



# STRENGTHENING SOCIAL COHESION IN KOREA

## Assessment and Recommendations

(Preliminary version)



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*Footnote:* This is the Chapter with the main Assessment and Recommendations from the new OECD publication *Strengthening Social Cohesion in Korea* launched by the OECD's Secretary-General Angel Gurría at the KDI-OECD Joint Conference on Korea's Social Policy Challenges – Seoul, 5 February.

## A POLICY TOOLKIT FOR GROWTH AND SOCIAL COHESION IN KOREA

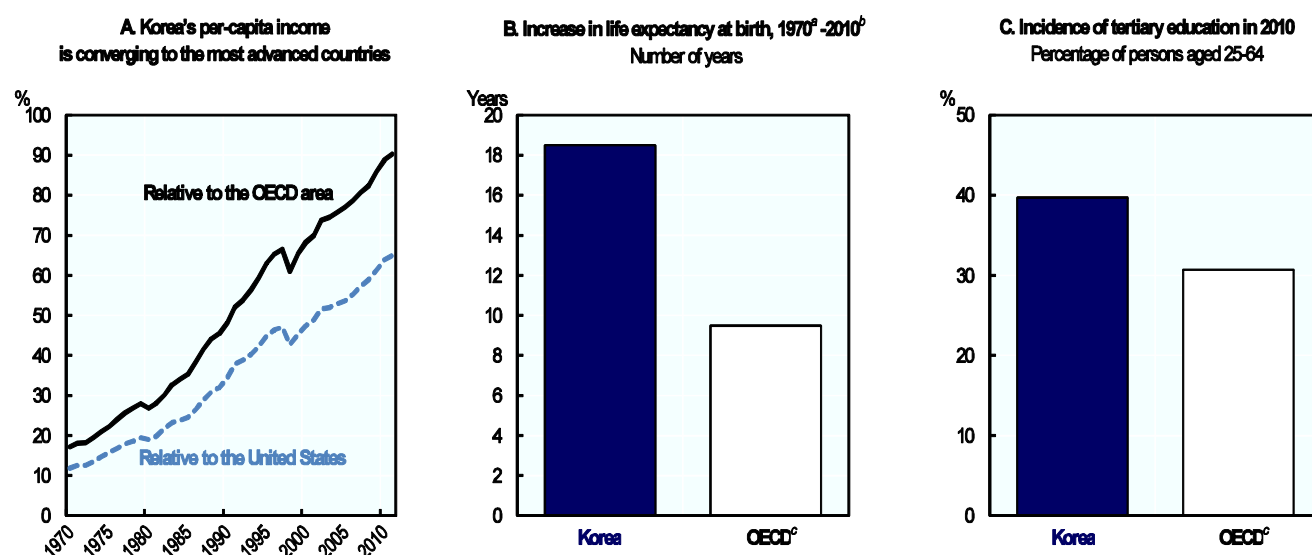
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*Korea's economic record is outstanding, but income inequality and relative poverty have risen markedly since the mid-1990s, along with a deterioration of other well-being indicators*

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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 1).

**Figure 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.

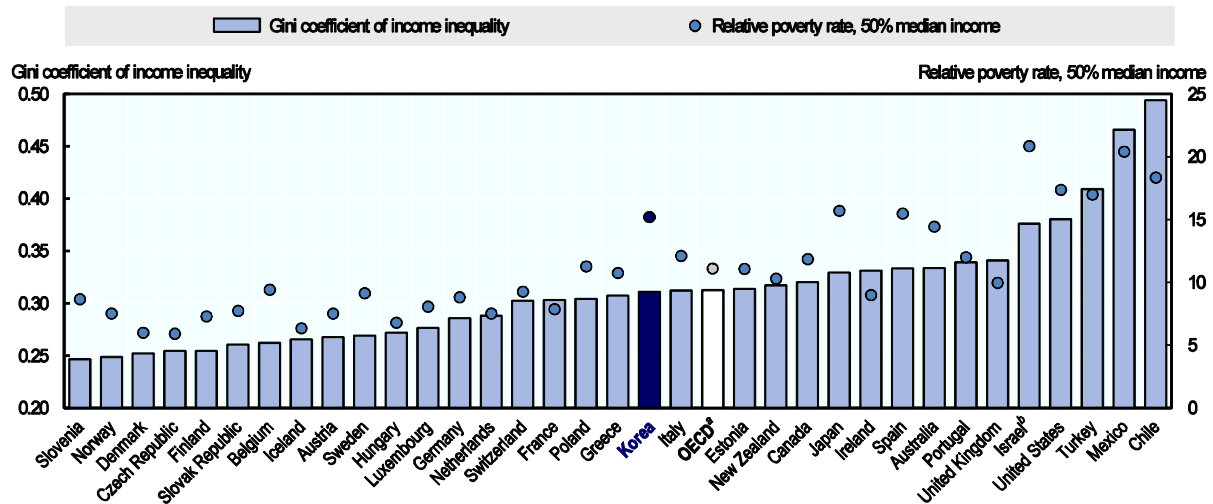
c) Unweighted average of the 34 OECD countries.

Source: OECD calculations based on the *OECD Annual National Accounts Database* for Panel A; *OECD Health Database* for Panel B; and OECD (2012a), *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 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 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](http://www.oecd.org/els/social/inequality), Preliminary data.

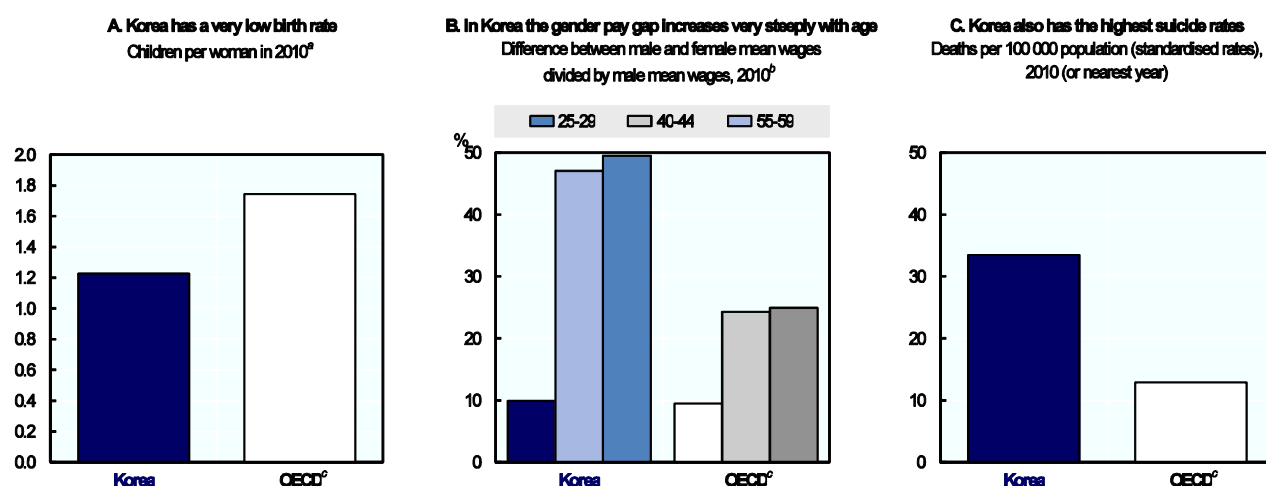
Other well-being indicators also point to tensions in the Korean economy and society. In particular, Korea has the lowest birth rate in the OECD, with two parents replacing themselves in the next generation by little more than one child (Figure 3). This is more than just evidence that the country is 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.<sup>1</sup> 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 3. The challenge of strengthening social cohesion in Korea cannot be reduced in 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.

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

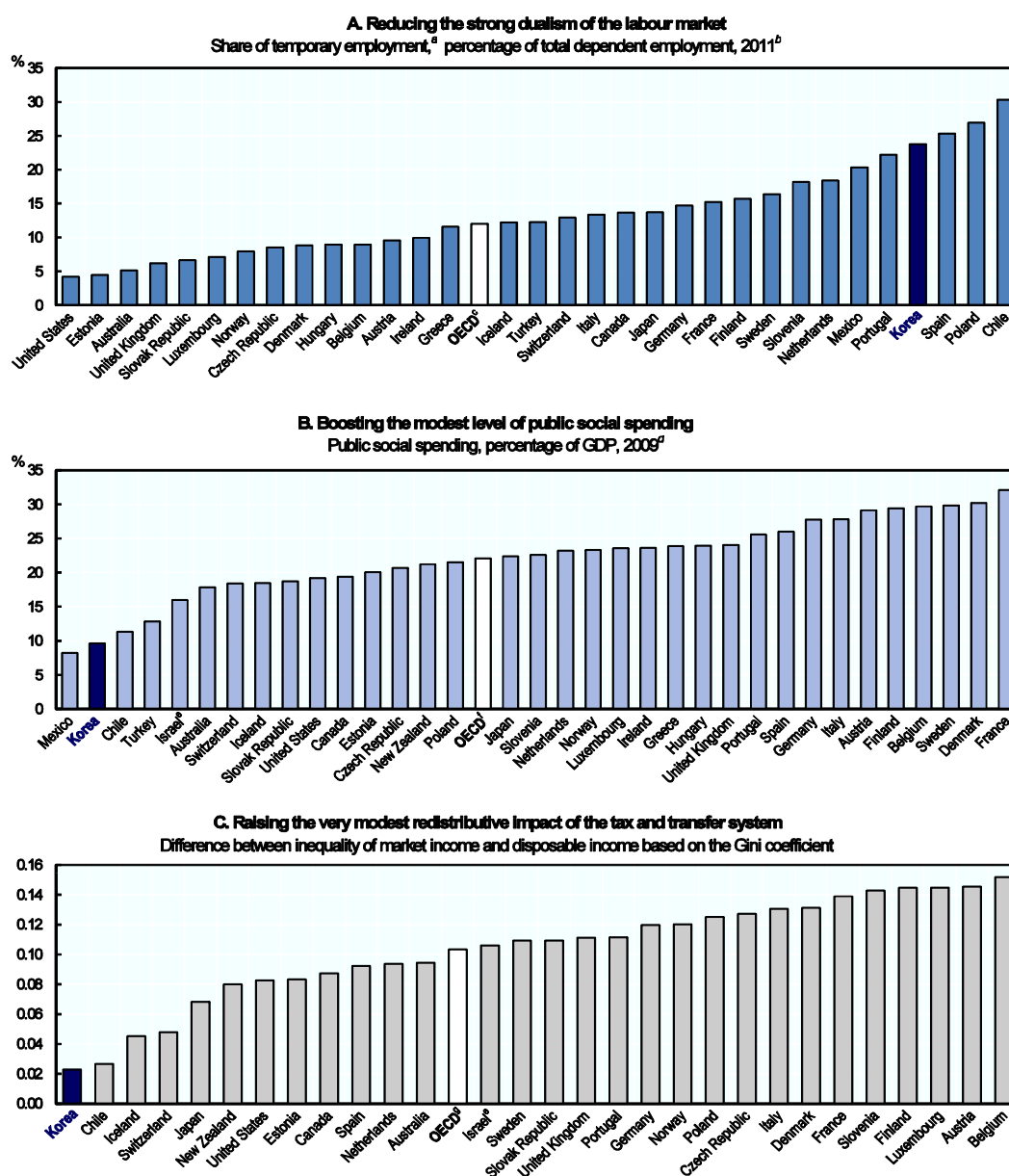
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Looking further ahead, the fact that Korea is now increasingly integrated in the global economy implies that it is facing the same pressures that contribute to rising inequality in many other OECD countries (OECD, 2011a). In particular, in Korea, as 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 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.

**Figure 4. Three challenges that Korea policy markets need to meet in order to reverse the rise in income inequality**



- 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).
- 2004 for Mexico, 2005 for the United States and 2006 for Australia.
- Weighted average of OECD countries whose data are available in 2011.
- Data for Mexico have been estimated. Data for Switzerland refer to 2008.
- Information on data for Israel is available at: <http://dx.doi.org/10.1787/888932315602>.
- Unweighted average of the 34 OECD countries.
- Unweighted average of the 29 OECD countries shown in Panel C.

Source: OECD Online Employment Database ([www.oecd.org/employment/database](http://www.oecd.org/employment/database)) for Panel A; OECD Social Expenditure Database ([www.oecd.org/els/social/expenditure](http://www.oecd.org/els/social/expenditure)) for Panel B; and OECD (2011a), *Divided We Stand: Why Inequality Keeps Rising*, OECD Publishing, <http://dx.doi.org/10.1787/9789264119536-en>, for Panel C.



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

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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.

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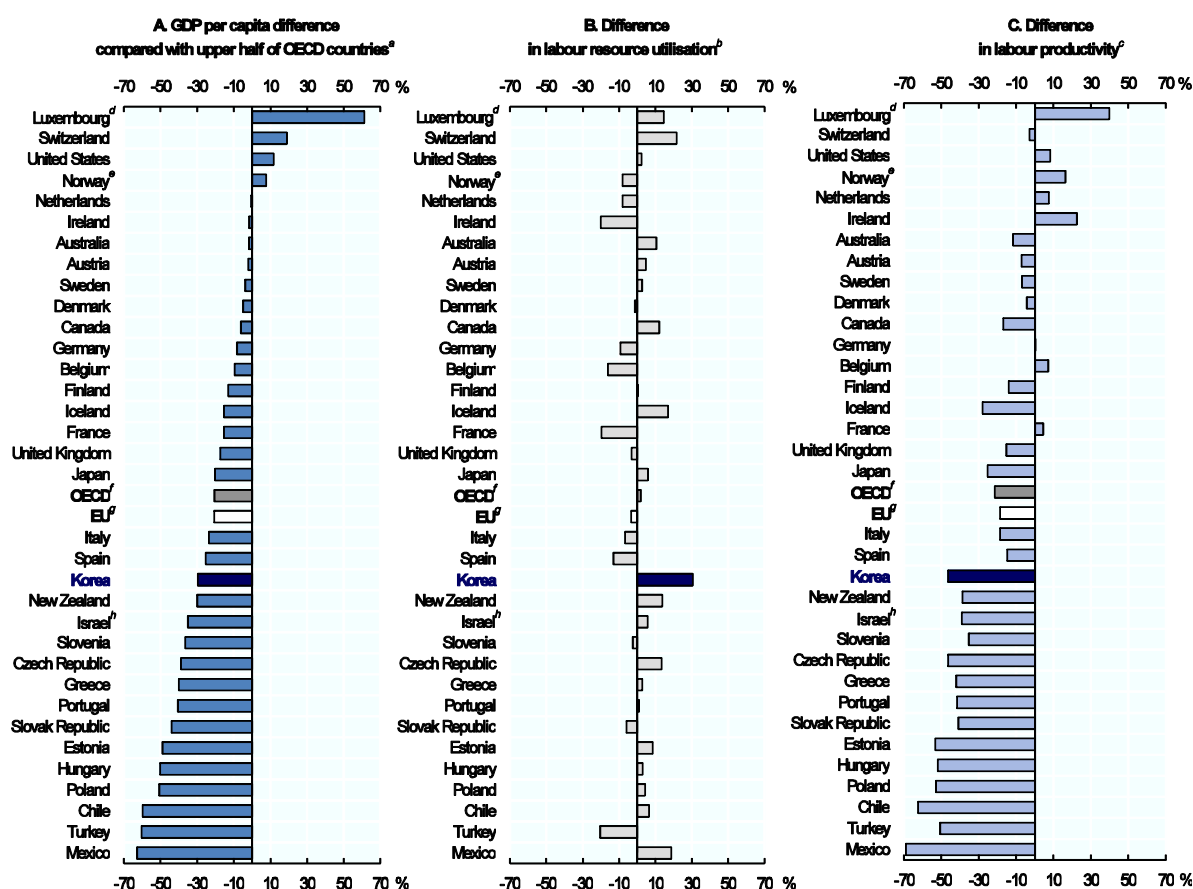
*Strong growth makes it easier to strengthen  
social cohesion*

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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.

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 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.

**Figure 5. Korea's future output growth will need to be strongly driven by gains in labour productivity, which remains very poor by international standards**



- 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.
- Labour resource utilisation is measured as the total number of hours worked per capita.
- Labour productivity is measured as GDP per hour worked.
- 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.
- 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.
- Unweighted average for the 34 OECD countries.
- 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.
- 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, forthcoming.

In contrast to labour inputs, labour productivity per hour worked is 55% below the average of the top half of OECD countries (Figure 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 60% of that in its manufacturing sector and 44% of the US service sector average in 2010.

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*Competition-friendly reform will help to support productivity growth*

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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 13% of GDP in 2010. Moreover, FDI in the service sector was only 6% of GDP compared with the OECD average of 37%. 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.

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*Fostering social cohesion requires a holistic approach*

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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.

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*The potential pay-offs of such an approach are large*

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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 work force, 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.

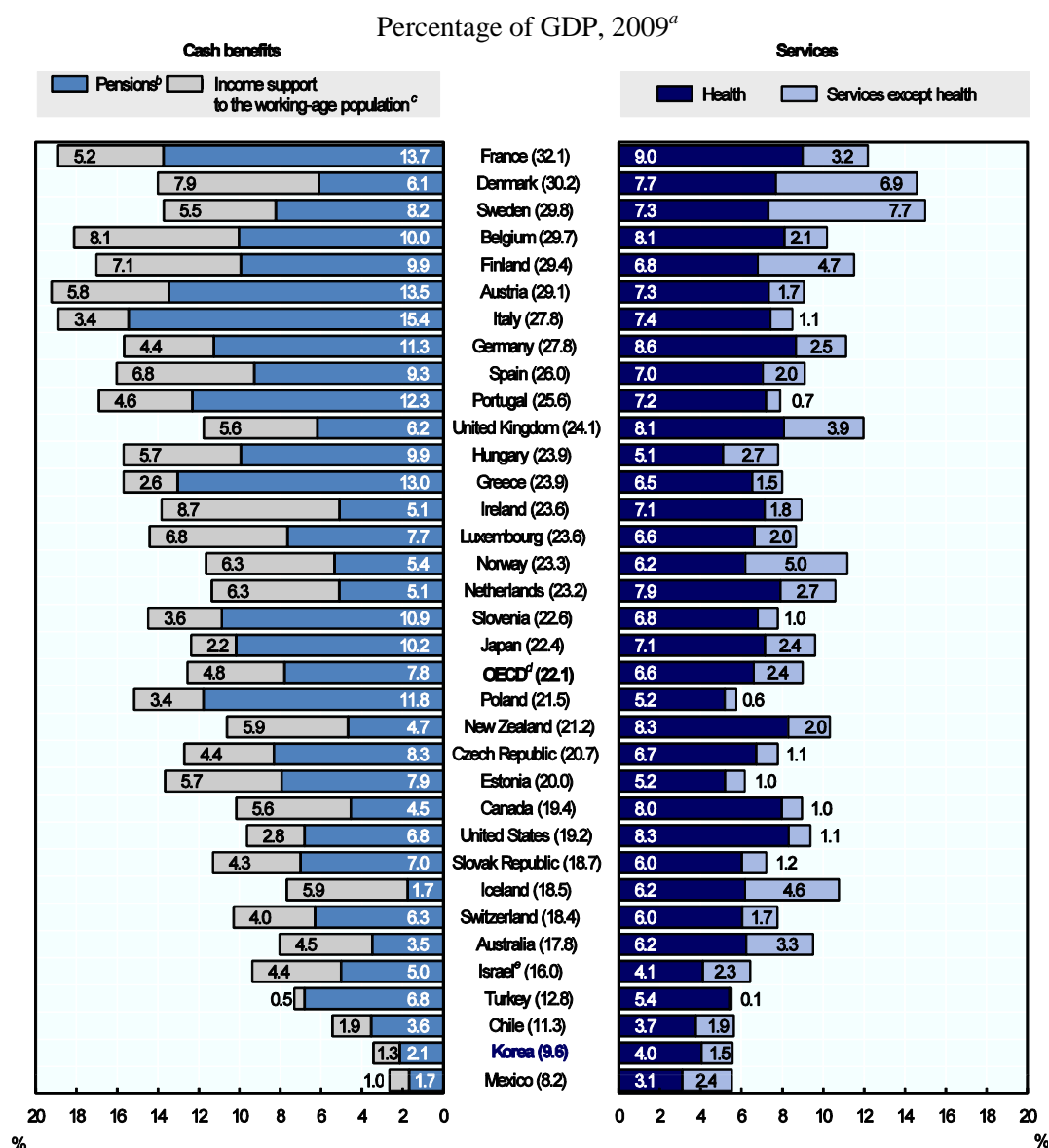
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*Increasing social spending can go a long way towards strengthening social cohesion but is also crucial to ensure efficiency in this spending*

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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 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.

Figure 6. Korea's public social expenditure is low in all main social policy areas



Note: Countries are ranked by decreasing order of public social expenditure as a percentage of GDP. Spending on Active Labour Market Programs (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 (2012b), "Social Spending after the Crisis, Social Expenditure (SOCX) Data Update 2012", available at [www.oecd.org/els/social/expenditure](http://www.oecd.org/els/social/expenditure).

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.

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*More efforts to ensure integration of social programmes must be undertaken*

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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.

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*How to finance higher social spending without hurting output growth?*

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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.

At present, the overall “tax wedge” on labour income, including social security contributions, remains comparatively low in Korea. At around 20% in 2010, it is the fourth 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%. 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.

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*Well-targeted tax and benefit programmes are also needed*

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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.

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

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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 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).

**Table 1. Scenario analysis of the macroeconomic impact of increases in public social spending and changes in labour supply<sup>a</sup>**

	Percentage of GDP (unless otherwise specified)			
	2015	2020	2025	2030
<b>Baseline scenario</b>				
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
<b>First scenario: Strong rise in public social spending to reach the OECD average by 2030</b>				
<i>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)</i>				
<i>Resulting deviation from the baseline in:</i>				
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
<b>Second scenario: Moderate rise in public social spending</b>				
<i>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)</i>				
<i>Resulting deviation from the baseline in:</i>				
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
<b>Third scenario: Gradual increase in female participation to achieve the same participation rate of male by 2030</b>				
<i>Resulting deviation from the baseline in:</i>				
Potential output of the total economy (percentage deviation from the level of the baseline)	0.1	1.6	7.0	19.0
<b>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</b>				
<i>Resulting deviation from the baseline in:</i>				
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 projection model described in Johansson *et al.* (2012). 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.



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%).

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 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 grow 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.

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#### *Tackling entrenched dualism in the labour market*

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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.

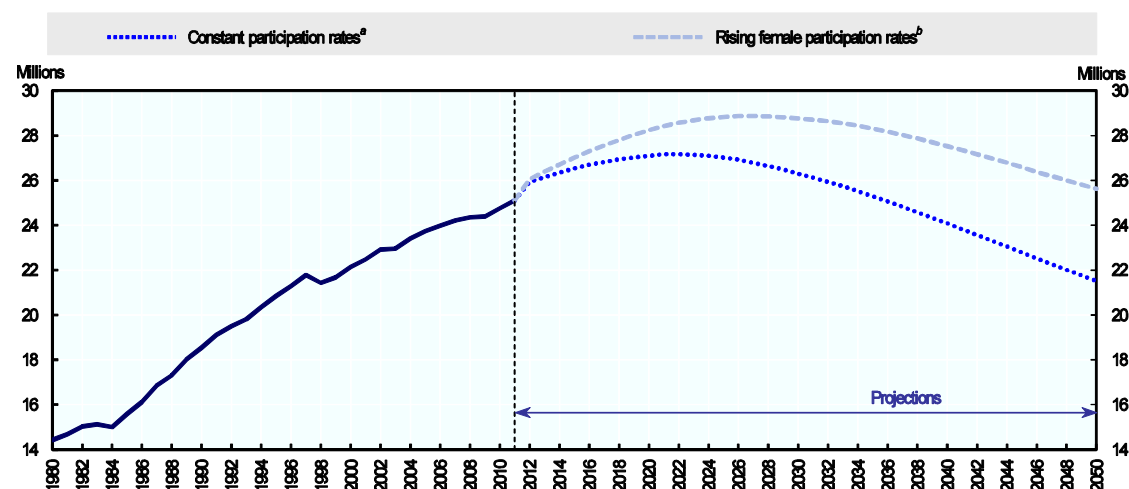
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*Complementary measures are required to tackle the labour market outcomes for specific groups: youth women and older workers*

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Rapid population ageing implies that increased policy attention needs to be devoted to making the best use of all human resources (Figure 6). 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.

**Figure 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 (2012d), *OECD Economic Surveys: Korea 2012*, OECD Publishing, Paris, [http://dx.doi.org/10.1787/eco\\_surveys-kor-2012-en](http://dx.doi.org/10.1787/eco_surveys-kor-2012-en).

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 childcare, 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).

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.

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.

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

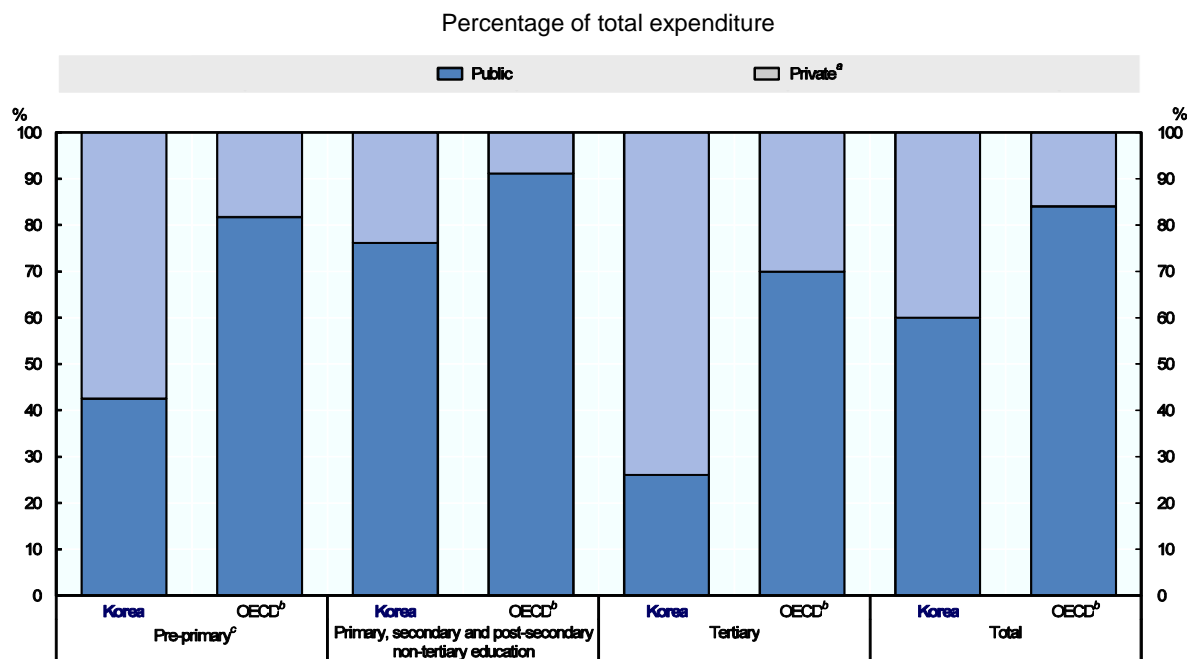


opportunities (as discussed above, this is important for supporting social mobility across generations), fewer school dropouts and greater labour market success.

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 7). 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.

**Figure 8. International comparison of private spending on education in 2009**



- 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 (2012a), *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.

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*Which policy measures are most suited to promote ECEC?*

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*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.

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

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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 dispensing 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 multiple-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.

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#### *Moving from hospitals to improve primary health care*

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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 multiple-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. Multiple-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.

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

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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 1. **Summary of recommendations for *Strengthening Social Cohesion in Korea***

**1. 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



Box 1. **Summary of recommendations for *Strengthening Social Cohesion in Korea* (cont.)**

***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.

**2. 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.
- 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.

### **3. 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 childcare 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 childcare 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.

### **4. 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 multiple-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 multiple-specialty primary care practices.
- Encourage a multiple-specialty team approach in new primary care multiple-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.

## NOTES

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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