Social Security and Retirement in Korea: Evidence from Longitudinal Data

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Abstract

Labor force participation of older males in South Korea is higher than other OECD countries, with the effective labor market exit age ranking the highest. The current retirement age, or the eligible age to receive pension benefits, ranges from 60 to 65. However, the effective labor market exit age in 2016 was 72.0 for men. This is much higher than the OECD male average of 65.1, United States male average of 66.8, and the age of 70.2 for men in Japan (OECD 2017). The labor market exit age for most OECD countries tend to be similar to the official retirement age. South Korea depicting a much higher labor market exit age, as well as the staggering high elderly poverty rate, indicates the fact that the elderly population needs to work longer for economic stability.

One of the main causes of the elderly population's unstable financial condition is due to low public safety-net benefits. In spite of the country's seeming wealth, government support for the senior population is very limited with only 1.7 percent of the GDP being spent on pension benefits for the elderly in 2015. It ranks the second lowest, just above Mexico which spends 1.5 percent of its GDP on pensions. This is appallingly small compared to the OECD average of 9 percent and Japan's spending of 11.2 percent of the GDP.[1]

Korea's largest social security system aimed for the elderly population – The National Pension Scheme (NPS) – was created in 1988 and achieved universal coverage in 1999. It has been known that in many countries, government pension programs have been the underlying force behind the decline in labor force participation of the older population (Blau and Goodstein 2010; Blondal and Scarpetta 1999; Gruber and Wise 2004). However, Korean seniors do not seem to retire after the official retirement age, implying that pension benefits from the government may be insufficient for later life.

Using six waves (2006-2016) of the Korean Longitudinal Study of Ageing (KLoSA), this study examines the impact of social security benefits on retirement decisions for older adults living in South Korea. Analysis is done separately for salaried workers and the self-employed. Comparisons also show differences in income levels. The methodology used in this paper is a widely used model in retirement studies, which have been applied to various other countries (Gruber and Wise 2004; Stock and Wise 1990). The unique labor market characteristics of Korea will provide valuable insights to other countries experiencing population aging. Furthermore, this study conducts policy simulations such as changing the retirement age or the net replacement rate to find the optimal policy solution.

Overall, regression analysis shows that social security benefits received from the NPS do not play a big role in retirement decisions of the elderly. Also, the incentives for retirement built into the national pension system do not seem to contribute much to early retirement or even retirement around the eligible age of 60, especially for the self-employed. This is in contrast with the experience in many advanced countries where government pension programs have been the underlying force behind the decline in labor force participation of the older population. With the increasing life expectancy, Korean seniors will find pension benefits from the government to be insufficient for later life. The government has currently announced a reform plan for the NPS which has already been receiving public backlash. This paper aims to provide insights on the

[1] Projections of public expenditure on pensions (% GDP, 2015). Source: OECD Statistics.

underlying incentives of the national pension program, as any further reforms will change the system in a manner that has crucial impacts on retirement decisions of Korean workers.

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