

RETIREMENT ALLOWANCE SYSTEM IN KOREAN COMPANIES

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In Korea, the retirement allowance system (RAS) has played a major role in social security in a country where social security is insufficient or wholly lacking. One of the functions of retirement allowance is to guarantee a person's livelihood after he loses his job, although this function is being replaced with the introduction of employment insurance.

In Korea, the retirement allowance system (RAS) has played a major role in social security.

Whatever the function of the retirement allowance system in Korean companies, its benefits are regarded as deferred wages or vested rights. The perspective of the RAS varies according to the basic characteristics and its social functions. It is necessary to have a systematic and full understanding of the character and the function of the RAS.

Characteristics of the RAS

The retirement allowance system developed in the advanced countries as company welfare programs for human resource management. In Korea, there was no social security system for private sector employees in the 1970's, and the retirement allowance system was introduced by the Labor Standards Act as a compulsory system.

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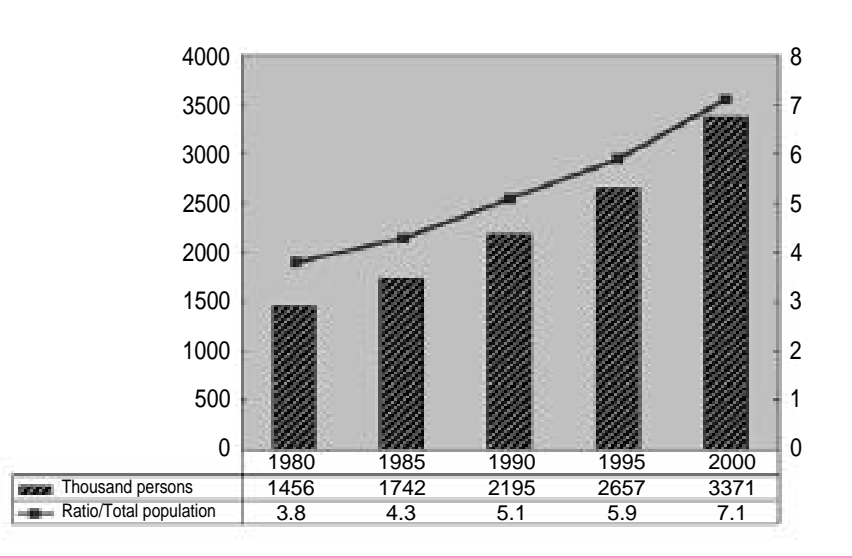
Introduced as a legislative institution, retirement allowance systems in Korean companies included multiple labor welfare functions that had been absent in the social security system during the economic development process.

In Korean companies, retired workers receive lump sum retirement allowances from their companies. The functions of the RAS include wage preservation, unemployment insurance and old age annuity. Namely, it provided compensation for the low-wage policy which was widespread in Korea, livelihood security during unemployment when unemployment insurance was nonexistent, and a sizable sum where pensions after retirement do not exist. Thus, the retirement allowance system is a multiple function welfare system from a socioeconomic viewpoint and is legislated in a different way than in advanced countries.

The functions of the RAS include wage preservation, unemployment insurance and old age annuity.

The RAS as the legislative system is a singular phenomenon that is not found in foreign countries. In most countries, retirement annuities are generalized but optional,

Figure 1. Population trend - Ratio of persons aged 65 and over



Source: National Statistical Office

while in Korea they are mandatory although they vary with the size of the company and have a restricted application. Another difference is that retirement allowances are provided in lump sum in Korea but in other countries they are dispensed as annuities. In most countries, retirement allowances act as livelihood security after retirement, but in Korea, it is a guarantee for the household economy by the lump sum.

Regulations for the retirement allowance system are not applied strictly and the case of each company varies.

Actually, regulations for the retirement allowance system are not applied strictly and the case of each company varies. So the system as a form of income guarantee for old age leaves much to be desired. In other words, the retirement allowance system in Korea has characteristics of both a formal social security system and of a private pension.

Application of the RAS

Allowance system is very generalized at 98% and has no relationship with the existence of labor unions.

The employee who benefits from the retirement allowance system is defined as a worker who offers labor for wages regardless of the industry. However, this doesn't apply for workers employed for less than one year. From here, continuous service year under one employment contract is not limited in the duration when it is continued, this includes the case where continuous tour of duty accomplished is 1 year over. Thus continuously it renews the temporary contract of 3 month units and it means that the case where integrated tour of duty has become 1 year over becomes the object of the RAS. In the Korean private sector, the application of the retirement allowance system is very generalized at 98% and has no relationship with the existence of labor unions.

The amount of retirement allowance payment is determined by law.¹⁾ The employer applies this rule based on the Labor Standards Act, by decision of collective agreement, or by establishing separate rules for the system.

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The level of benefits in the retirement allowance system differs for each company depending on organization, the management, and labor relations, but the basic formula is 'standard × payment rate'. For the payment rate, each company considers the length of the worker's service and adds the progressive rates of the company.

According to the Labor Standards Act, retirement allowances must pay one month's wages for every year of service, so the legal payment rate is 8.3%. But if companies apply progressive rates, they pay (n+) months wages, with 'n' being years served, and the payment rate exceeds 8.3%. In this case, the payment rate is (n+)/n × 12 and the progressive rate is /n × 12. So if companies utilize progressive rates, retirement allowance grows faster for every additional year served.

The average wage is used as a standard for retirement allowances. This is the average of the worker's last three months' wages before his retirement. The wage hikes and the increase in continuous service in the 1990s adds extra weight to retirement allowances in Korean companies. For retirement allowances, companies are required to reserve 8.3%(legal rates)+ (progressive rates) of the wages that the company should pay every month. Cumulative retirement allowances occupy a higher share in capital stock for companies that are bigger, older, in the private sector, and in service industries.

Problems in the RAS

From the worker's viewpoint, the RAS favors white collar and professional workers who earn relatively high wages and serve longer years. In contrast, it is a disadvantage to technicians and blue collar workers. This is the main issue regarding the retirement allowance system, which was originally meant to enhance income security.

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To companies, the RAS is an important tool for securing competent manpower and for boosting motivation, but it is insufficient as a legislative system. In addition, workers view the system as a right, so it does not act as an incentive for workers to raise productivity.

Another problem of the RAS is that older Korean companies have a heavier burden. And if a company goes bankrupt, retirement allowance is not guaranteed at all, because companies must pay the entire sum of retirement allowance. **VIP**

Another problem of the RAS is that older Korean companies have a heavier burden.

1) Article 34 (Retirement Allowances System) An employer shall establish a retirement allowances system whereby an average wage of more than 30 days shall be paid for each year of consecutive years employed as a retirement allowance to a retired worker.