New Zealand's experience in integrating ECEC services**

The ECEC sector in New Zealand is made up of private and community-based providers. The lead authority for early childhood education and care in New Zealand is the Ministry of Education. In New Zealand, there is no distinction between early childhood education and day care for children aged 0-5 years old. Almost all children start primary school at age 5.

The Ministry of Education has the main responsibility for the following areas of ECEC:

- Statutory regulation, and criteria and guidelines related to regulation;
- Policy;
- Curriculum;
- Government funding; and
- Monitoring.

The ministry administers the regulatory regime and delivers programmes and interventions, which support the sustainability of ECEC services and high-quality education and care. The ministry also supports the planning and development of local ECEC provision. There are no official local or regional authorities with responsibility for ECEC.

The government provides significant funding, which is intended to reduce the level of cost that ECEC providers pass on to parents through fees. A smaller range of ECEC-related financial assistance is also available through the Ministry of Social Development, subsidising ECEC primarily to enable labour market participation by parents.

Funding system changes for ECEC followed the move to an integrated system. Different funding rates partly cover, or wholly in some cases, average total costs of providing ECEC. In 2001, government spending on ECEC was approximately NZD 330 million (0.32% of GDP), increasing to NZD 1.1 billion in 2009 (0.61% of forecast GDP). This follows increases from 2002 to 2008 in participation (92.3% to 95.1%), in enrolments in licensed ECEC (156 187 to 176 993), and in services (3 488 to 3 881). Additional expenditure has mostly been on registered teachers and higher subsidies (from July 2007) designed to reduce cost and increase participation.

It was important for New Zealand to manage the integration process. Integration at the system level had required about 20 years with the carefully designed sequencing. The government reviewed ECEC and set the direction for changes, partly in response to the initiatives of teachers, unions and academics to improve recognition and funding for ECEC, and partly as part of regulatory reform in ECEC. In 1980, the State Services Commission determined that care and education could not be easily distinguished. Therefore, although a top-down approach drove government integration and the merging of care and education, this was kindled by public interest. This approach further focused the interest of non-government groups.

First, child care services were transferred to the Department of Education in 1986. In 1988, the first three-year teacher training programmes inclusive of infant and cultural training components began to be phased in. In 1989, the Department of Education was replaced by the Ministry of Education, and guidelines provided for ECEC services in the *Statement of Desirable Objectives and Practices*. The new government funding system for ECEC started in 1990, changing in 1996 to focus on quality improvements, and again in 2005 to incentivise higher levels of qualification in the teaching workforce. In 1996, *Te Whāriki*, the ECEC bicultural curriculum, was launched.

Steps towards a more centralised governance and administration followed the promulgation of the revised education legislation in 1985. In 1986, responsibility for child care was transferred from the Department of Social Welfare to the Department of Education. In 1990, the new government funding system for ECEC was launched, along with the plan to phase in qualification requirements for ECEC services. The Diploma of Education (Early Childhood Education) established in 1987 became the benchmark teaching qualification.

Box 4.1. **Case Study: New Zealand's experience in integrating ECEC services** *(cont.)*

In the integration process, the stakeholder management was of particular importance. The integration and implementation decisions in the early 1990s were based on policies of the government of the day. However, as mentioned above, sector interest groups and academics had long been seeking improved recognition of ECEC by government. The implementation changes may have accelerated the further development of sector interest groups, which wished to have a stronger voice. After the 1989/90 reforms by the government, *Te Riu Roa*, the New Zealand Educational Institute (ECEC and primary teachers union), started a project to review future directions of ECEC in New Zealand.

Important dates and changes in sequencing

Date	Changes associated with integration
1980	State Services Commission review says care and education cannot be easily separated
1985	Promulgation of the revised education legislation
1986	Child care services transferred to the Department of Education
1987	Diploma of Education (Early Childhood Education) established
1988	Three-year teacher training programmes to be phased in
1989	Department of Education replaced by the Ministry of Education
1989	Guidelines provided for ECEC services in the *Statement of Desirable Objectives and Practices*
1990	New government funding system for ECEC established
1990	Funding for Kōhanga, Māori language ECEC services, transferred from Ministry of Māori Affairs to Ministry of Education
1996	New funding system focused on quality improvements
1996	Introduction of *Te Whāriki*, the bicultural curriculum
2002	Government's strategic plan established to focus on participation and quality – intended duration of plan: ten years
2005	New funding system to incentivise quality – linked to registered teachers with qualifications recognised for funding purposes

Positive outcomes as a result of integration were reported as a response to OECD surveys of the OECD Network on ECEC: e.g. the development of a child-centred curriculum with a continuous child development vision (e.g. ages 0-6, ages 0-10, ages 3-15); increased participation in ECEC; improving the quality of ECEC services (e.g. minimum standards, staff qualification and education; professional development and pedagogy, etc.); better data and monitoring; and cost savings by streamlining the administrative overlaps.

Critical success factors in the implementation process were reported by countries to an OECD survey on ECEC:

- *Political commitment:* a strong political leader or a political agenda that remain regardless of a government change is essential to implement the long-term reform agenda.
- *Adequate funding:* without sustained funding, the expected outcomes (e.g. increased participation, improved quality) would not be achieved.
- *Stakeholder-buy in:* without the commitment of stakeholders (such as providers, practitioners, academics), the plan will be easily overhauled.
- *Coherence for parents'/children's local needs:* the implementation plan needs to be designed, managing to meet both the parental needs, as well as children's needs, that could differ at times (e.g. operational hours and other minimum standards of integrated ECEC services).
- *Realistic timeline:* the implementation plan needs to be designed with feasible sequencing and a realistic timeframe.

Source: Country responses to the questionnaire for the 6th meeting of the OECD Network on Early Childhood Education and Care.

4.3. Policy issues related to female labour market outcomes and demographic challenges

In its response to the OECD survey, Korea included raising maternal labour force participation and boosting fertility rates as one of its ECEC policy goals (OECD, 2012b). Korea has a below-average female employment ratio in the prime age cohort and the lowest rate among OECD countries for gender equality in median earnings of full-time employees. Korea also has the lowest fertility rate among OECD countries. One of the major obstacles for women to have children and remain employed after giving birth is the lack of affordable, high-quality ECEC services. Others include work/family-life balance, such as maternity leave and parental leave, and long working hours. To expand ECEC services with public financing, major questions to resolve include how to balance targeted and universal access and how to balance demand-side and supply-side interventions. When universal access is provided, further questions arise with respect to the coverage (e.g. age and hours), considering the fiscal constraints.

Low female labour force participation

OECD (2012a) suggests that one of the most important strategies to mitigate the impact of population ageing on the size of the labour force is to increase the female labour force participation. The survey projects that, with the increased female participation rate converged to the current level for males for each age group, the labour force would only decline from its 2022 peak of 27.2 million to around 25.6 million by 2050. However, if participation rates were to remain unchanged, the labour force would be 16% smaller at 21.5 million (OECD, 2012a).

The women's participation rate was 54.5% for the working-age population in 2010, compared to an OECD average of 61.8% with some countries above 70%. Although the participation rate of prime-age women (the 25-54 age group) increased from 54% in 1990 to 62% in 2010, it was still the third lowest in the OECD area. A majority of women withdraws from work at the time of marriage or childbirth, resulting in an "M-shaped pattern" as a whole for the labour market participation across the age spectrum. Such a pattern is not commonly found for women in other OECD countries. The government has set a target of boosting the overall rate to 60% by 2014.

The increase in the female labour force participation since the 1960s in the OECD area is associated with the accessibility to affordable, high-quality ECEC services in order to achieve work/family-life balance (OECD, 2011a). The survey points out that 57% of married women in Korea are not in the labour force and instead bear most of the family responsibilities, including children's schooling and child care. Child care is part of a comprehensive approach proposed to boost female participation in Korea (OECD, 2012a):

- Narrow the gender wage gap by reducing the high share of non-regular employment and making greater use of performance-based pay;
- Increase the availability of affordable, high-quality child care;
- Extend maternity leave and promote the take-up of maternity and parental leave; and
- Expand flexibility in working time to make it easier to combine paid employment with family responsibilities, given that total working hours in Korea are the longest in the OECD area.

As ECEC policy is the focus of this chapter, the second bullet point will be analysed in depth, mainly from the perspective of two key policy design issues in the Korean context: *i)* how to balance between targeted and universal access, and *ii)* how to balance between demand-side and supply-side interventions.

Targeted and/or universal access

If the government considers boosting female labour force participation as the policy priority, affordable, high-quality ECEC should be made available for all families rather than targeting disadvantaged families only. OECD (2012a) suggests that the government expand the availability of affordable, high-quality child care, which women cite as a major obstacle to employment. OECD studies have found a positive relationship between child care and female employment (OECD, 2007a).

Universal access to affordable, high-quality ECEC is not an inexpensive policy choice. Therefore, countries consider the coverage (e.g. age and hours) carefully in its design. In an OECD survey on ECEC, many countries responded that they have started to offer free ECEC services to certain age groups (Table 4.2).[11] Universal free ECEC is most frequently provided to children in the year before compulsory schooling starts. Some countries have extended this right to cover younger children as well: France, Israel, Mexico, Portugal and Sweden provide free ECEC to all 3-6 year-olds, while the Netherlands does so for 4- and 5-year-olds, and England and Scotland for 3- and 4-year-olds. Among the countries that ensure universal access, the main difference is the number of hours of ECEC a child is entitled to (free) ECEC. In some countries, children have a right to full-day (five to eight hours per day) or half-day preschool (three to four hours per day).

Most universal entitlements were introduced in the 1990s or 2000s as governments became increasingly aware of the importance of encouraging participation in ECEC to enhance female labour market participation as well as early child development. Few countries have a longstanding tradition of legal entitlements to ECEC access, such as Italy, which established in 1968 a legal right to a place in school-based ECEC for 3-6 year-olds and Sweden, which granted a legal right to free preschool to 6-year-olds in 1975.

The entitlement to free ECEC for 3- and 4-year-old children is targeted to children from a low income background in Korea and the Slovak Republic. Korea plans to extend its free ECEC provision to all 3- and 4-year-olds in 2013. However, this needs to be interpreted with caution, as pointed out in the 2012 OECD Economic Survey of Korea; even families that are classified as exempt from child care fees still spent about 5% of average household income on child care.

Approaches to ECEC provision for children under age 3 vary considerably across countries. Only a few countries have a right to ECEC access in place for all children in the ECEC age range, such as Finland, Norway and Sweden. The provision of such services is facilitated by the integrated system for child care and kindergarten. Furthermore, support is often combined with other schemes, such as maternity/paternity leave and gender equality in wages. Many other countries, including Korea, are refining their effective family and child care support. Considering the cost implications, ECEC policy for the youngest children is often designed as a targeted intervention that is co-ordinated with the length of maternity/parental leave.

Germany intends to implement a legal right to ECEC access for 1- and 2-year-olds, in addition to 3-6 year-olds, in 2013. Giving a legal entitlement is a costly policy for providers, and when it is announced without a sufficient resourcing plan, it could lead to a policy implementation failure. Thus, careful budget planning is required before launching a universal access policy.

If the policy objective is to boost female labour force participation, universal measures would be likely to incentivise more females to continue or resume working after giving birth to a child. This could increase the tax base through more income tax from increased female labour force. If the objective is to ensure equity in child outcomes, target measures would be more suitable, in particular, in time of financial difficulties. It would require careful alignment between the policy objective and the policy choice.

Table 4.2. **Legal entitlements to ECEC access**

Country	Type of legal entitlement	Year of implementation of the entitlement	Hours/days to entitlement	Aged covered	Scope	
					Universal[a]	Targeted[b]
Australia[c]	a	a	a	a	a	a
Western Australia	Legal right to preschool	1999	11 hours/week	4-year-olds	x	
Austria	Compulsory free ECEC	2010	4 hours/day	5-year-olds	x	
Belgium	a	a	a	a	a	a
Flemish Community	Legal right to universal preschool from age of 2½	m	28 Lesson Time (50 minutes)/week	2½-6 year-olds	x	
French Community	Legal right to universal preschool	m	5 days/week	2½-6 year-olds	x	
Canada	a	a	a	a	a	a
British Columbia	Legal right to kindergarten	Longstanding	4.75 hours/day	5-year-olds	x	
Manitoba	No legal right to kindergarten, however, all Manitoba's school divisions provide kindergarten	a	a	a	x	
Prince Edward Island	Legal right to kindergarten in the public school system	2010	5	5-year-olds	x	
Czech Republic	No legal right for preschool or care in place	a	a	a	a	a
Denmark	Legal right to a place in free preschool class in centres and primary schools	m	m	6-year-olds	x	
Estonia	Right to a place in kindergarten if parents request it	1999	8 hours/day 5 days/week	1½-7 year-olds	x	
Finland	Legal right to a place in centre-based or home-based ECEC after parental leave ends	1996	a	0-7 year-olds	x	
	Legal right to a place in a free pre-primary education in centres and primary schools	2001	4, max 5 hours/day	6-7 year-olds	x	
Germany	Legal right to ECEC services	2013	a	1- and 2-year-olds	x	
	Legal right to ECEC services	m	m	3-6 year-olds	x	
Brandenburg	Right to a kindergarten place	m	6 hours/day	3-6 year-olds	x	
Thuringia	Right to an ECEC place	m	full day	2½-6 year-olds	x	
Ireland	Legal right to a place in school-based preschool	m	m	4-6 year-olds	x	
Israel[d]	Legal right to a place in school (6-18 years) or kindergarten (3-6 years)	1984 (regarding kindergarten)	Kindergarten: 6 days/week for 220 days/year from 07:55 am to 13:30 or 15:40 pm	3-18 year-olds	x	
Italy	Legal right to a place in school-based ECEC	1968	m	3-6 year-olds	x	
Japan	No legal entitlements in place	a	a	a	a	a
Korea	Legal entitlement to free ECEC services	1997	m	5-year-olds	x	
	Legal entitlement to free ECEC services (Nuri Curriculum)	2013	3 to 5 hours/day	3-5 year-olds	x	
	Legal entitlement to free access to ECEC for children with low socio-economic background	2002	12 hours/day	5-year-olds		x
Mexico	Legal entitlement to free and compulsory attendance at school-based ECEC centre	Gradual implementation: for age 5, 2004-05; for age 4, 2005-06; for age 3, 2008-09	3 or 4 hours/day	3-6 year-olds	x	

Table 4.2. **Legal entitlements to ECEC access** *(cont.)*

Country	Type of legal entitlement	Year of implementation of the entitlement	Hours/days to entitlement	Aged covered	Scope	
					Universal	Targeted
Netherlands	Free preschool/kindergarten	m	5½ hours/day	4- and 5-year-olds (compulsory for age 5)	x	
New Zealand	No legal entitlements in place	a	a	a	a	a
Norway	Legal right to a place in kindergarten	2009	a[e]	(0) 1-5 year-olds	x	
Poland	A statutory right to one year of pre-primary education in a kindergarten or another type of preschool institution	2009	m	5-year-olds	x	
Portugal	Legal right to free *jardim de infancia* (kindergarten) enrolment	m	5 hours/day	3-6 year-olds	x	
Slovak Republic	One year of free preschool prior to primary school entry	2008	m	5-year-olds	x	
	Legal right to free ECEC services for children from low income families	2008	m	3-5 year-olds		x
Slovenia	Legal entitlement to an ECEC place	m	m	m	x	
	Legal entitlement to free ECEC services for the second child in family	2008	m	m		x
Sweden	Legal obligation to provide a place in ECEC for children/right to a place	1995	a	1-6 year-olds		x (working or studying parents)
	Legal right to free preschool class	1975	3 hours/day	6-year-olds	x	
	Legal right to a free preschool morning service	2003	3 hours/day	3-6 year-olds	x	
Turkey	Legal right to a place in school-based ECEC	m	m	3-6 year-olds	x	
United Kingdom	a	a	a	a	a	a
England	Legal entitlement to free ECEC	m	12½ hours /week	3- and 4-year-olds	x	
Scotland	Legal entitlement to free preschool	2007	475 hours/year	3- and 4-year-olds	x	

Note: a = Not applicable; m = Missing; x = Applicable.

a) Whether the legal right is universal, i.e. for all children.
b) Whether the legal right is only for a targeted/specific group.
c) Whilst nearly all jurisdictions in Australia (excepting Western Australia) do not have a legal right to preschool enshrined in legislation all ministers and the Commonwealth have committed to and funded access to ECEC for all 4-year-old children.
d) Information on data for Israel is available at: *http:/dx.doi.org/10.1787/888932315602*.
e) In Norway, parents normally pay a monthly fee. A handful of municipalities provide free kindergarten places (4 of 430 in 2009), and some provide 20 hours a week (part of a national project – trying out the effect for integration and social equity).

Source: OECD Network on Early Childhood Education and Care's Survey for the Quality Toolbox and ECEC Portal, June 2011.

Demand-side and/or supply-side[12]

Currently, there are imbalances between the supply and demand of ECEC services in Korea. While there are waiting lists for public kindergartens and child care, there is also a significant excess capacity in private providers, which tends to be of lower quality. With the continued rise in female labour force participation, there will be more demands for good quality ECEC services. It is important to address the issues of the affordability and a lack of places in higher-quality public centres today to accommodate the future demands. Under the current ECEC institutional arrangements in Korea, one suggested solution is to increase publicly provided child care from equity and quality assurance perspectives, which is of more transparent and consistent quality.

Generally speaking, countries with a low level of public spending on ECEC opt for subsidising families through vouchers, family allowances and tax measures (indirect, demand-side subsidies). However, a risk of indirect subsidising is an increasing gap in the use of high-quality provisions between high- and low-income groups (Eurydice, 2009). There is considerable uncertainty about the quality of services provided by the private sector, and it is difficult to monitor and control this quality.

The debate about financing ECEC on the demand side or the supply side often invites ideological and theoretical discussions. Proponents of demand-side financing typically argue for the importance of parental choice over a range of child care services, thus, strengthening competition between child care providers. Such competition will ensure the lowest possible cost for the quality chosen by requiring providers to constantly seek to innovate. Private providers respond best to these market incentives, and therefore they should be eligible for public subsidies (Cleveland and Krashinsky, 2003).

Proponents of supply-side financing typically believe that the market does not work particularly well for ECEC, as direct subsidies to parents do not solve all of the "market failures". In particular, parents are not well-placed to measure the quality of ECEC services, in contrast to other services and do not usually have sufficient information to monitor the quality of ECEC services. Institutions that provide the highest quality at the lowest price are not usually rewarded. The government, therefore, should monitor, promote and regulate quality and allocate public funds only to public or non-profit services because private ECEC services have strong incentives to cut costs. A competitive market invites mixed quality services and the low-cost producers will tend to drive the high-quality services out of the market (Cleveland and Krashinsky, 2003).

The research on the effectiveness of the demand-side versus supply-side interventions shows mixed results. Reviewing the consequences of implementing a child care voucher scheme in Australia, the Netherlands and the United States, Warner and Gradus (2011) suggest that the voucher system can be effective in increasing demand, but there can be uneven supply responses. They argue that voucher schemes must take into account the complex nature of the child care market and the substitutability among free public care, private market care and unpaid household care. To secure quality and access, the government must play a key role in securing quality and access (Warner and Gradus, 2011; Cleveland and Krashinsky, 2003).

Instead of providing demand-side subsidies, some countries chose to directly subsidise ECEC provisions, making ECEC a public investment. Evidence suggests that direct public funding of services brings more effective governmental steering of early childhood services, advantages of scale, better national quality, more effective training for educators and a higher degree of equity in access compared with parent subsidy models (indirect subsidy models) (OECD, 2006). Directly subsidising ECEC provisions can ensure that a minimum level of (high) quality is provided for all children and public providers can be more easily monitored. Additionally, if high quality is provided, cost-benefit studies show that the benefits significantly exceed the costs (Belfield et al., 2006; Cleveland and Krashinsky, 1998). Thus, publicly funded direct provision of ECEC would represent an efficient use of scarce public funds.

OECD (2012a) suggests a mixed package of demand-side and supply-side interventions for kindergartens and/or child care. To meet the excess demand for public child care and upgrade the quality of private institutions, which care for nearly 90% of the enrolled children, the survey suggests: *i)* expand the capacity of public kindergartens;[13] *ii)* prioritise extending public support for ECEC to all 3- and 4-year-olds starting in 2013, as planned; *iii)* align the standards and regulations to harmonise quality across public and private ECEC settings; *iv)* make accreditation mandatory for private institutions and raise its requirements; and *v)* remove entry barriers to promote competition, while partially offsetting higher tuition fees through increased subsidies to parents and with an introduction of a well-established information and accreditation system.

Box 4.2. Case Study: Ireland's shift from cash benefits to ECEC services

The Irish economy during 1994-2007 was referred to as "The Celtic Tiger", when economic growth averaged 7% per annum between 1997 and 2005. Unemployment declined from 13.2% in 1990 to 4.3% in 2006. The female labour force participation rate rose from 30% in 1985 to 59% in 2006. The national debt as GDP ratio declined from 65% in 1997 to 28% in 2005. From 2004-07, government spending increased by 7% per annum. Taxation rates were reduced (CGT 20%, CT 12.5%, Income Tax 20% and 41%). The main political party returned in three successive elections (1997, 2002 and 2007).

During this time, the government launched "Equal Opportunities Child Care Programme (EOCP)". It was an EU co-funded scheme for 2000-07. The budget was EUR 525 million over seven years, of which 50% was spent on capital, 34% on staffing, and 16% on quality improvement and supports. The scheme created and/or supported 40 000 child care places. The scheme was succeeded by the National Child Care Investment Programme 2006-10 (NCIP).

The EOCP also had a component focusing on staffing "EOCP Staffing Scheme". It provided start-up grants for not-for-profit services, generally linked to the EOCP Capital. It was originally designed for three years, but it was extended for services targeting disadvantaged children in late 2004-07. It spent about EUR 37 million in 2007.

In 2005, there were two bye-elections. The government announced the establishment of the Office of the Minister for Children (OMC) and the Early Child Care Supplement (ECS) to reduce the financial burden on parents spending on child care costs. ECS was designed, in response to political pressures, as "universal family benefit" (EUR 1 000 per annum, which rose to EUR 1 100 in the following year) for children under six and was exportable under EU regulations.

The proponents for ECS argued that it supported families with high child care costs, who also had high housing costs; supported all families regardless of child care choices; could be one of the possible reasons for increased fertility rates; and was a preferred approach of the Finance Ministry. The opponents argued that it did not support the ECEC sector; could be spent on non-child care expenses; was unlikely to improve access to preschool among disadvantaged children; would not facilitate improvement of standards in the ECEC sector; and was not the preferred approach of the Child care Directorate.

While the debates continued, the financial crisis hit the country in 2008. As a response to the crisis, the Community Child Care Subvention Scheme (CCSS) was launched for 2008-10. It replaced the EOCP Staffing Grant, based on the Value for Money Review of EOCP. The funding increased by 50%, but it now focused on disadvantaged children, whose access had been uneven. The scheme aimed at "targeted universalism".

During 2008-10, there was a massive downturn in economic activities, and tax revenues were cut back to the 2005 level. In 2008, the ECS was redesigned with the restored rate to EUR 1 000 per annum, the reduced eligibility to 5-year-olds for administrative savings. It was also widely accepted to be abolished and replaced by the Early Childhood Care and Education (ECCE) scheme in 2009.

The budget plan for the ECCE scheme was prepared by the Finance Minister's advisor and presented to the Minister for Children by the Minister of Finance. The scheme aimed at providing a free year of ECCE for all children usually when they are aged over 3 years and 3 months and less than 4 years and 6 months. It was intended to re-direct over EUR 170 million from ECS into ECCE, capitalising upon the child care places created through the EOCP.

The appeal of the scheme was for child well-being, such as that the scheme would support children who would *not* otherwise attend pre-school; support the costs of families who *would* have used preschool; safeguard child care services under severe strain; maintain employment in the child care sector, retaining trained/experienced staff; allow higher standards to be required of participating services; better long-term outcomes for all children.

The appeal of the scheme was that it provided a finance-saving perspective, such as that it would be more targeted; be seen as an intelligent use of limited resources; safeguard capital investment; maintain employment in the child care sector and lessen likely increases in welfare costs; support parents; and benefit all families as an educational measure.

Box 4.2. Case Study: Ireland's shift from cash benefits to ECEC services *(cont.)*

While it is currently in operation, some lessons learnt in the transition were reported by the concerned authorities as critical success factors:

- Link policy with a credible implementation plan.
- Demonstrate that the proposal meets needs that the general public understands and supports.
- Identify where the money will come from (and why).
- Think about how the scheme can develop.
- Know what you will compromise on, and what you cannot.
- Understanding Key Deliverables for the Finance Ministry.
- Value for money.
- Show immediate "return" to Exchequer if possible.
- Move quickly.

Source: Presentation by Mr. Darragh Doherty, Office of the Minister for Children & Youth Affairs (OMCYA), Ireland, at the 7th Meeting of the OECD Network on Early Childhood Education and Care, OECD, Paris.

The low fertility rate

Korea's fertility rates have decreased significantly around 1.2 births per woman since 2005, the lowest rate in the OECD (OECD, 2012a). The high level of household spending on ECEC and other education is a factor negatively affecting fertility in Korea, according to a recent survey of Korean parents. Due to these low fertility rates, Korea's population currently the third youngest in the OECD area will be the second oldest in less than 40 years time (OECD, 2011c).

Governments face a double challenge of encouraging women to both have children and work, which compete with each other for the uses of their time. The availability of formal child care has a positive effect on fertility intentions according to a recent OECD study (OECD, 2011a). Unlike in most OECD countries, in Korea, the high costs for ECEC services borne for parents is one reason that prevents women from having children; 44% of Korean women aged between 20 and 39 cite child care and education costs as a key barrier to having children (OECD, 2011a). While the relationship between the level of family cash benefits and fertility rate tends to be positive but weak, there is a strong cross-country relationship between total fertility rates and the availability of child care for children aged less than 3 (Sleebos, 2003).

If boosting fertility rate is the target policy outcome, it is more likely that indirect policies, such as providing affordable, high-quality ECEC for all families, would be more effective than direct policies, such as tax payments or cash benefits. However, achieving a positive impact requires the coherent application of a range of well-designed interventions consistently over time. Also, while indirect policies, such as ECEC programmes, are a better predictor of a country's fertility rates, we cannot establish a causal relationship with the data currently available.

OECD (2012a) suggests that the availability of affordable, high-quality child care would also help achieve the government's goal of boosting the fertility rate. OECD studies have found a positive relationship between child care and the fertility rate (D'Addio and

Mira d'Ercole, 2005). Boosting the fertility rate also depends on reducing the burden of education, including ECEC, for families with all income levels. In this respect, universal ECEC provision is preferable for Korea, but its implementation will need to consider the financial and political sustainability, given the constraints on public expenditure.

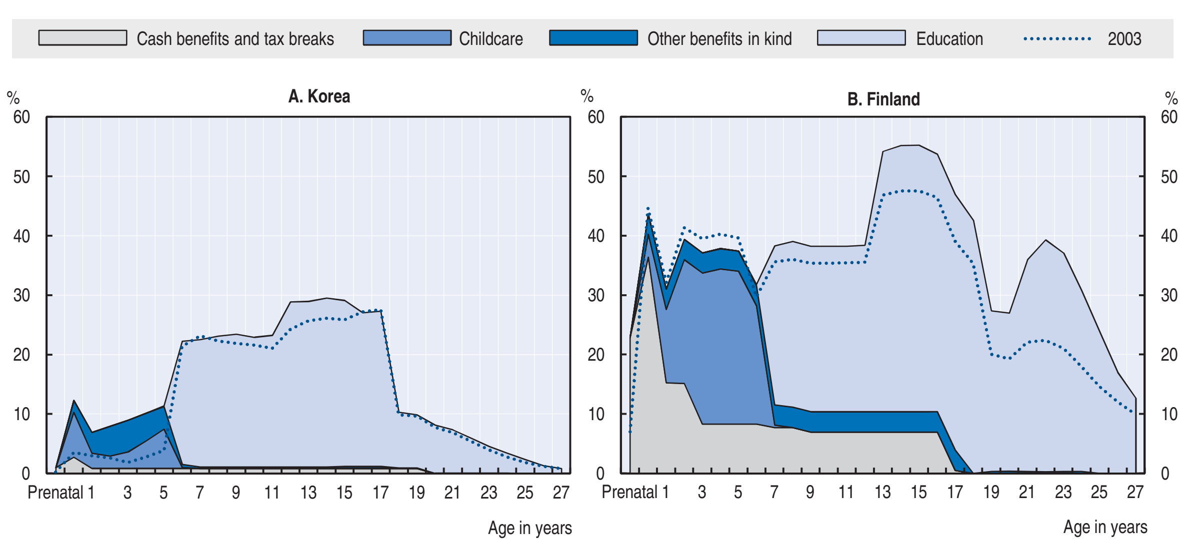
4.4. Reviewing public responsibility and investment, and identifying policy issues

Korea also included public responsibility and public investment as an ECEC policy goal in the OECD survey. There is a growing consensus among OECD countries that ECEC is not consumption but an investment, and it is a public responsibility to ensure that children have a fair and strong start in life. Public spending indicators show that Korea needs efforts to improve. For family benefits, early education, child care and other in-kind services, Korea spends the least or close to the least among OECD countries. In a period of fiscal consolidation, the relative effectiveness of cash benefits and ECEC services in meeting the different policy objectives should be evaluated carefully to ensure the best ways to improve child support policy.

Low public spending on early childhood education and care

An OECD study, published in *Doing Better for Families*, shows that Korea significantly increased its public spending per child under age five between 2003 and 2007 (Figure 4.9).[14] Nevertheless, the study indicates that Korea still stands out as having the least spending at most points in the child life cycle, with around 30% of median household income spent at all points (OECD, 2011a). Although Korea's spending on ECEC per child significantly increased from 2003 to 2007, the international comparison highlights that it is still far below Nordic countries focus public spending in early years of childhood (Figure 4.9, Panel B). Indeed, as mentioned earlier, the share of public expenditure on pre-primary education is the lowest and that of household expenditure is the highest in Korea according to the latest OECD data (OECD, 2012c). Finland is selected as a reference country for comparison as Korea often compares its policy inputs with Finland's to identify different approaches to producing similar outcomes, such as on students achievements on the PISA assessments.

Figure 4.9. **Average social expenditure by child by intervention as a proportion of median working-age household income, 2007**



Source: OECD (2011), *Doing Better for Families*, OECD Publishing, *http://dx.doi.org/10.1787/9789264098732-en*, Figure 2.4.

In the absence of direct public funding or parental subsidies, there is greater risk that ECEC services will vary in quality, or that access to high-quality ECEC will be restricted to more affluent families (OECD, 2006). Low-income families suffer most in this situation as access to ECEC services depends largely on the availability of free or low-cost – publically funded services as they have fewer resources for private services (Cleveland and Krashinsky, 2003). This is problematic, given that ECEC can help to ameliorate disadvantages and can enhance child outcomes for children, especially those considered "at risk" (OECD, 2007b).

In the last decade, the Korean government has implemented three main ECEC policies to lessen the financial burden on households for ECEC. First, a targeted programme to support low-income and middle-class families was implemented in 1999, although the programme benefited more low-income families (originally with a focus on children with farming and fishing families). The programme could not cover 100% of the expenses for the low-income families. Needless to say, it could not cover middle-class families and, thus, the financial burden persisted (Jung, 2010). To improve the programme, access was expanded in 2004 by providing 3-4 year-olds with income-contingent subsidies for ECEC services. In 2009, the eligibility criteria on the income levels for families have been revised.

Second, free early education was legislated in 1997 for all 5-year-olds and finally achieved in 2012. It will be extended to 3- and 4-year-olds, staring in 2013 by providing a monthly allowance to parents of children who attend a kindergarten or child care centre. The government should prioritise this planned extension of free ECEC to all 3- and 4-year-olds starting in 2013. It is important to consider that "free" ECEC in the Korean contexts would not mean the same in the OECD countries. The government should design "free" ECEC, detailing the number of hours provided as free (half-day or full-day) with consideration of children from low-income families. The eligibility concerning the intensity of the programme (full- or half-day) could also factor in the mother's employment status to encourage female labour force participation.

Third, the government decided to increase the child care budget on child care by 36% in March 2012 for children from birth to 2 years. In September 2012, the government had to redesign the programme by changing from full subsidy to partial subsidy for the top 30% of households, as the policy was considered as "not viable". The government should reconsider whether this policy remains a priority under the current budget constraints, especially where local governments are responsible for funding this policy. The OECD suggests that the government focus on phasing in free ECEC for 3- and 4-year-olds.

Low public spending on child benefits (cash or tax credits)

Regarding public expenditure on family cash benefits and tax credits, as a percentage of GDP in 2007, Korea has the lowest expenditure level as a share of GDP in 2007 among OECD countries (OECD, 2011a). However, since 2009, child-rearing allowances for low-income families with children under age 2 has been provided to parents who do not use ECEC services and gradually expended to the lower 70% of the income distribution.

In many countries, child support policy is delivered with a combination of cash benefits, tax credits, education and care, and other in-kind supports at different times and with different policy objectives. In a period of fiscal consolidation, ECEC policy should be evaluated carefully against the different policy objectives and ensure the most efficient and fair ways of reforming child support policy. From the fertility, labour market and equity perspectives, family benefits may not be the priority policy choice as the evidence suggests that the effect of family benefits on fertility *per se* is limited. Moreover, lower-income households are more likely to take up home-care cash benefits and stay out of work for a long period of time (OECD, 2011a).

From the child development perspective, ECEC interventions may be found to be more effective than cash benefits (Nores and Barnett, 2010). The impact is the largest for ECEC for cognitive and schooling outcomes, while nutrition services have the largest effects on social outcomes. Cash incentives, referring to the family benefits, have shown smaller effects in these areas while they have shown effects similar to nutrition services for health outcomes (Table 4.3).

As Korea responded to the OECD survey that boosting fertility is part of its ECEC goals, it should design measures to tackle the falling fertility rate, such as universal access to affordable, high-quality ECEC services. A universal ECEC policy can also ensure that all children have access, without stigmatising them. But it is costly for the government. Under growing fiscal pressure, Korea could consider a "cascaded" approach, which is a combination of universal and targeted approaches, as it is considered to be an efficient model (OECD, 2011a).

For example, half-day free ECEC can be delivered for all children, with full-day free ECEC for children with parents with low socio-economic status.In most countries, disadvantaged families have less access to (good quality) early childhood care and education provisions (Chan and Mellor, 2002; Magnuson and Waldfogel, 2005; LoCasale-Crouch et al., 2007; OECD, 2001; and Sylva et al., 2007). Stipek et al. (1998) found that, in the United States, pre-primary schools for low-income and disadvantaged children are often more oriented on didactic and basic skills and have a negative social-emotional climate, and often employ lower educated teachers. Phillips et al. (2000) found that day care centres and pre-primary schools with higher educated and better paid staff, with lower staff-child ratios and higher classroom quality had higher parental fees. This makes higher quality provisions less accessible, especially for low-income groups. A study by Sylva et al. (2007) in the United Kingdom (England) provides similar social selective evidence for the use of pre-primary education and care. Although these findings pertain to the United States and the United Kingdom, they may be indicative for other countries with largely private pre-primary care and education systems as well – such as Korea. This constitutes an obstacle to using early education and care as a means to enhance educational opportunities of children.

Full-day free ECEC can be provided to children with working parents in order to support women with children to work. Child benefits can further be provided to low income-level families as part of anti-poverty measures as well as for better health outcomes.

Table 4.3. **Effect magnitudes by type of early childhood development policy**

Percentage of one standard deviation

	Nutrition	Cash incentives	ECEC
Cognitive	0.26	0.17	0.35
Social	0.46[a]	0.21	0.27
Schooling	0.11	–	0.41
Health	0.38	0.38	0.23

– Not applicable.

a) Only one study in this category.

Source: Nores, M. and W.S. Barnett (2010), "Benefits of Early Childhoo, Interventions Across the Word: (Under)Investing in the Very Young", *Economics of Education Review*, Vol. 29, pp. 271-282.

4.5. Conclusions

With widening income inequality, growing relative poverty and rapid population ageing, Korea faces the challenges of ensuring maintaining social cohesion while sustaining economic growth. Public awareness and political commitment are required, and public spending on ECEC must be considered *not as a consumption* but *an investment* in: children to develop a strong foundation for better life chances; women to be able to work after childbirth and balance their family responsibilities; and families to remove obstacles to raising children. To make this possible, a combined package with the right mix of ECEC policy measures is needed.

The key policy suggestions include: *i)* prioritising extending public support for ECEC to all 3- and 4-year-olds, such as by increasing the capacity of public kindergartens, as well as supporting infants and toddlers with a different combination of ECEC policy measures; *ii)* relaxing the price ceilings and entry barriers for child care to promote quality, accompanied by subsidies to parents to ensure affordability; *iii)* creating an effective accreditation, monitoring and information system – common to both kindergartens and child care – so that parents can make an informed decision about their choice for an ECEC provider; *iv)* ensuring effective implementation of the common curriculum for 5-year-olds in child care and kindergarten, continuing the harmonisation for 3- and 4-year-olds, and aligning and upgrading the programmes for younger children with the common curriculum; and *v)* setting out common regulations and standards (e.g. staff qualifications, staff-child ratio) for all children aged 3 to 5, regardless of whether they attend kindergarten or child care. This could be accomplished through a gradual integration of the administration of kindergarten and child care, at least for children aged 3 to 5.

Notes

1. The Act aims to facilitate the establishment of public kindergartens. Public kindergartens can be established such as by being attached to primary/secondary schools or newly created as independent entities, depending on the local conditions of a city or a province.

2. The system should be common to both kindergartens and child care services so that it can capitalise on the new system on monitoring and information for kindergartens that has been implemented since September 2012.

3. This will be presented in comparison with the OECD average and the highest scored country (at the maximum value of 100) and the lowest scored country (at the minimum value of 0). First, this can help visualise where Korea stands against international standards. Second, it can imply which outcomes might require more policy attention in the international comparison perspective, independent of the domestic policy discussions. Third, it can set the scene for Korea to reflect upon how its selected focus could help improve the target outcomes.

4. The estimates of the proportions of public and private spending on ECEC have been calculated, for a research purpose, based on the estimates on the enrolment numbers and the budget for 2012 and 2013 by Professor Eun Hye Park and Professor Eun Soo Shin. The Standardised Educational Fee (tuition) for NURI per child is calculated as KRW 380 000 per month, KRW 4 560 000 per year, which was endorsed by the government on 16 January 2013. The NURI voucher begins in 2012 for 5-year-olds (with KRW 200 000), and 3-5 year-olds (with KRW 220 000) in 2013. Before 2012, the voucher was provided for the lower 70% income families. Financial Support for Kindergarten includes support for teachers in the private sector, full-day programme support, building reconstruction, etc. for 2012 (with KRW 80 000) and 2013 (with KRW 80 000).

5. Proficiency Level 2 in PISA is considered a baseline level where students face a disproportionately higher risk of not continuing onto later stages of education, failing to find employment at age 19, and having worse outcomes at age 21 (OECD, 2010a).

6. Percentage of explained variance in student performance, defined as the "strength of the relationship between student performance and the PISA index of economic, social and cultural status".

7. Research argues that qualification is a key factor: it is not the level *per se* but more so about contents and specialisation of the teacher education and training.

8. While staff-child ratio in pre-primary education is positively associated with student learning outcomes at age 15, PISA suggests that increasing the duration of pre-primary education by one year can raise scores by ten points compared to only one point by reducing staff-child ratio (OECD, 2011b).

9. Scaffolding is a pedagogy that aims to promote a learning process and a deeper learning by providing support during the learning process which is tailored to the needs of the student with the intention of helping the student achieve his/her learning goals.

10. The jurisdictions included in the research are: Finland, Greece, Hong Kong, Indonesia, Ireland, Italy, Poland, Spain, Thailand and the United States.

11. *A legal entitlement* refers to a right by legislation (law) to access to an ECEC programme for a particular group. This can be, for example, a right to a place in an ECEC centre, a legal entitlement to free ECEC for 3-6 year-olds, or free early education for children with a low-income background. *Universal entitlement*: A legal entitlement for all children in a

certain age group, e.g. to all 4- and 5-year-olds, or all children below the age of 6. *Targeted entitlement*: An entitlement limited to a specific group of children meeting specific requirements, such as children from a low socio-economic background or children of working parents.

12. Demand-side financing is funding directed towards parents, either in the form of a tax credit based on eligible child care expenditures, or some kind of voucher which parents can "spend" buying child care services; supply-side funding is directed to accredited ECEC providers.

13. The survey suggests: "There is scope to finance increased outlays for ECEC through reallocations within the overall education budget, particularly as school rolls shrink. Indeed, outlays per student in kindergarten were only 37% of that in primary and secondary schools, well below the OECD average of 70%."

14. OECD (2011a), *Doing Better for Families*, suggests that Korea increased in social spending between 2003 and 2007 in the early years. However, the social spending profile still resembles an "inverted U". It is comparatively low during the ECEC period before it rises to a peak in the early- to mid-teens, and thereafter tailing off. Such pattern is likely to reinforce inequality, at least in qualitative terms. In comparison, some countries follow a "front-loaded" pattern, such as the Czech Republic, Hungary and Iceland, and Estonia, Norway and Slovenia to some extent. This means that countries place a stronger emphasis spending in the ECEC period, creating left-to-right sloping triangular shape. In general, education spending patterns are highly path-dependent, i.e. historical spending patterns can drive future spending patterns, for example, maintaining school buildings. Countries could do more to re-orient public resources towards the early years. For example, whilst maintaining overall investment in tertiary education, countries could envisage a greater role for private investment and a well-developed system of student loans (i.e. a system that recoups costs from later earnings whilst minimising disincentives on educational aspirations of older children regardless of their socio-economic background). The public resources so freed up could be geared towards young children.

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Annex 4.A1

Notes, methodology and data sources to the spider webs

Table 4.A1.1. **Overview of available indicators per country: Policy outcomes**[a]

Country	Fertility	Infant survival	Children under age 18 above poverty line	Enrolment in formal care for children under age 3	Enrolment rates at age 3	Enrolment rates at age 5	PISA Reading, Mathematics and Science	Female employment ratio (25-49 age cohort)	Gender equality in median earnings of full-time employees
Australia	X	X	X	X	X	X	X	X	X
Austria	X	X	X	X	X	X	X	X	X
Belgium	X	X	X	X	X	X	X	X	X
Canada	X	X	X	X	m	m	X	X	X
Chile	X	X	X	X	X	X	X	m	m
Czech Republic	X	X	X	X	X	X	X	X	X
Denmark	X	X	X	X	X	X	X	X	X
Estonia	X	X	X	X	X	X	X	X	m
Finland	X	X	X	X	X	X	X	X	X
France	X	X	X	X	X	X	X	X	X
Germany	X	X	X	X	X	X	X	X	X
Greece	X	X	X	X	m	X	X	X	X
Hungary	X	X	X	X	X	X	X	X	X
Iceland	X	X	X	X	X	X	X	X	X
Ireland	X	X	X	X	X	X	X	X	X
Israel[b]	X	X	X	X	X	X	X	m	m
Italy	X	X	X	X	X	X	X	X	X
Japan	X	X	X	X	X	X	X	X	X
Korea	X	X	X	X	X	X	X	X	X
Luxembourg	X	X	X	X	X	X	X	X	m
Mexico	X	X	X	X	X	X	X	X	m
Netherlands	X	X	X	X	X	X	X	X	X
New Zealand	X	X	X	X	X	X	X	X	X
Norway	X	X	X	X	X	X	X	m	X
Poland	X	X	X	X	X	X	X	X	X
Portugal	X	X	X	X	X	X	X	X	X
Slovak Republic	X	X	X	X	X	X	X	X	m
Slovenia	X	X	X	X	X	X	X	X	m
Spain	X	X	X	X	X	X	X	X	X
Sweden	X	X	X	X	X	X	X	X	X
Switzerland	X	X	X	m	X	X	X	X	X
Turkey	X	X	X	m	X	X	X	X	m
United Kingdom	X	X	X	X	X	X	X	X	X
United States	X	X	X	X	X	X	X	X	X

a) The table shows the availability of the indicators for each country; "m" refers to *missing* and "X" to *available*;
b) Information on data for Israel is available at: *http://dx.doi.org/10.1787/888932315602*.

Source: As mentioned in Table 4.A1.2.

Table 4.A1.2. **Spider web methodological notes and data sources: Policy outcomes**

Indicator	Notes	Source
Fertility	Year 2009 or latest available year. 2007 for Belgium and Canada; 2008 for Australia, Germany, Greece, and Iceland.	National Statistical Offices, 2010, and Eurostat Demographic Statistics, 2010 (*OECD Family Database*, 2011).
Infant survival	Year 2008 or latest available year. 2007 instead of 2008 for Canada and Ireland; 2006 for Korea and the United States. Infant survival rates are calculated as the inverse of the infant mortality rates (deaths per 1 000 live births).	OECD Health Data 2010, June 2010 (*OECD Family Database*, 2011).
Children under 18 above poverty line	Data refer to 2006 for Japan; 2007 for Denmark and Hungary; 2009 for Chile. Children under 18 above poverty line reports the inverse of poverty for children under 18.	OECD Income Distribution Questionnaire, version October 2011, for OECD countries; EU-SILC 2009 for non-OECD countries
Enrolment in formal care for the under 3s	Year 2008.	For children aged 0-2: Australia, ABS Child care service (2008); Canada, National Longitudinal Survey of Children and Youth (2008); Japan, *Statistical Report on Social Welfare Administration and Services* (2008); New Zealand, Education Counts' statistics (2008); United States, Early Childhood Programme Participation Survey (2005); European countries, EU-SILC (2008) [except Germany: administrative data]; Nordic countries: NOSOSCO (2007-08); Other: national authorities. For children aged 3-5: *OECD Education Database*; Canada, National Longitudinal Survey of Children and Youth (2008); Korea, Ministry of Health and Welfare (2010); and Eurostat (2008) for non-OECD countries.
Enrolment rates at age 3 and 5	Year 2009. At age 3, OECD does not include Greece and Canada.	*OECD Education Database*, November 2011. Data for Korea come from national sources for year 2010.
PISA Reading, Mathematics and Science	Year 2009. PISA: Programme for International Student Assessment.	*OECD, PISA 2009 Database*.
Female employment ratio (25-49 age cohort)	Year 2008 or latest year available. 2007 for Sweden; 2006 for Mexico and Switzerland; 2005 for Australia, Japan, New Zealand and the United States; 2002 for Iceland; 2001 for Canada; 1999 for Denmark.	European Labour Force Surveys (2007-08) for EU countries; Australia: Australian Bureau of Statistics (2005); Canada: Statistics Canada (2001); Denmark: Statistics Denmark (1999); Iceland: Statistics Iceland (2002 for women aged 25-54); Japan: Japanese national census (2005); Mexico: Encuesta Nacional de la Dinamica Demografica 2006; Switzerland: Swiss Labour Force Survey (2006); United States: US Current Population Survey (2005). (*OECD Family Database*, 2011).
Gender equality in median earnings of full-time employees	Year 2008 or latest year available. Data refer to 2005 for the Netherlands and to 2007 for Belgium and France. The gender wage gap is unadjusted and is calculated as the difference between median earnings of men and women relative to median earnings of men. Estimate of earnings used in the calculations refer to gross earnings of full-time wage and salary workers. However, this definition may slightly vary from one country to another.	*OECD Earnings Distribution Database.*

Chapter 5

Moving from hospitals to primary care for chronic diseases

This chapter provides policy recommendations to help develop stronger primary care in Korea, by suggesting a new type of service delivery – multi-specialty group practices (polyclinics). It examines the rapid growth of health care costs, fuelled by payments that encourage the delivery of high volumes and complex services. Hospitals dominate Korea's health system, which also has one of the highest of avoidable hospital admissions in the OECD. At a time when more Koreans are facing health problems as they get older, primary care services that help people manage health conditions like diabetes and heart diseases are under-delivered. Improving access to high quality primary care services can decrease health inequalities and contribute to social cohesion.

5.1. Introduction

Within less than 30 years, Korea has made remarkable strides in health, controlling communicable diseases, and rapid improvement in life expectancy. Korea has also undertaken one of the most dramatic transformations of its health care system among OECD countries during the past 30 years. Universal access to health insurance was achieved in a very short time span through multiple insurance funds, which were consolidated into a single fund in 2000. This has created a strong institutional framework.

Having pursued these major reforms during the past decade, successive Korean governments have gradually expanded the number of items financed under basic insurance to reduce the high out-of-pocket costs that Koreans face compared to other OECD countries. This helps explain the rapid growth of health care spending per capita at an average rate of 8% per year since 2002, faster than any other OECD country and more than double the OECD average of 3.6% per year over the same period.

While reforms over the past decade have focused on the financing of health care and delivering greater financial protection across the population, health care providers have developed organically with little regulation. Today, Korea is one of the most competitive markets for health care amongst OECD countries with a growing hospital sector. Health care is dominated by private providers and there is little regulation on the scope of practice for hospitals and ambulatory care. The government barely intervenes to influence the location of services compared to other OECD countries.

Korea's health insurance pays both hospitals and physicians on the basis of how many services they deliver ("fee-for-service"). Prior to 2000, this included paying for pharmaceuticals that were dispensed by physicians. In 2000, prescribing and dispensing were separated, which led to a significant loss of income to providers. They responded by expanding services, particularly more complex services that paid more, contributing to the rapid growth of health care spending in Korea.

This organisational structure has benefitted large tertiary hospitals that are ideally suited to high volume and high complexity services. It has also encouraged independent practitioners and smaller health care facilities to try to scale up or to deliver more complex services.

In this environment, the services that tend to be most likely to be under-delivered are primary health care. They generally involve higher levels of patient counselling, less technological intensity, and are relatively less expensive. The *OECD Review of Health Care Quality in Korea* (OECD, 2012b) provided a number of policy recommendations, including strengthening the focus of governance on quality of care, using better financing methods to drive improvements in quality of care in hospitals and improving care for cardiovascular diseases. A central message of this review was that in order to be better prepared for tomorrow's challenges, Korea ought to shift the centre of gravity in its health care system towards primary care and away from hospitals. This chapter seeks to build on the earlier review by detailing the case for primary care and providing policy recommendations to develop a stronger primary care sector. The recommendations contained in this chapter come in two parts, the first are to put the "building blocks" for better primary care in place, for which it is recommended that Korea:

- Proactively use the single insurer to rebalance growth in spending away from hospitals and towards developing primary care services.
- Decrease financial barriers to accessing primary care services by decreasing co-payments to ensure access to primary care to decrease health inequalities and increase social cohesion.
- Increase payments for preventative services, patient counselling and management of chronic health care conditions delivered in primary care.
- Create a new system of primary care based on multi-specialty group practices (polyclinics) staffed by private practitioners.
- Create model primary care polyclinics in medical schools and expand undergraduate and postgraduate training of doctors and nurses in primary care.
- Develop clinical guidelines for primary care, strengthen primary care professional societies and provide better access to information for patient self-management.

Beyond these policies, the critical challenge for the future is to establish this new model of multi-specialty group practices (polyclinics). This model ought to:

- Change the method of paying hospitals from fee-for-service towards a capped system of Diagnosis Related Groups (DRGs). DRGs should be expanded to cover all hospital services and there should be volume caps to prevent excessive growth in hospital spending.
- Provide increased funding to primary care by raising the reimbursement rate for preventative services, counselling and management of chronic diseases; complemented by a pay-for-performance (P4P) scheme to reward high quality primary care.
- Provide targeted government investment to build polyclinics and remove the regulatory and financial barriers in contracting with private practitioners.
- Incentivise primary care to co-ordinate with other public services (e.g. education, employment, social protection) to ensure cross-sectoral collaboration to improve outcomes and increase social cohesion.

5.2. Defining primary care

There is considerable debate as to what constitutes "primary health care" and considerable diversity in how OECD countries organise services that provide the first point of contact with patients. WHO defines primary care as "providing the basis for person-centeredness, continuity, comprehensiveness, and integration. Barbara Starfield, the foremost expert on primary care, states "primary care is the provision of first-contact, person-focused, ongoing care over time that meets the health-oriented needs of people, referring only those too uncommon to maintain competence, and co-ordinates care when people receive services at other levels of care". A primary care team would do such things as offering health promotion and disease prevention; delivering public health services such as vaccinations; diagnosing common health problems like hypertension and depression; referring and co-ordinating health care for patients – managing their journey through the health system. Following the early lead of the United Kingdom, some OECD countries having been moving towards larger clinics with multi-disciplinary teams or polyclinics providing a wide range of services and which serve as the co-ordinating hub for all health services.

Primary care in Korea is more similar to that in the United States, which has not had a tradition of the public provision of primary health care. Instead, it relies on independently operated specialist health care practitioners. During the 1970s, the United States saw the establishment of the "speciality of family medicine" and primary care sub-specialities, such as ambulatory-focused internal medicine and paediatrics. Primary care in Korea (as in the United States) is often synonymous with health care that is delivered by a doctor trained in addressing a wide range of health care needs of lower acuity, who is referred to as a doctor specialising in "family medicine". Unlike Korea however, the United States also has a tradition of integrated service delivery models, or health maintenance organisations, where primary care and hospital physicians are combined into a single entity and received a capitated payment from common health insurers.

5.3. The health system faces looming challenges

Life expectancy has improved dramatically in Korea in recent decades

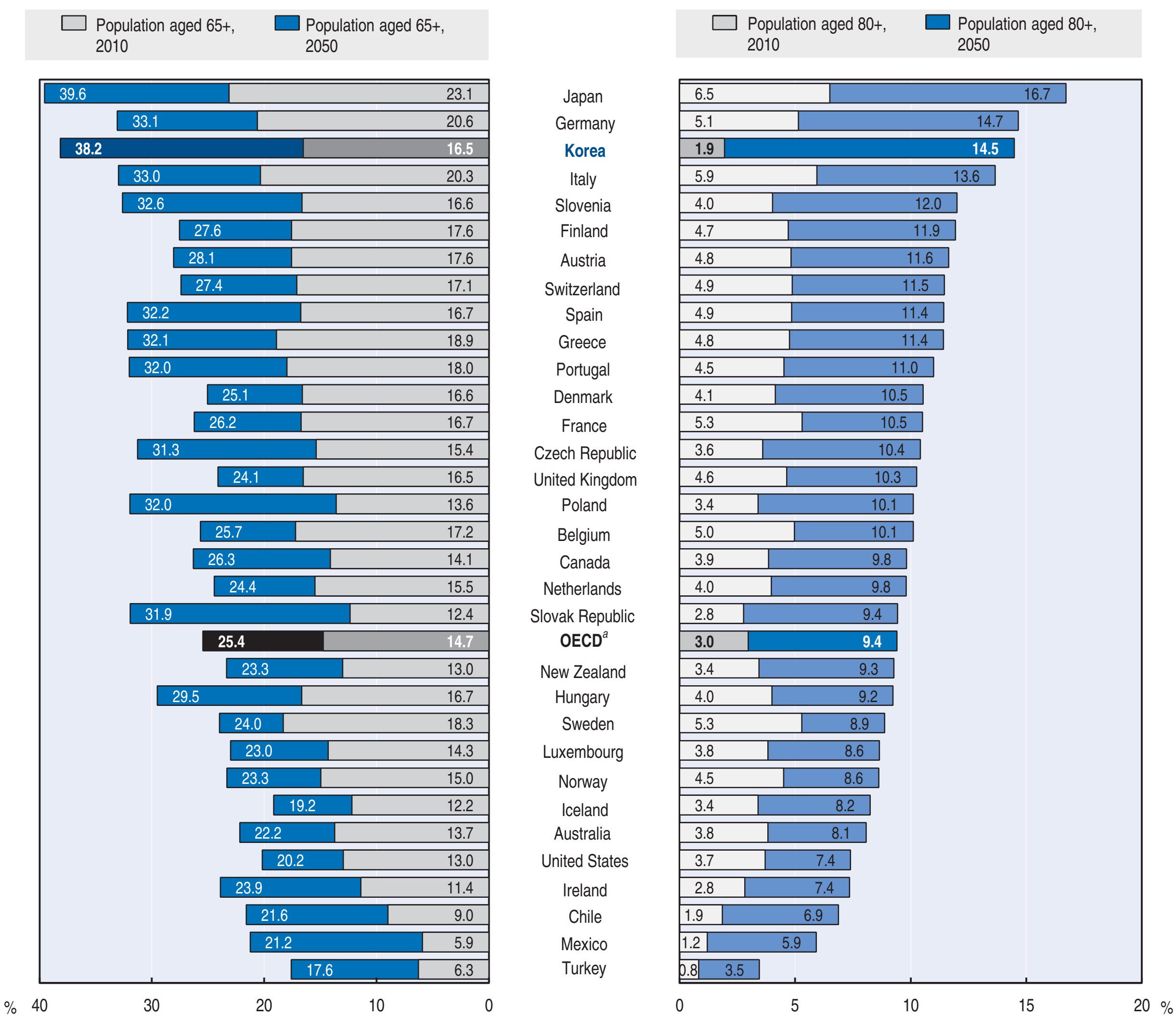
Korea has achieved major strides in improving the overall health of its population in recent years. In 1960, the average Korean could look forward to around 51 years of life. By 2009, life expectancy for the average Korean had risen to 80.3 years – a 57% increase to a level that is above the OECD average of 79.3. As in many OECD countries, life expectancy gains for people aged 65 have been similarly substantial, with Korea outpacing every OECD country (for which data are available) since 2000. In 2009, the average male and female Korean aged 65 could expect to live for another 17.1 years and 21.5 years, respectively compared to OECD averages of 17.1 years and 20.4 years. Korea has also recorded an impressive decline in the infant mortality rate, another key indicator of population health. In 1970 the rate stood at 45 per 1 000 live births. By 2009, it had dropped to 3.5, which is below the OECD average and on par with Germany, Belgium and Italy (OECD, 2012a).

It is likely that these significant improvements in life expectancy reflect the rapid pace of economic development in Korea as much as the influence of the health system or public health practices. In seeking to measure the impact of the health care system, it is important to look at its impact on areas within its influence. The OECD's Health Care Quality Indicators project measures specific health care outcomes in areas where the health services can make a major difference to life and morbidity outcomes.

Korea's substantial elderly population is likely to live longer and suffer from multiple chronic diseases

Population ageing in Korea will be the fastest in the OECD area through 2050. In 2010, persons aged 65 years and above represented 16.5% of the Korean population, slightly higher than the OECD average of 14.7%. Similarly, those aged 85 and over represented 1.9% of the Korean population, slightly lower than the average of 3.0% among OECD countries. By 2050, the number of persons aged 65 years and above in Korea is projected to climb to 38.2% – the second highest level among OECD countries and significantly higher than the OECD average of 25.4%. Most dramatically, persons aged 85 or above are projected to grow to 14.5% of Korea's population, placing it behind only Japan and Germany (Figure 5.1). Significantly longer life spans means that a larger share of the population is likely to be actively managing a chronic health condition.

Figure 5.1. **Shares of the population aged over 65 and 80 years in OECD countries will increase significantly by 2050**



a) Unweighted averages of the 32 OECD countries shown above.

Source: OECD Demography and Population Database.

The demographic shift will apply significant pressure on an already stretched health system as patients seek care across multiple settings and across different clinical and non-clinical specialisations. This will require more frequent use of health services, particularly to help patients who will live longer while managing a chronic condition.

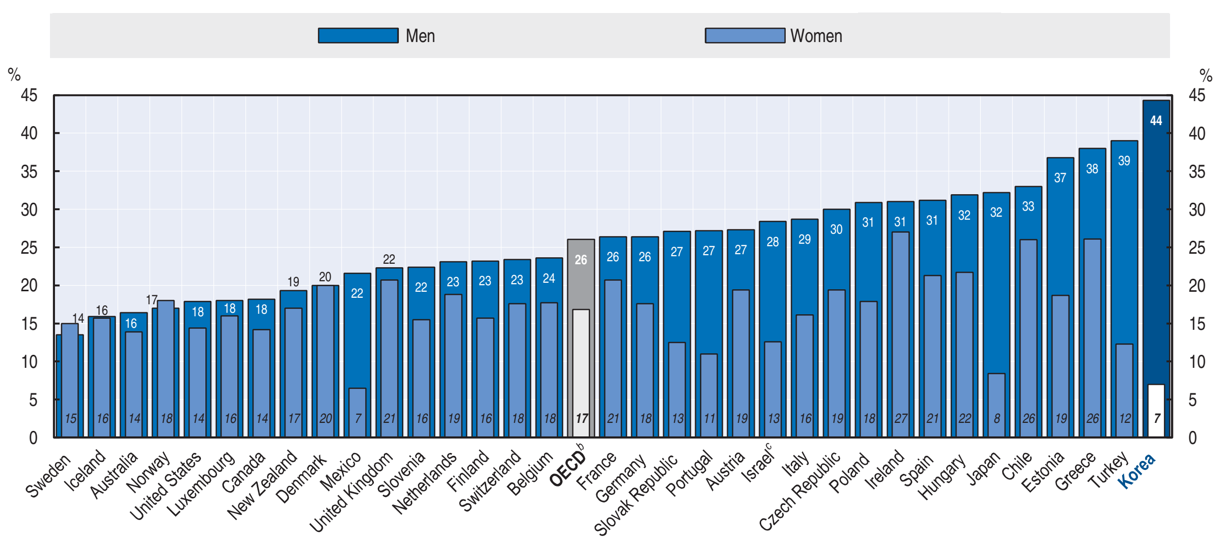
Risky health behaviours amongst the population today may mean that more Koreans will face chronic diseases

The increase in risky lifestyle behaviours amongst Korea's population is cause for concern. As is the case across the OECD, Korea's economic development has been accompanied by changes in dietary habits that result in a steady increase in the total level of fat intake. Data from the Korean National Health and Nutritional Examination Survey showed that the prevalence of abdominal obesity, which is associated with various forms of chronic disease including diabetes, increased among adults aged 20 and over by almost 9% over the period 1998-2007 (Lim et al., 2011). The OECD projections indicate that Korea's current obesity rates will rise by a further 5% within ten years (Sassi, 2010). Inevitably, this increase in obesity will result in more Koreans suffering from chronic diseases such as diabetes, cancer, cardiovascular and respiratory conditions (Berry et al., 2011).

Smoking rates are also a public health concern, as it is a major risk factor for cardiovascular disease, cancer, chronic obstructive pulmonary disease (COPD) and asthma. While having fallen considerably from very high levels during the 1980s, Korean males still have smoking rates that are among the highest across OECD countries (Figure 5.2). While the proportion of women who smoke is the lowest in the OECD, those that do are likely to start at a younger age and are therefore exposed to the harmful effects of smoking earlier in life. This underlines the importance of comprehensive health promotion and preventive action for both males and for females.

Figure 5.2. **People smoking daily in OECD countries, by gender, 2011 or latest year available[a]**

Percentage of 15-year-olds and over



Note: Countries are ranked in ascending order of the male category.

a) Data refer to 2006 for Austria, Mexico and Portugal, 2007 for Ireland, New Zealand, Slovenia and Switzerland, 2008 for Belgium and the Czech Republic, 2009 for Canada, Chile, Germany, Greece, Hungary, Iceland, Israel, Korea, Poland, the Slovak Republic, Spain, Sweden, the United Kingdom and the United States, 2010 for Australia, Denmark, Estonia, Finland, France, Japan, the Netherlands and Turkey, and 2011 for Italy, Luxembourg and Norway.

b) Unweighted averages of the 34 OECD countries shown above.

c) Information on data for Israel is available at: *http:/dx.doi.org/10.1787/888932315602*.

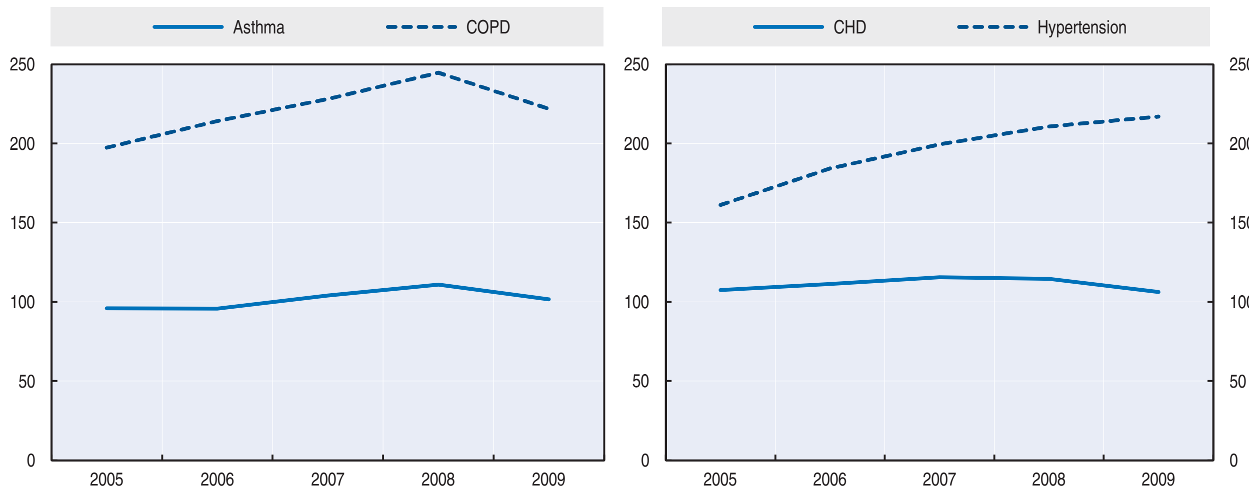
Source: OECD Health Database 2012, *www.oecd.org/els/health-systems/*.

High avoidable hospital admissions point towards weaknesses in primary care

Korea performs consistently poorly on indicators on the ability of primary care services to reduce hospital admission. Korea has persistently high admission rates for COPD and asthma. While asthma has remained constant, COPD admissions appear to be rising (Figure 5.3). Hypertension admission rates are also high and have increased steadily over the past few years.

Figure 5.3. **Potentially avoidable hospital admissions rates in Korea, 2005-09**

Per 100 000 patients admitted to hospital



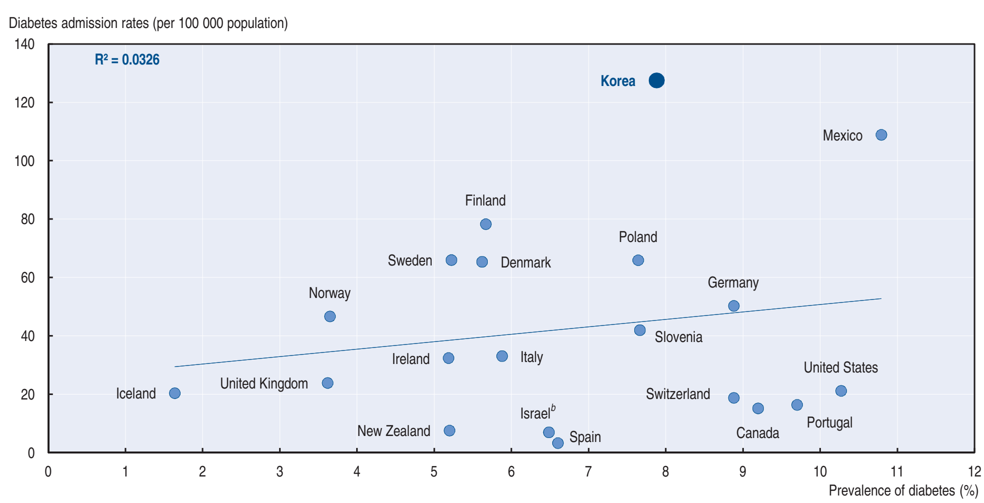
CHD: Coronary heart disease.

COPD: Chronic obstructive pulmonary disease.

Source: OECD Health Database 2012, www.oecd.org/els/health-systems/.

Korea also has very high hospital admission rates for uncontrolled diabetes relative to its prevalence of diabetes. In 2009, it accounted for 127.5 admissions into hospital per 100 000 population, significantly higher than countries that shared Korea's level of prevalence such as Poland, Slovenia, Germany, Canada and Israel (Figure 5.4).

Figure 5.4. **Uncontrolled diabetes admission rates and prevalence of diabetes in OECD countries, 2009 or latest year available**[a]



Note: Prevalence estimates of diabetes refer to adults aged 20-79 years and data are age-standardised to the World Standard Population. Hospital admission rates refer to the population aged 15 and over and are age-standardised to 2005 OECD population.

a) For diabetes admission rates, data refer to 2007 for Spain, 2008 for Hungary, Iceland, Switzerland and the United States, and 2009 for all other countries. For the prevalence of diabetes, estimates refer to 2010 for all countries.

b) Information on data for Israel is available at: *http:/dx.doi.org/10.1787/888932315602.*

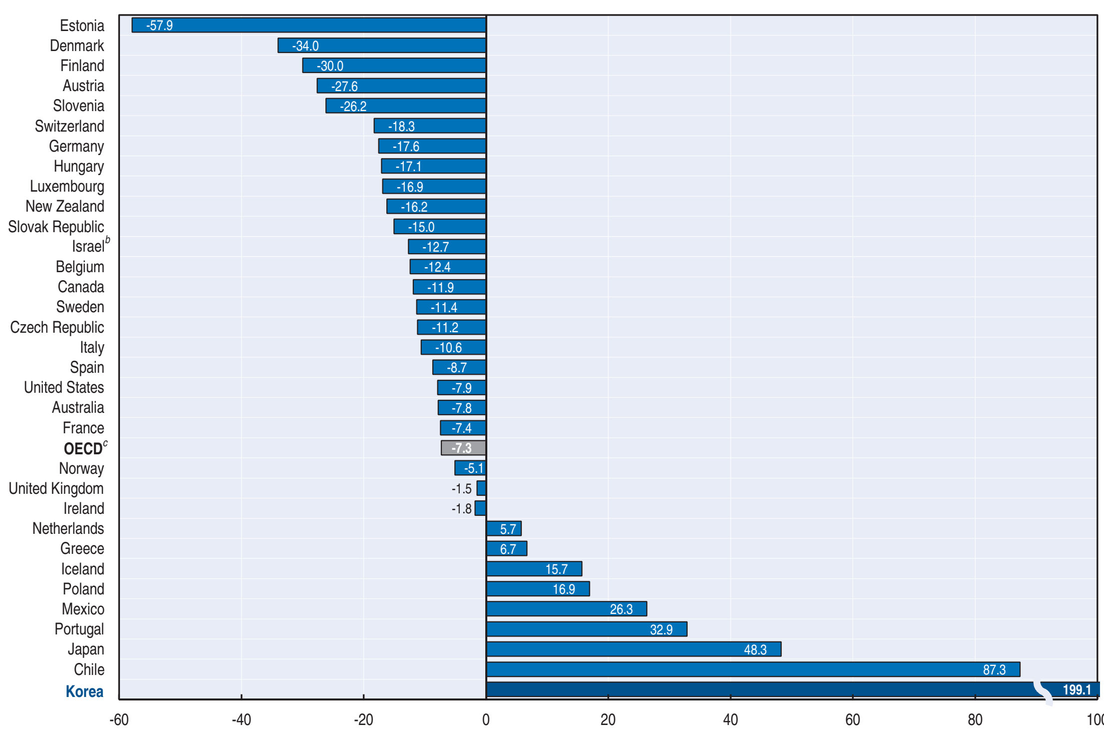
Source: International Diabetes Federation for prevalence of diabetes estimates; *OECD Health Database 2012* for hospital admission rates, *www.oecd.org/els/health-systems/.*

Diabetes is a complex chronic condition that cannot be cured but can be managed with good quality care. The cornerstone is fostering healthy lifestyles based on diet, physical activity, not smoking and, for some patients, appropriate medications or insulin injections. Each element can be aided through health care that emphasises regular review and assessment and support for patient education and lifestyle management, which are often best delivered in primary care settings. As diabetes also increases the likelihood of other chronic diseases, care should be co-ordinated by a generalist doctor who can provide support across the whole of a person's health needs. The management of diabetes is therefore a good indicator of the quality of primary health care.

Korea also faces major challenges in mental health and primary care

There are signs of severe mental distress in Korea, in particular the suicide rate, which is the highest among OECD countries and the fourth leading cause of death in 2010. Using suicide as a crude litmus test for the mental health of the population thus gives an alarming picture of mental well-being in Korea. The suicide rate was highest among the elderly, and it is rising among adolescents. Whilst most OECD countries have seen decreasing suicide rates since 1995, with pronounced declines observable in a number of countries, deaths from suicide have increased significantly – by 199% in Korea (Figure 5.5).

Figure 5.5. **Change in suicide rates in OECD countries, 1995-2010 (or latest year available)**[a]



a) Data refer to 2005 for Belgium, 2006 for Denmark, 2007 for Switzerland, 2008 for New Zealand, Spain and Sweden, 2009 for Canada, Chile, France, Greece, Hungary, Iceland, Israel, Italy, Japan and Luxembourg, and 2010 for all other countries.

b) Information on data for Israel is available at: *http:/dx.doi.org/10.1787/888932315602*.

c) Unweighted average of the 32 OECD countries shown above.

Source: OECD Health Database 2012, www.oecd.org/els/health-systems/.

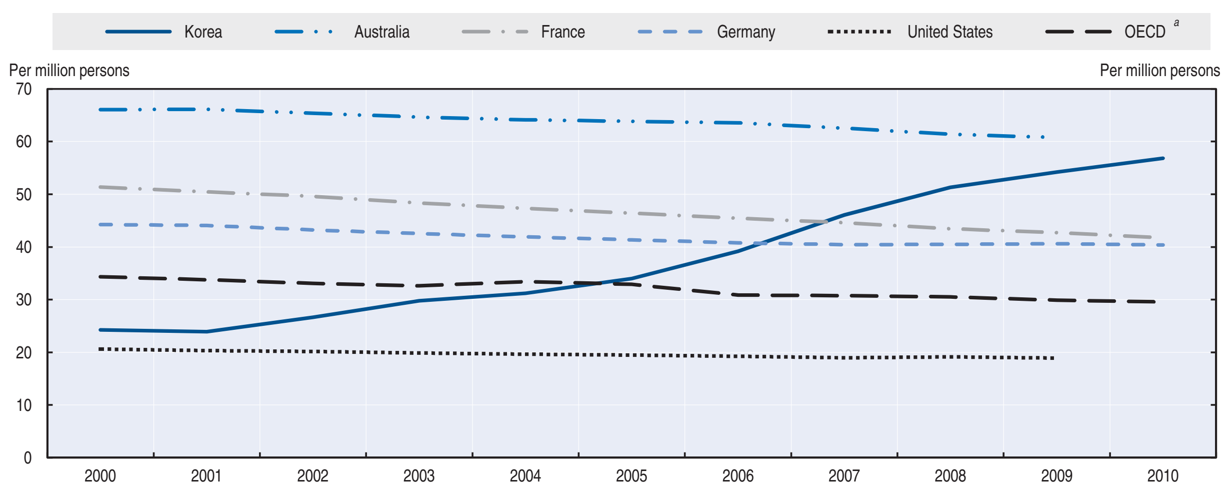
High and rising rates of suicide in Korea indicate a significant level of unmet mental health needs. Mental health services provide significantly lower treatment rates for mild-to-moderate mental illnesses, such as depression and anxiety, when compared to other countries (Kim, 2012). These services would best be provided by a strong system of primary care. It is particularly important given the high rate of suicide among the elderly, where mental illness often accompanies other chronic diseases such as diabetes and cancer.

5.4. Korea's health system is geared towards hospitals and not primary care

Hospitals dominate the health system

At a time when Korea faces the rising onset of chronic diseases, the health care system is biased towards supplying hospital services rather than primary care. Korea has one of the most substantial hospital sectors, relative its population, amongst OECD countries. While most OECD countries have been gradually reducing the number of hospital beds, Korea has seen a major expansion in the supply and availability of resources in the hospital sector. Consequently, the number of hospitals and hospital beds relative to the population in Korea has overtaken almost all OECD countries over the past 20 years (Figure 5.6). In 2010, with 57 hospitals per million persons, Korea is behind only Japan (68) and Australia (61 in 2009), and well above the OECD average of 30 hospitals per million population. Similarly, Korea's 8.8 hospital beds per thousand people places it behind only Japan and well above the OECD average of 5.1.

Figure 5.6. **Number of hospitals relative to the population, selected OECD countries, 2000-10**

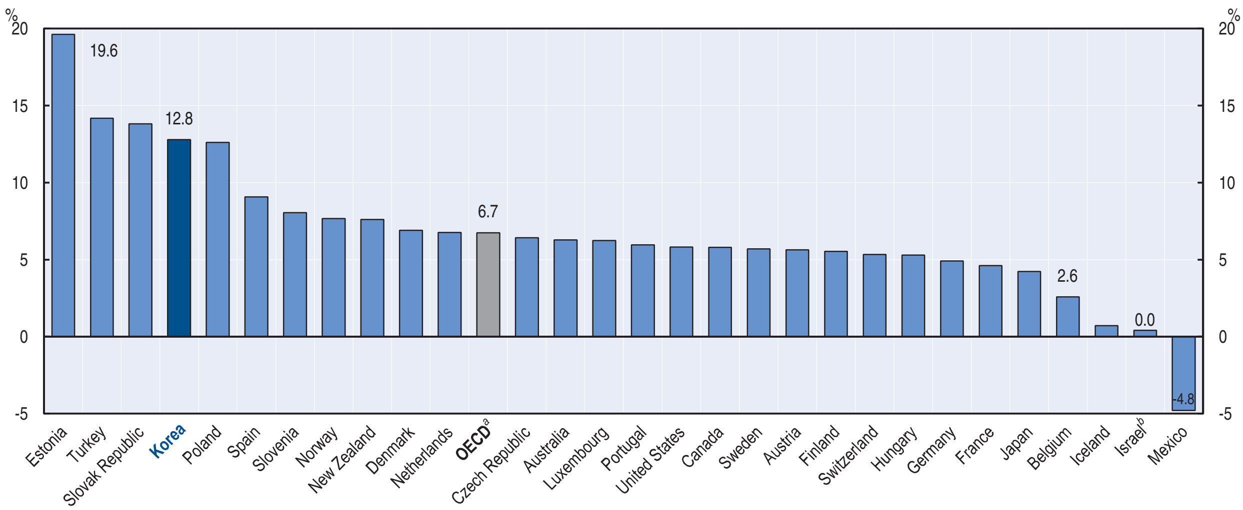


a) Unweighted average of 32 OECD countries whose data are available over the period 2000-10.

Source: OECD Health Database 2012, /www.oecd.org/els/health-systems/.

Spending on hospitals has been the major driver of growth in health expenditure in Korea over recent years. Spending on hospitals in Korea increased by 13% a year between 2002 and 2009, compared to 6% a year for spending on ambulatory care services (principally physician offices and dentists' offices) and 9% a year for retail sales of health and medical goods (principally pharmaceuticals sold from chemists) over the same period. While it is not unusual for hospitals to be the fastest growing area of spending across OECD health systems, the growth rate of hospital spending in Korea, at an average of 12.8% per year between 2002 to 2009, is close to double the OECD average (excluding Chile, Greece, the United Kingdom, Italy and Ireland where data was not available) of 6.7% a year over the same period (see Figure 5.7).

Figure 5.7. **Average annual growth in hospital spending per capita in OECD countries, 2002-09**



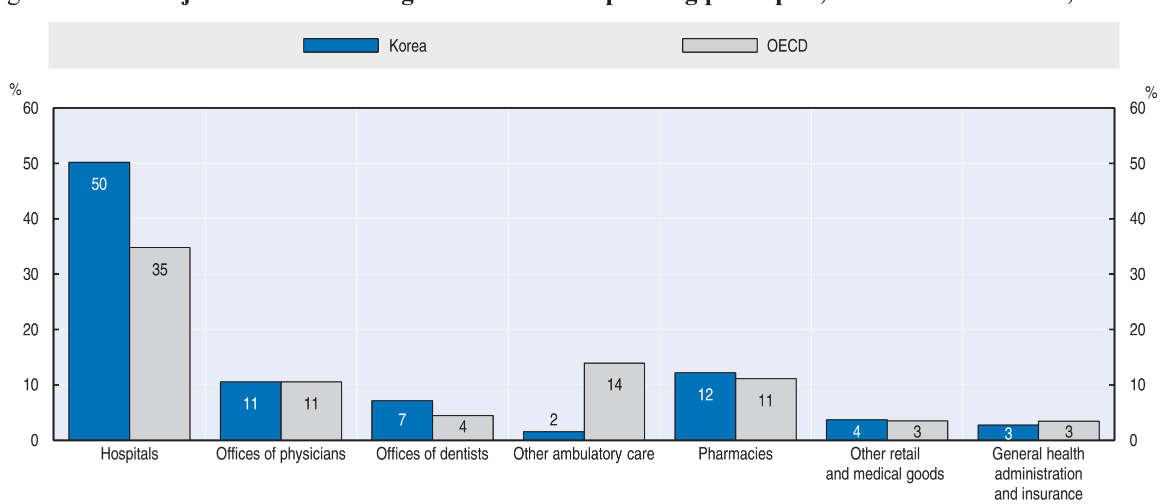
a) Unweighted average of the 29 OECD countries whose data are available over the period 2002-09 (excluding Chile, Greece, Italy, Ireland and the United Kingdom).

b) Information on data for Israel is available at: *http:/dx.doi.org/10.1787/888932315602*.

Source: OECD Health Database 2012, *www.oecd.org/els/health-systems/*.

As the single largest component of health spending in OECD countries, hospitals often account for a significant share of growth. Over the past five years, hospital spending accounted for half of the growth in overall health spending in the Korean health system (see Figure 5.8). In comparison, across the group of 17 OECD countries for which data was available, hospitals accounted for 35% of the growth in health spending over the same period. This strong growth in hospitals spending reflects the structure of health services and operation of payments in Korea.

Figure 5.8. **Major contributors to growth in health spending per capita, Korea versus OECD,[a] 2004-09**



a) Unweighted average of the 17 OECD countries whose data are available over the period 2004-09 (Belgium, Canada, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Hungary, Iceland, Korea, the Netherlands, New Zealand, Poland, Slovenia, Spain and Switzerland).

Source: OECD Health Database 2012, *www.oecd.org/els/health-systems/*.

A large amount of the growth in the number of hospitals in Korea has occurred amongst smaller hospitals. Hospitals in Korea are generally classified into major “tertiary hospitals”, larger “general hospitals” and comparatively smaller “hospitals”. As can be seen in Table 5.1 below, increases in the number of “hospitals” and “general hospitals” have been accounting for most of the new institutions over the past half decade.

Table 5.1. **Distribution of hospitals by size in Korea, 2006-10**

Units

	Tertiary hospitals	General hospitals	Hospitals	Clinics
2006	43	253	1 322	25 789
2007	43	261	1 639	26 141
2008	43	269	1 883	26 528
2009	44	269	2 039	27 027
2010	44	274	2 182	27 469

Source: HIRA/NHIC (2011), *National Health Insurance Statistical Yearbook 2010*, December.

The high rate of admissions to hospital for avoidable conditions suggests that primary care is not playing its critical role of prevention and diagnosing and treating patients for chronic diseases Many Koreans admitted to hospitals are for conditions that should have been treated earlier in primary care. Given the rise in chronic diseases like diabetes, an approach stressing prevention to address changing risk factors for health will be a key to helping reduce relatively more expensive hospital admissions in the future.

Gatekeeping in the Korean health care system is weak

A major challenge for ensuring that patients receive appropriate care is weak gatekeeping in the Korean health system. Ideally, patients should have a trusted advisor to help them navigate through the complex number of available services. The purpose of gatekeeping is to strengthen the relationship between primary care providers and patients, thereby enhancing patients’ agency in selecting the most appropriate form of care. Unfortunately, patients do not generally have long-term relationships with a primary care provider. Instead, they face an almost unconstrained choice of provider and can choose between western and oriental medicine. While there is notionally a requirement to have a referral from a family medicine specialist or a general medical practitioner prior to visiting a tertiary hospital, gatekeeping is not strictly enforced and patients have relatively easy access to tertiary hospitals and their specialists (Chun et al., 2009).

Indeed, with significant competition between hospital outpatient departments and small clinics with minor surgical facilities, many health care providers are likely to see family medicine as an “entry point” for more (or more complex) services such as diagnostic testing, screening and minor surgical procedures. Many hospitals have adopted practices that have weakened the effectiveness of the requirement to seek a referral before accessing specialist care. One example is the establishment of family medicine centres (or departments) on hospitals premises that can sometimes also serve as a “gateway” for patients into the hospital at large. Absent the availability of longitudinal information on health outcomes experienced by patients, it is difficult to determine the extent to which weak gatekeeping practices facilitate the provision of unnecessary care.

The boundaries between primary and secondary care are blurred

The demarcation between primary and secondary care in Korea is very blurred. Most of Korea’s very large number of clinics (Table 5.1) have a medical specialisation, leading to a very fragmented array of health services. Typically, clinics are operated by those specialising in general medicine, internists, family physicians and paediatricians (HIRA, 2011). Amongst physicians working in clinics, the largest category, "general medicine" represents physicians with a medical degree but without a specific specialisation in "family medicine". Family medicine in Korea is equivalent to what many OECD countries refer to as "general practice", and these professionals account for less than 3% of physicians working in health care clinics (Table 5.2).

Table 5.2. **The major specialties of physicians working in clinics in Korea, 2005-09**

	2005		2006		2007		2008		2009	
	Number	%	Number	%	Number	%	Number	%	Number	%
General medicine	7 851	26.3	8 165	26.4	8 466	26.8	8 803	27.3	9 179	27.8
Internal medicine	4 041	13.5	4 220	13.7	4 317	13.7	4 384	13.6	4 505	13.7
Orthopaedics	2 008	6.7	2 060	6.7	2 067	6.6	2 051	6.4	2 057	6.2
Obstetrics and gynaecology	2 674	8.9	2 591	8.4	2 539	8.0	2 499	7.8	2 484	7.5
Paediatrics	2 536	8.5	2 570	8.3	2 541	8.1	2 558	7.9	2 601	7.9
ENT	1 992	6.7	2 088	6.8	2 146	6.8	2 194	6.8	2 284	6.9
Family medicine	774	2.6	789	2.6	773	2.5	751	2.3	777	2.4

ENT: Ear, nose and throat.

Source: HIRA (2010), "HIRA Report on Medical Care Institutions" (in Korean), Seoul, Korea.

Some OECD countries that do not have a large cadre of people who specialise in general practice (or family medicine in the Korean context) have sought to overcome this challenge by promoting multi-specialty health clinics where doctors can work together to address people's health needs. However, this is not the case in Korea. In addition to being staffed by those without specific training in general practice, 94% of health care clinics are solo practices (Table 5.3).

Table 5.3. **Solo and group practice amongst clinics in Korea, 2010**

	Solo practice		Group practice	**Total**
	Private	Incorporated		
Number	24 792	629	1 606	**27 027**
Percentage	*91.7*	*2.3*	*5.9*	***100.0***

Source: HIRA (2010), "HIRA Report on Medical Care Institutions" (in Korean), Seoul, Korea. These statistics exclude dentistry and oriental medicine clinics.

Another major concern is the large number of small health care clinics with a small number of beds. In 2010, there were an average of 3.6 beds across the 27 469 small clinics (HIRA/NHIC, 2011), despite the fact that Korea population is concentrated geographically. The tendency towards having the physical infrastructure for complex services readily available suggests that these facilities may be delivering services of a higher clinical intensity than may be medically appropriate.

Competition between health care facilities is significant as many institutions have the capability to deliver similar services. Clinics and general hospitals provide basic surgery and limited inpatient services, and most major hospitals have large outpatient departments. In this market, larger hospitals often distinguish themselves by virtue of their ability to deliver a greater range of more complex services and utilise the latest technology effectively, as a single destination for all medical needs, staffed by the most prominent medical specialists. Over time, these hospitals have benefitted from a prestige factor amongst consumers who often turn to the most qualified medical specialist they can access rather than general practitioners who specialise in managing the range of a patient's needs.

The way Korea pays providers encourages greater activity rather than improved health outcomes

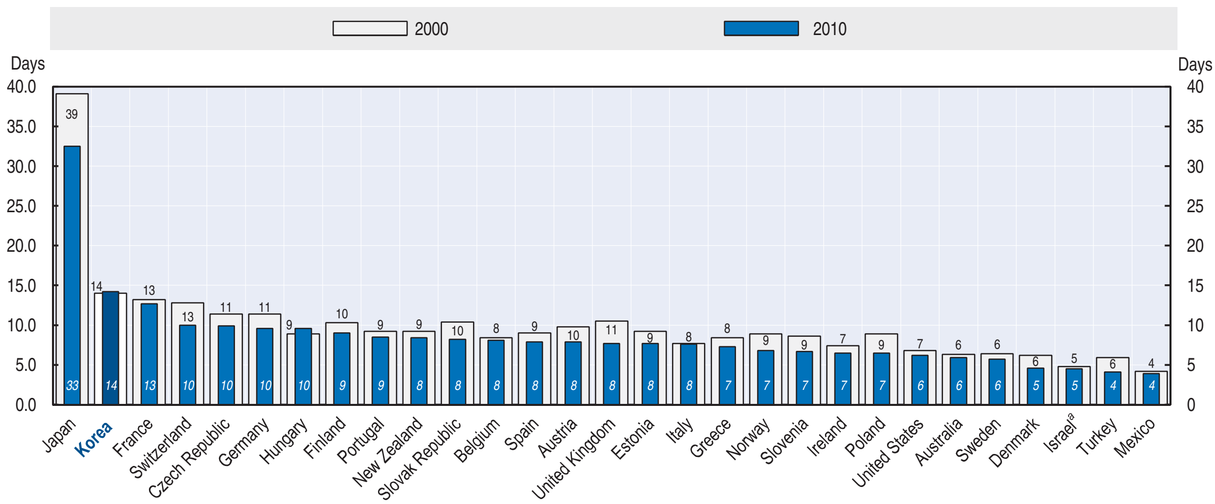
Korea pays providers using a fee-for-service payment system, for both hospitals and primary care, which are process-based and reward providers for the number and type of activities they perform. At a system-wide level, this form of payment can create incentives for overprovision as providers seek to maximise revenues that depend on the volume and intensity of services delivered. While many OECD countries still use fee-for-service payments in primary care, Korea is unusual in that it still applies to hospital care as well. All health care services – whether in primary care or hospitals – are reimbursed on a common fee schedule that ranks all health care services by their degree of clinical intensity. This is potentially an inflationary system, as the more services are provided, the more a health care facility is paid.

Most OECD countries have shifted to Diagnosis Related Groups (DRGs) approach, which charges a fixed fee for a hospital visit (in practice, such as setting a limit on the number of fee-for-service items that can be billed). Korea has started to introduce DRGs, but it's still in its infancy, and only a small percentage of hospital services are covered by the DRG system. From the standpoint of cost control, Although DRGs regulate the prices for hospital services and encourage a decrease in the length of stay, they still provide an incentive to increase volume many OECD countries also set an overall budget for hospital care. Korea currently lacks limitations on the amount of services that can be delivered per case and on the overall hospital budget.

For patients, the incentives created by the Korean payment system often mean a greater number of services per episode of care and long hospital stays. After Japan, Korea has the longest average length of hospital stays for inpatient care amongst all OECD countries. Indeed, Korea's average length of 16.7 days per inpatient admission in 2008 was almost double the OECD average of nine days (Figure 5.9). While variations in the average length of stay can often reflect a number of factors, Korea is an outlier together with Japan. Both these countries also have a fee-for-service payment system and an abundant supply of hospital beds. This suggests that paying providers based on the number of activities being undertaken gives a strong incentive to hospitals to extend patient stays. In addition, the provision of long-term care in hospitals also increases the average length of stay (Jones, 2010).

As the fee-for-service schedule in Korea is common across primary and hospital services, by design, primary care services are generally cheaper than those in hospitals and doctors have an incentive to provide more complex services. As a result, primary care providers have a financial incentive to become mini-hospitals that provide surgical procedures, often when not appropriate or safe. Furthermore, fee-for-service systems often do not pay (or pay comparatively less) for services such as counselling, education and guidance (Fujisawa and Lafortune, 2008). At a time when the burden of disease in Korea is shifting towards chronic diseases, which requires ongoing medical care of lower acuity and doctors' support in encouraging patient self management, a fee-for-service reimbursement structure may not be the best approach to fostering high quality chronic care. At the very least, fee-for-service should be adapted to encourage key interventions that would improve outcomes for chronic diseases such as diabetes, hypertension, and asthma. Fee-for-service payments to hospitals should be de-linked from payments for primary care services – or capped altogether.

Figure 5.9. **Average length of stay for inpatient care in OECD countries, 2000 and 2010**



Note: Countries are ranked in ascending order of the data for 2010.

a) Information on data for Israel is available at: *http://dx.doi.org/10.1787/888932315602*.

Source: OECD Health Database 2012, *www.oecd.org/els/health-systems/*.

The combination of poor gatekeeping, fragmented health services and fee-for-service entrenches institutional incentives for all providers to deliver as many and as complex services as possible. Within this market structure, doctors have the difficult task of both self-regulating the care they provide while balancing entrenched institutional or personal imperatives to maximise profits. Perhaps nowhere is this pressure stronger than in primary care, where doctors receive relatively lower incomes.

5.5. Getting the building blocks right: Payments, flexible institutions and workforce

To deal with looming challenges, the Korean health care system needs to adapt to support patients in co-ordinating their health needs across multiple services and ensuring good continuity of care. Critically, it will need to help patients avoid unnecessary acute care. Currently, the system does the opposite – it encourages further diagnosis and the utilisation of the large hospital sector. This is medically undesirable, unnecessary, and expensive. Without a strong community-based primary care system, consumer preferences for hospital care have been reinforced by a fiercely competitive market of health care providers who tend to deliver what is profitable for them and not what is most appropriate for patients' long-term health needs. It is important to emphasise the provision of evidence-based health promotion and prevention along with partnering with patients to help them select the appropriate services for their needs

Korea already has some of the key features needed to develop world class primary care. It has a good supply of physicians working in local clinics and an outstanding record for technological innovation. There are also individual projects that can serve as good examples of how effective primary care can promote good health, raise health awareness and prevent the deterioration of chronic disease. The challenge is to ensure that the building blocks that are already in place are financially supported to grow, and that institutional conditions are put in place that allow for these models to expand across the country. This will require dedicated investment that cannot be easily diverted towards funding services that serve as a conduit to hospital admission.

The following measures could help Korea develop a stronger primary care sector:

- Separate hospital and primary care payment. For hospitals, move away from fee-for-service towards a full DRG system for all hospital services and a capped hospital budget.
- For primary care, increase payments for preventative services, counselling, and management of chronic diseases; complemented by a pay-for-performance scheme that rewards high quality primary care.
- Building the capacity within government to channel money towards primary care especially capital investment.
- Create a network of multi-specialty group practices (polyclinics) staffed by private practitioners.
- Create model primary care polyclinics in medical schools to train the primary care workforce.
- Developing supporting infrastructure for primary care including clinical guidelines and strengthening professional societies, and providing better access to information for patient self-management.
- Incentivise primary care to co-ordinate with other public services (e.g. education, employment, social protection) to ensure cross-sectoral collaboration to improve outcomes and increase social cohesion.

Moving away from fee-for-service payments

Korea is facing a future with an ageing population and rising chronic diseases, Korea ought to move beyond a financing an expansion of health care and towards financing care that is appropriate for a particular patients needs and is of high quality. Currently, doctors have incentives to deliver the services on which they can earn higher profits. Variations in the profitability of certain services influences the pattern of services provided in Korea. Recent efforts by the Health Insurance Review and Assessment Service (HIRA) have sought to revise the fee structures by adjusting fees within a particular speciality in line with their resource intensity. Nevertheless, it is likely that distortions between different specialties will remain, with specialities enjoying higher fees from the start maintaining their position (Mathauer et al., 2009).

To address this situation, policy makers should increase financial support to doctors for prevention and patient self-management of chronic disease. With the type of services often delivered in primary care settings (such as physician advice and the treatment of common conditions) attracting lower fees than specialist services, the current payment system pushes service providers towards delivering additional services that provide higher fees. One way of addressing this situation in an environment of budget constraints would be to consider increasing the relative price of general practitioner services (particularly for a doctor’s time spent in counselling and guidance) while decreasing relative prices for specialities that are over-supplied, as has been suggested by the World

Health Organization (Mathauer et al., 2009). A further challenge to increasing fees for patient counselling and more cognitive services has been the poor coding showing which services are actually delivered when a doctor provides a standard consultation in a health clinic. Better coding could provide policy makers with the possibility of increasing fees for consultations for patient counselling and offsetting this through reductions in fees for consultations associated with lab tests such as radiology and endoscopy.

While this approach will help make primary care services more financially viable, it may not be enough if implemented on its own. There is a risk that such a policy may fail to change the underlying culture of doctors not prioritising counselling their patients, and indeed, could simply be absorbed as a higher payment for a similar amount of work.

This suggests the need for additional funding mechanism beyond fee-for-service. Pay-for-performance (P4P) is increasingly popular approach across OECD countries, where payments are made for collecting additional data and achieving improved clinical outcomes. Korea is already using P4P in hospitals with the Value Incentive Programme. In most OECD countries, P4P is used in primary care to collect better data in primary care and processes that lead to better clinical outcomes and fewer hospital admissions. The United Kingdom has introduced the most far-reaching P4P scheme in primary care, the Quality and Outcome Framework (QOF), but there are many other schemes including France, Germany, and Estonia. Most of these schemes cover chronic diseases and collect clinical data that are linked to improved outcomes. For example, the schemes mandate the collection of data on the level of Haemoglobin A1C, a measure of diabetes control, and providers are rewarded for good scores.

P4P can be used as an overlay on fee-for-service to encourage care co-ordination. Germany introduced disease-management programmes that paid providers more to follow evidence-based guidelines for diabetes and other chronic conditions. France created a P4P scheme to increase the uptake of prevention for diabetes and hypertension as well as monitoring generic prescribing. While the evidence on whether P4P schemes lead to better health outcomes in primary care is ambiguous, they can be a useful tool to drive specific activities associated with good care, such as the use of guidelines and regular monitoring of patients' health.

A more fundamental reform would be to provide a means by which primary health care professionals can derive a greater proportion of their income outside of the fee-for-service structure. An example could be to progressively move to a mixed payment system that provides some capitation payments for patients that register with a medical practice as their chosen first point of call for health care services and fee-for-service for important services like measuring blood glucose levels and lowering it for patients with diabetes.

Delivering targeted funding to primary care requires the National Health Insurance to be a proactive purchaser not a passive payor

Despite the major reform of consolidation under a single insurer, the institutions behind Korea's National Health Insurance do not make the most of their position to be an active purchaser shaping the market for health care. The National Health Insurance Corporation's (NHIC) activities are focused on reimbursement and claims process, and it has little scope to use the financing of health care services to drive policy changes. This is instead located in another agency, the Health Insurance Review and Assessment Service (HIRA), whose mandate as the assurer of insurance claims limits it to paying small amounts of funds to providers. HIRA's role in the Korean health system positions it as the institutional leader for driving quality, but leaves it with few functional levers other than a retrospective assessment of claims and collecting and reporting performance data. The consequence of this functional separation between HIRA and the NHIC is that no one organisation has the in-house capacity (or incentive) to proactively design and implement a payment arrangement that embeds quality into purchasing.

Instead, financing of National Health Insurance in Korea remains characterised by a system of fee-setting largely occurring through a centralised National Health Insurance Policy Deliberation Committee. As a result of this centralised (and annual) process, it is likely that discussions over quality improvements are often "crowded out" at precisely the time they ought to occur. Annual negotiations conducted with peak bodies negotiating on behalf of all providers leave little scope to foster competition amongst providers in driving improvements in quality or lowering costs. With little capacity for the purchaser to vary compulsory contracts from one hospital to another (for example, by altering prices or quality obligations), health insurance in Korea has weak quality and budgetary controls. In effect, the Ministry of Health and Welfare currently determines the overall budget for health insurance when it negotiates fees through the National Health Insurance Policy Deliberation Committee. A more proactive effort is needed to design health care policies which meet Korea's future needs.

Korea ought to make more of its single insurer. Theoretically, a single insurer should have a strong bargaining position in negotiations with provider groups, enabling it to drive change in the way private providers deliver health care. With no risk that patients can move to another fund, a single insurer has an economic incentive to focus on prevention and early intervention – investing in a person's good health today leads to fewer claims (and payouts) in the future.

Efforts ought to be undertaken to ensure that an institution in Korea develops the tools needed to help direct funding to patients or areas of need, and has the flexibility to invest funds beyond simply paying the medical bills of patients under a common fee-for-service schedule. Policy makers ought to have the financial freedom to assess and invest in proposals that develop best value for money in delivering high quality primary care. Such flexibility would allow health insurance to fund worthwhile services using different payment models, and to target funding services on patients or areas most in need. There is a case for locating funding for primary care within the overall budget of the National Health Insurance and not as discrete government programmes, as this would align new investments with the institutional imperative of reducing longer-term payouts by the National Health Insurance. It would also help foster an operating culture where the national insurer is seen as a financial agent capable of driving system change to improve quality of care and not just a payments clearinghouse.

In the same manner in which the gradual expansion of insurance helped underwrite the development of Korea's hospital sector, an ongoing financial commitment from the National Health Insurance ought to become a major source of financing for the development of a stronger primary care sector. This funding could be modest initially, but over time should be scaled up over time. This would serve as a discipline that locks in a sustained increase in investment in primary care, and as an incentive to drive ongoing policy efforts to contain spending on acute care services.

Developing a workforce for primary care

Even with a commitment to increased funding, Korea's lack of a sufficiently strong base of doctors with training or experience in primary health care is a major stumbling block to its further expansion. A stronger primary care sector will require a larger, dedicated workforce of primary care professionals. For the longer term, Korea needs to grapple with the question of whether it goes down the path of many other OECD countries that have promoted the training of dedicated physicians who cover the whole gamut of clinical care, or tries to make the most of a more specialised model where paediatricians, internal medicine, and obstetrics and gynaecology, along with support from nurses function as primary care units. While there is no right answer for Korea, going down the former path would require significant changes in medical education and take a long time to engineer. Given the high esteem for specialists, it will be critical to ensure that family medicine becomes a well respected speciality with post-graduate training qualification and strong speciality society.

The majority of new medical graduates in Korea prefer to gain a specialisation. At the same time, independent medical professionals working in primary care often feel the need to deliver basic surgical and inpatient services to maintain their viability. While investment and a more pronounced role in the health system would help enhance the professional status of family physicians, Korea also needs to engender an awareness of the importance of primary care in its medical profession. Providing more medical students with the experience of working in primary care could help impart an understanding of the role and importance of primary care and encourage more people to choose this as a profession.

Policy makers should work with medical associations and universities to introduce a mandatory training rotation in a primary care facility. This requires creating new model primary care practices affiliated to medical schools, since at the moment there is nowhere to train physicians in primary care. Establishing good working models of primary care is the critical first step in training a new workforce. Korea should consider adding ambulatory tracks to paediatric and internal medicine that focus on the provision of primary care-oriented service. A mandatory post-graduate rotation could also bolster the size of the primary care workforce, especially in rural areas where the number of community-based health professionals has been steadily falling in comparison to Seoul. Providing a modest training subsidy would support the development of a training culture in primary care practices across the country, and would most likely have lower supervision costs than the training currently being undertaken in hospitals.

Developing support for primary health care: Professional societies, guidelines, and information for patient self-management

In the longer term, creating a stronger sub-speciality of primary care based in medical schools would help put it on the same footing as other specialities. To raise the prestige of primary care, the current “family medicine” speciality should be a more prominent part of medical school faculties, including its research programmes. There should also be ambulatory sections of other specialities such as internal medicine, paediatrics, and obstetrics and gynaecology. The professional societies would also be responsible for developing a programme of continuing medical education to help convert existing practitioners, particularly Korea’s large number of internal medicine and general internists, into primary care specialists. Given the relative lack of prestige for family medicine relative to other specialities, speciality societies are likely to need government support to take on such an enhanced role.

Clinical guidelines would also facilitate the development of a strong system of primary care especially if they were re-enforced by health insurance rules. The high rate of hospitalisation is partially due to the lack of attention to prevention and the incentives to hospitalise patients. Clinical guidelines would make clear the key preventative interventions that should be taken in primary care, as well as broader clinical pathways for the treatment of complex problems, including the relative roles of primary and secondary care. The guidelines should be based on a systematic review of the literature and adapted to the Korean context. Although there are several different medical and academic institutions developing clinical guidelines, they are not used by public insurance as a means of rationalising clinical pathways. Ideally, a strong primary care speciality society, along with other specialist societies, would play the role of adapting guidelines for both primary care and speciality care to the Korean context. These clinical guidelines could be used as part of the process of continuing medical education for primary care physicians to ensure their adoption and use.

Enhancing patient self-management for chronic diseases should play an important role in strengthening primary care. For diabetes, patients are expected to manage their blood sugar, since good control leads to fewer complications. Patient self-management could be facilitated by primary care facilities offering health education to patients. In many countries, this is done through patient groups co-ordinated with primary care. Korea needs to develop models of patient self-management as part of broader initiative to strengthen primary care. The provision of information ought to extend to the internet, where patients are increasingly seeking information, and it is important that patients receive unbiased information. Korea could look to the example of NHS Choices in the United Kingdom, where patients can access information on diseases and treatment to help them manage their own health.

5.6. A Korean model of primary care: Multi-specialty group practices (polyclinics)

These fundamentals for primary care reform – reforming payment systems, ensuring institutional flexibility and supporting primary health care workers – in themselves are unlikely to be sufficient to ensure the development of a stronger primary health care sector. The OECD work published in *OECD Reviews of Health Care Quality: Korea – Raising Standards* (2012b) recommended that policy makers seek out desirable models of what uniquely Korean approaches to primary health care services should look like and support them. This section builds on the broad approach outlined in the earlier report by providing some potential paths to scale up primary care in Korea.

Encouraging hospitals to vertically integrate may be the optimal policy, but is likely to be difficult to achieve

Given that the centre of gravity in the health care system is in the hospital sector, a possible path to bolstering primary care would be to strengthen the financial interests of hospitals to deliver more primary care. Given Korean interest in the US health system, it is surprising that there has been limited interest in moving towards a model of integrated care, where an organisation receives a capitated payment from the National Health Insurance to manage all of the care of the patients. This type of reform provides incentives for big hospitals to restructure their service delivery model to include stronger primary care. This would require comparatively simple changes to payment methods, or at least experimentation to allow some big hospitals to receive a capitated payment.

While vertical integration and encouraging hospitals to invest downstream has some advantages, there is a risk that it could simply reinforce Korea's hospital-centric health system. With Korea's largest tertiary hospitals accounting for a major share of activity as well as having a major financial influence in the system, making them responsible for primary care may perversely result in them under-investing in primary care, as it conflicts with their incentive to deliver high-margin acute-care services. This is evident in the some of the large hospitals in Korea which currently offer primary care through clinics located on site but functionally use this as a gateway to more complex services.

Team-based clinics are an appropriate starting point for strengthening primary care services

Nonetheless, making a break from weak family medicine services and a highly fragmented model of specialist services requires changes to the physical infrastructure of health care outside hospitals in Korea. Developing a network of primary health care polyclinics across communities could provide the physical infrastructure needed to encourage health practitioners to work in teams with a community focus. This reflects the experiences of the United Kingdom and Israel (OECD, 2012c), whose strong primary health care is based on a network of easily accessible community-based polyclinics where doctors and other health professionals work together. Shifting primary care towards group practice and locating multiple services – of both a specialist and lifestyle support nature – into one location is also an emerging feature underway or being considered in Australia, Switzerland, Denmark and the United States (known as “medical homes”). As in Korea, many of these countries have a tradition of primary care services delivered through privately practising specialists who are often reimbursed on a fee-for service basis. Policy initiatives have often sought to preserve the private nature of doctors’ operations while providing payments to a polyclinic where groups of doctors work or by providing capital grants to subsidise the cost of several doctors consolidating services in one location.

Korea already has the embryo of a national network of primary health care clinics through its municipal public health centres, which provide care to the 2% of the population currently in the medical scheme for the poor. They are also often the hub for health care screening and chronic disease management programmes. As their funding originates from a combination of medical aid, municipal government and funding for special programmes, the capacity and quality of these centres vary considerably across the country. In richer areas, these clinics are often equipped beyond simply providing care to the poor but also to other high needs groups such as the elderly living with chronic diseases. Greater public funding could be provided to systematically add additional chronic services and expand the availability of doctors at these clinics for the broader population. Such an approach has already been trialled in the establishment of new dementia centres that are similar to community health centres.

However, municipal public health centres have numerous problems especially funding. Currently, most public health centres directly employ practitioners on civil service contracts that are inflexible and pay salaries that are lower than available in the private sector doctors. This already poses a challenge for those public health centres that wish to use their resources to get full-time physicians on-site or deliver community services on their behalf. Consequently, public health centres are usually only staffed by part-time physicians, younger nurses and social workers which are a poor model for chronic diseases. Since there is widespread variation across municipalities in funding levels for public health centres, this means that relying on them would lead to wide variations in the quality of care. In general, universal access to primary care should decrease health inequalities and increase social cohesion, but this would lead to greater health inequalities.

The government could provide direct block grants to public health centres to scale up their services to resemble multi-disciplinary group practices (polyclinics). For public health centres to be able to scale up into larger practices, they will need the ability to contract private practitioners at higher payment rates and while being allowing doctors to remain independent practitioners. If contract payments are set at a sufficient level, health centres could induce those currently operating their own practice to practice from public health centres by offering the prospect of a stable pipeline of patients (through referrals from screening and other services already delivered at the public health clinic) and sparing sole practitioners from the overhead and administrative costs of maintaining an independent practice. At a practical level, such a model has been trialled in mental health. The city of Seoul has contracted with a major private hospital to staff the mental health centre as well as a new centre for suicide prevention. Such an approach has also allowed policy makers to overcome the limitations of fee-for-service and to attract full-time physicians to work in the centres.

An alternative approach would be to directly fund multi-specialty group practices (polyclinics through the Health Insurance Corporation). They could provide both capital investment and pay recurrent costs through the fee schedule augmented by a pay for performance scheme. Another option would be to allow private practitioners to use the public clinic's facilities at low (or no) cost from where they can bill the NHI for the patients that they see. This would still offer Korea's substantial number of solo practitioners the opportunity to reduce overhead and administrative costs for of maintaining an independent practice.

However, these team-based clinics ought to be staffed by specialists, not generalists

The model of primary care in Korea is likely to be materially different that in the United Kingdom, Australia, New Zealand, Estonia and Italy. Unlike these countries, Korea does not have a large number of doctors trained as general practitioners, a strong professional identity for general practitioners, and high pay rates for general practitioners relative to specialists. To date, it has been difficult to raise the prestige of doctors that specialise in general practice – both amongst the medical profession and in terms of how they are perceived by consumers.

As highlighted earlier, clinicians working in smaller community clinics in Korea generally do not have a specific specialisation in family medicine and are more likely to be trained in internal medicine, orthopaedics, obstetrics and gynaecology, paediatrics, and ear, nose and throat. Indeed, the number of doctors trained in "family medicine" (broadly equivalent to "general practice") and working in clinics was only 2%. With such low numbers of generalist doctors and a high proportion of specialists working in the community, a major hurdle in establishing generalist primary health care services is the fragmentation of the delivery system. Korea currently has specialist physicians for children, adults and women. A uniquely Korean model of primary care ought to take advantage of this.

A practical policy would be to pursue the development of group practices staffed by multiple specialists. At the most pragmatic level, there are unlikely to be sufficient numbers of doctors trained in family medicine to form the backbone of a national network that provide services at the first point of call. Training such a cadre of doctors with specialisations in family medicine will require a long term commitment between policy makers, educators and the medical profession, with lead times of 8-10 years before the first cohort of students are able to bolster the primary care workforce.

Multi-disciplinary group practices are also likely to be a better fit with Korean medical culture and patient expectations. Ideally, groups could be formed that included the core sub-specialties of family medicine: paediatrics, internal medicine, and obstetrics and gynaecology at a minimum. The triaging of patients, children, women and other adults, within these group practices is likely to occur on the same basis as occurs today in the United Kingdom, where health clinics are staffed by general practitioners with their own practice preferences.

Without a longstanding culture of valuing (or indeed, recognising) general practitioners, Korean patients are more likely to be amenable to the notion of visiting a specialist. At the same time, location in a common facility puts the onus on doctors to work together to help meet the complex needs of patients, which may require the support of multiple specialists, and makes it physically easier for them to do so. In addition to collaboration, doctors and patients could benefit through the co-location of other health workers such as practice nurses, physiotherapists, dieticians and psychiatrists in the same facility, offering more immediate possibilities to provide a wide array of services to patients in one location, and freeing up doctors to focus on clinical work.

Over time, a multi-specialty polyclinics could absorb new family medicine specialists if the medical profession and the government commit to promoting this a career path for promising medical graduates. Irrespective of workforce planning decisions, getting the organisational structure right offers a more immediate path to a stronger primary health care system than a more fundamental re-engineering of Korea’s health workforce to emphasise primary care.

Strengthening primary care in Korea will be a daunting task, but no less daunting than other reforms that Korea has already successfully achieved such as achieving universal access to health insurance; creating a single payor health insurance system; and separating prescribing and dispensing. The heart of the new model of primary care would be multi-specialty polyclinics staffed by private practitioners. They would be paid on a new fee schedule with higher payments for preventative services, counselling, and management of chronic diseases. This would complemented by a P4P scheme to reward high quality primary care. Medical schools would create model primary care polyclinics to train future primary care physicians. With these reforms, Korea could develop a health system that is more efficient, with fewer avoidable hospital admissions, that achieves better outcomes for chronic diseases, decreases health inequalities, and improves social cohesion.

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