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**Research Report**

## Remaining Tasks after Passing of the Retirement Age Extension Bill

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**KDI FOCUS** | Analysis on critical pending issues of the Korean economy to enhance public understanding of the economy and provide useful policy alternatives

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## Remaining Tasks after Passing of the Retirement Age Extension Bill

Soo Kyeong Hwang, Fellow at Korea Development Institute

**“Having made a retirement age of 60 mandatory through the revision of the law this time has obviously arranged a turning point in relation to utilization of middle/high-aged human resources. But, extension of retirement age which does not accompany wage adjustment may increase corporate labor costs, reduce new employment of youngsters, and may rather act as a cause for layoff of middle/high-aged workers.”**

### I. Introduction

The Retirement Age Extension Bill which had been a controversial issue between the labor side and the management side for a long period of time passed the National Assembly. The Retirement Age Extension Bill of which the main content is to guarantee the retirement age of 60 passed the National Assembly in the main session held on April 30 and the related law (Act on Prohibition of Age Discrimination in Employment and Elderly Employment Promotion) was revised on May 22, putting an end to the controversy. Accordingly, the retirement age of 60 will be made mandatory in Korea in stages from 2016.

When we look into the content revised this time, first, the existing clause which recommends the retirement age of 60 without having any legal force is substituted by the mandatory clause (Paragraph 1 of Article 19) reading, “the employer should set the retirement age of the employees to 60 or higher”, and the effectiveness of the retirement age of 60 is guaranteed by having a new clause of legal fiction (Paragraph 2 of the same article), reading “in the case the

**The retirement age of 60 will be made mandatory in Korea in stages from 2016.**

retirement age is set to below 60, it will be deemed to be 60”, instead of the forceful execution clause such as penalty. It means that, if the employer sets the retirement age to below 60 and lays off employees based on it, it may be deemed an unfair dismissal in accordance with the Labor Standards Act. Public institutions, local government corporations, provincial industrial complexes, and business places with 300 workers or more shall be subject to this law from 2016, and the government, local governments, and business places with less than 300 workers shall be subject to this law from 2017.

In the meantime, it is specified that the companies that extends the retirement age should take the necessary actions such as restructuring the wage system through consultation with the labor side so that the wage of the workers whose retirement age is extended can be adjusted together with the extension of the retirement age, and the necessary supports such as employment promotion subsidy, consulting on wage system restructuring, and so on are made available for the companies that take or are going to take such actions (Paragraph 2 of Article 19).

As such a revision was made by mutual agreement between opposing parties, it seems that the social controversy or resistance will not be that big after it has passed the National Assembly. Throughout our society, a bond of sympathy has been formed to some extent that the current retirement age system which retires workers at an excessively early age is not desirable for individual workers and the national economy in view of the fast aging trend of our society.

But, even though the validity of or necessity for an extension of the retirement age is acknowledged, concerns about the side effects of the extension of retirement age when the reality in our labor market is taken into account still exist. For example, extension of the retirement age which does not accompany wage adjustment is likely to reduce new employment of youngsters, and may provide the cause for layoff of middle-aged/aged workers differently from the intent of the system. Also, if the actual beneficiaries of the extension of the retirement age are limited to the public sector and the labor union section, it may possibly cause further expansion of the polarization of the labor market. Unfortunately, the revision of the law this time is not enough to clean out such concerns. There are more remaining tasks to be performed in the future in order to fully achieve the original intent of the extension of the retirement age.

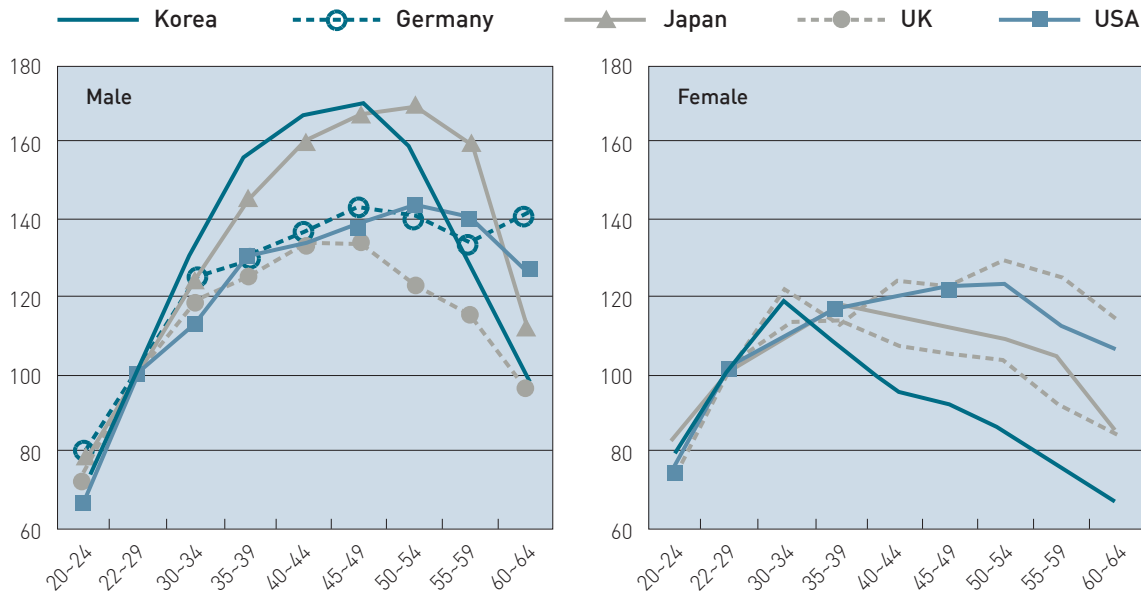
In this writing, we intend to analytically review the diverse issues remaining after the introduction of the retirement age of 60, based on which we shall present a policy task which can be promoted to practically stabilize employment without losing vitality of the labor market.

## **II . Issue 1: Seniority Wages and Increase in Labor Costs**

The biggest issue related to extension of the retirement age is the issue of increase in the cost resulting from maintenance of employment of middle-aged/aged workers. As the wages of workers in a competitive labor market are decided reflecting the productivity of individuals, no additional cost burden is placed on the company even if the employment period of middle-aged/aged workers

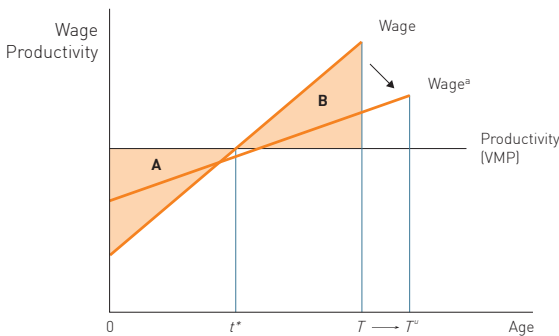
Throughout our society, a bond of sympathy has been formed to some extent that the current retirement age system which retires workers at an excessively early age is not desirable for individual workers and the national economy in view of the fast aging trend of our society.

[Figure 1] Age-Wage Curve of Major Countries (Age of 25~29 = 100)



Data: OECD (2004), p. 99.

[Figure 2] Seniority Wage and Retirement Age System



Data: Hwang et al. (2005).

is extended. But, the situation is different if the wages of the company is independently decided in the internal labor market and strongly assumes the nature of the seniority wages.

A retirement age system, viz. mandatory retirement system, is an employment practice mainly found in Japan and Korea where seniority-based personnel practice is common. In [Figure 1], age-wage curves of major countries are compared, and those of Korea and Japan show a very steep seniority

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nature up to the late forties and early fifties respectively (for males). In the figure, the wages of Korean workers reach the peak at their late forties and then decreases, which does not result from the wage system within the company but reflects dual structure of the middle-aged/aged worker labor market, and the wage continuously increases in general as far as the relevant workers remain in the internal labor market of the company (Hwang et al. [2005]).

Seniority wages are adopted when a company has an incentive system for long-term contract, in which younger workers are paid less than their productivities and older workers are paid more than their productivities in order to induce long-term service of workers. In this sense, seniority wages are also called deferred compensation. The relation between seniority wages and retirement age system is well explained in the long-term contract model of Lazear (1979) (Figure 2). If the continuous service of a worker in a company with seniority wages

passes through a certain point in time ( $T$ ), a gap between the lifetime wages and the lifetime productivity will take place (that is to say,  $B > A$ ). As the company will incur a loss, it is reasonable for the company to forcefully terminate the employment relation by setting the retirement age. According to such an explanation, extension of the retirement age without wage adjustment will cause a decrease in efficiency by increasing the labor costs of the company. If the retirement age is to be extended ( $T \rightarrow T'$ ), the seniority rule of the wages should be also adjusted.

**Seniority wage is a wage system wherein the economic rationality is pursued by quadrating lifetime wage with lifetime productivity on the premise of long-term employment.**

Seniority wage is a wage system wherein the economic rationality is pursued by squaring lifetime wages with lifetime productivity on the premise of long-term employment contract. It also is a wage system which enables the company to make continuous investment in workers based on the long-term employment relation, and the workers to continuously improve productivity and design a stable work life. But such an economic rationality of seniority wages is confronted with a fundamental challenge in several aspects.

**As the cycle of production is reduced and change in technology progresses rapidly, the likelihood that the gap between a life-long increase in the wage and life-long increase in the productivity is further amplified has increased.**

The first point is that, as the cycle of production is reduced and change in technology progresses rapidly, the likelihood that the gap between life-long increase in the wage and life-long increase in the productivity is further amplified has increased. In this case, excessively steep seniority-based wage system results in the rigidity of wage, which acts as a cause for the company to further increase the demand for contingent jobs.

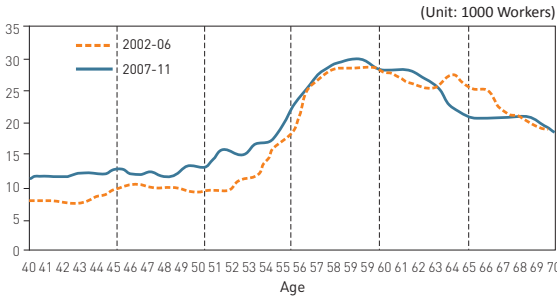
**Companies have come to induce early retirement of middle-aged/aged workers in diverse forms, and, as a result, the long-term employment relation itself which has been the base of the seniority wage is in a threatening situation.**

Second, the steep seniority-based wage system is greatly increasing the labor cost burden of companies in concert with overall aging of workers. For example, companies with more middle-aged/aged workers than young workers should put up with the burden of labor costs exceeding the productivity of the workers at all times. For such a reason, companies have come to induce early retirement of middle-aged/aged workers in diverse forms, and, as a result, the long-term employment relation itself which has been the base of the seniority wage is in a threatening situation. [Figure 3] illustrates the cases which fall under 'full retirement/old age' or 'honorary retirement/early retirement/redundancy' among the causes for retirement of the workers who retire within 1 year. Though the official retirement age of 55 or 58 accounts for the biggest portion (Table 1), in practice, the number of the main job workers who have retired increases from the age of 50. It shows that the number of workers who retire early before the retirement age for various reasons in reality is more than a little.

Third, when long-term employment relation is not expected, the seniority-based wage system may fail to properly reflect the productivity of workers or motivation mechanism, which may devitalize the organization by distorting the distribution of wage among workers and seriously damaging the fairness of wage.

If these points are considered, the extension of the retirement age is required to be done in parallel with the adjustment of wages in any form. Though it is specified in the law revised this time to take the action of wage system restructuring together with the extension of the retirement age, it is difficult to interpret this clause as a requisite for extension of the retirement age. Also, there still remains a room for controversy over the interpretation of the wage system restructuring or concrete restructuring direction.

[Figure 3] Distribution of the Number of Main Job Workers by Age Who Retire



Note: The number of the main job workers who have retired is adjusted based on the moving average of 3 years from the year of birth.

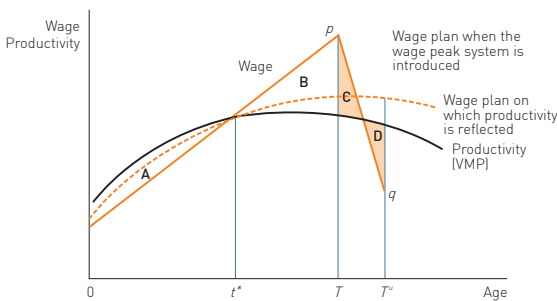
<Table 1> Retirement Age Status of Business Places Which Have Adopted the Single Retirement Age System

(Unit: Number of Places, 1000 Workers, %)

|                        | 54 or Younger | 55           | 56         | 57          | 58           | 59         | 60 or Older  | Average Retirement Age |
|------------------------|---------------|--------------|------------|-------------|--------------|------------|--------------|------------------------|
| No. of Business Places | 8 (0.4)       | 668 (36.5)   | 7.9 (4.3)  | 190 (10.4)  | 415 (22.7)   | 66 (3.6)   | 403 (22.0)   | 57.3                   |
| No. of Workers         | 5.0 (0.2)     | 782.6 (33.7) | 84.9 (3.7) | 192.2 (8.3) | 809.0 (34.8) | 75.0 (3.2) | 374.3 (16.1) |                        |

Data: Ministry of Labor, Employment Status of the Aged and Operation Status of Retirement Age System, Jun. 2011.

[Figure 4] Extension of Retirement Age and Restructuring of Wage System



decrease in the investment for human capital.<sup>1</sup> [Figure 4] is the diagram of the relation between age and productivity/wage drawn under such an assumption. At this time, the gap between the wage and the productivity grows bigger at the point in time of the retirement age, in which case wage adjustment like the wage peak system is required when extending the retirement age (straight line  $pq$ ). However, as the workers may experience rapid reduction in the income during the extended employment period in the case of the wage peak system, there seems to be a problem that it is not easy for the workers to accept the income reduction. More desirably, it is presumed that employment stability of middle-aged/aged workers can be achieved when the wage plan of companies is adjusted to be almost similar to the actual productivity (wage schedule in the dotted line) still maintaining the incentive for long-term contract.

### III . Issue 2: Substitutability with Youth Employment

Concerns are also raised that the extension of the retirement age will deprive youngsters of an employment chance in return for extension employment of the middle-aged/aged

1) The peak time (age) of productivity may differ greatly depending on the detailed business type and job type. In the empirical studies on manufacturing business, the peak is reported to be at the thirties to forties in general. But, the peak time of the workers engaged in brain labor may be later than this, and the peak time may also be delayed in an environment friendly to the aged. Some empirical studies recently have reported that the peak time is delayed due to various causes for change (Skirbekk [2008]).

As the workers may experience rapid reduction in the income during the extended employment period in the case of the wage peak system, it may be more desirable to adjust the wage plan to be similar to the actual productivity still maintaining the incentive for long-term continuous service.

**<Table 2> Findings of Domestic and Overseas Studies Related to Employment Substitution of Youngsters and Middle-aged/Aged Workers**

| Classification                                     | Domestic Studies   | Overseas Studies   |
|--|--|--|
| No Substitutive Relation or Complementary Relation | - Jooyub Ahn (2011), Joonyoung Kim (2011), Hyeja Kwon (2010), Daeil Kim (2004), Hyundai Research Institute (2010): The relation between the employment of youngsters and the middle-aged/aged workers is not a substitutive relation but is close to complementary relation. | - Hebbink (1993): No forward (+) substitutive relation has been found between youngsters and the aged, and the relation between the two classes is close to a complementary relation.<br>- Kalwij <i>et al.</i> (2009), Jousten <i>et al.</i> (2010), Boesch-Supan <i>et al.</i> (2010): There is no evidence that a decrease in the employment of the aged due to early retirement in Europe has led to an increase in the employment of youngsters.<br>- Oshio <i>et al.</i> (2010), O-ota (2010): There is no evidence that the extension of the retirement age has a negative effect on employment of youngsters in Japan. |
| Substitutive Relation Exists                       | -  | - Card and Lemieux (2001): There is an incomplete substitutive relation between employment of youngsters and the aged.   |

Note: Quoted from Jaeho Keum (2011).

**It is a general analysis that the substitutive relation between employment of the aged and youth is not apparent in the macroeconomic aspect.**

workers. But, it is a general analysis in domestic studies that the substitutive relation between employment of the aged and youth is not apparent in the macroeconomic aspect (Daeil Kim [2004]; Hyeja Kwon [2010]; Jooyub Ahn [2011]; Hyundai Research Institute [2010]). Such a result is based on the points that total employment is not predetermined but primarily changes depending on the economic growth factor, and that the jobs the aged are employed for are different from those the youngsters want to be employed for. While young employees are concentrated on professions and office jobs in the service sector, middle-aged/aged employees flock to traditional ones such as production job in manufacturing business, construction business, and transportation business.

**Competition between generations can partially exist for good quality jobs in public corporations and large companies.**

However, though no substitutive relation appears between the employment of the aged and youngsters in the long-term or macroeconomic aspect, there is not little possibility for an individual company to adjust the size of new employment due to the extension of the retirement age. Though the jobs for the aged and youngsters are different as a whole, competition between generations can partially exist for good quality jobs in public corporations and large companies, and most of such jobs will be affected by extending the retirement age. In particular, the extension of the retirement age without wage adjustment in the public sector in which the total labor cost is controlled may directly result in reduction of new employment.

Eventually, an elaborate examination is required in order to minimize the side effects of the extension of the retirement age that deprives the company of a chance to employ good quality youngsters through adjustment of wages to a reasonable level. In addition, it is required to cut off in advance the problems of extending the retirement age leading to aging of the organization and of the conflict with the young generation being amplified due to personnel congestion by restructuring the seniority based personnel management system which has nothing to do with ability of workers into an ability/performance centered personnel management system.



#### IV. Issue 3: Issue of Non-beneficiary of Retirement Age Extension

The last issue related to the extension of the retirement age is fairness between the beneficiaries and non-beneficiaries. The beneficiaries of the guarantee for the retirement age of 60 this time are of course limited to the workers to whom the retirement age system is applied to. The workers in a company where there is no retirement age system at all or contingent workers such as contract workers who are excluded from the objects of retirement age basically cannot be the objects of the benefit. In this aspect, the objects of retirement age are very limited.

According to the additional survey for the Enterprise Labor Force Survey conducted in 2011, while 94.5% of public corporations and large companies are shown to be running a retirement age system, only 20.0% of small/medium-sized companies are running a retirement age system. The ratio of the companies that have a retirement age system is only 20.2% of the total as a whole (Ministry of Employment and Labor [2012]). The prediction that the extension of retirement age will encourage polarization of the labor market as the benefit is limited to only some of the workers who have a good job is not a simple undue worry.

Furthermore, in the baby boom generation which will become the first beneficiary group of the retirement age legislation this time, two heterogeneous groups exist internally. According to Hwang (2012), the result of analyzing the retention rate of career jobs and retirement time after defining the job which a worker can stably retain for 10 years or more in a workplace as a 'career job' has shown that 49.5% of the baby boom generation has never experienced a career job as of 2010, and the ratio of the workers still in service is only 52.7% of the total. That is to say, only about 26% of the baby boom generation is having a career job at present, and the remaining 3/4 of the workers have already retired from the career jobs or are engaged in a job far from a long-term service job.

When such points are taken into account, the beneficiaries of the extension of the retirement age this time are limited to a very small part of the baby boom generation. Also, when it is taken into account that the retirement ages of a considerable number of companies are between 55 and 58, most of the baby boom generation workers born before 1960 who are going to reach the retirement age before 2016 will highly likely be excluded from the direct objects of the benefit.

In this aspect, the policy to promote employment stability of middle-aged/aged workers relying on the retirement age system has only a very limited meaning. A policy which supports

<Table 3> Experience of Retaining a Career Job<sup>1)</sup> and Ratio of Workers in Service

(Unit: Number of Workers, %)

| Year of Birth   | Before 1936   | 1937 ~ 1945   | 1946 ~ 1954   | 1955 ~ 1963   | 1964 ~ 1972   | Total         |
|---|---------------|---------------|---------------|---------------|---------------|---------------|
| None  | 236 (19.1)    | 344 (26.6)    | 657 (33.5)    | 1,392 (49.5)  | 1,714 (69.7)  | 4,343 (44.5)  |
| 1 Job   | 785 (63.6)    | 711 (54.9)    | 1,045 (53.2)  | 1,274 (45.3)  | 727 (29.6)    | 4,542 (46.5)  |
| 2 Jobs or More  | 214 (17.3)    | 239 (18.5)    | 262 (13.3)    | 148 (5.3)     | 19 (0.8)      | 882 (9.0)     |
| Total   | 1,235 (100.0) | 1,249 (100.0) | 1,964 (100.0) | 2,814 (100.0) | 2,460 (100.0) | 9,767 (100.0) |
| Ratio of Workers in Service Among Those Who Have an Experience of Retention | 11.8          | 24.2          | 41.0          | 52.7          | 68.4          | 39.5          |

Note: 1) Career job means the case wherein the worker has worked in a company for 10 years or longer.

Data: Lifetime job history data reorganized using KLIPS (13th, 2010).

The issue of fairness between the beneficiaries and non-beneficiaries of the extension of the retirement age should be taken into account.



The policy to promote employment stability of middle-aged/aged workers relying on the retirement age system has a limit.

expansion of chance for employment across the whole labor market of middle-aged/aged workers, enhancement of employment stability, and improvement in the quality of employment should be promoted in parallel with the extension of the retirement age lest the extension of the retirement age this time should act in the direction of strengthening only the vested rights of the workers who are employed in comparatively good jobs.

## V . Remaining Tasks

The revision of the law this time which made the retirement age of 60 mandatory can be clearly interpreted as a meaningful progress which can arrange a new turning point in relation to utilization of middle-aged/aged workers. It rather feels like it is somewhat late when the speed of aging of the Korean labor market is taken into account. However, as seen above, supplementary measures are required in diverse aspects if the original intent of the extension of retirement age is to be achieved.

The most basic premise is that the extension of the retirement age should be promoted in parallel with restructuring of the seniority wage system. If such a wage adjustment is not promoted in parallel, it is to be recognized that it may cause various problems such as inefficiency of the labor market, conflict between generations, and aggravation of polarization. The reason why the representatives of the labor, management and government have concluded ‘Labor/Management/ Government Agreement for Accomplishment of the 70 %

Employment Rate’ on May 30 and agreed to cooperate for an age system restructure such as a wage peak system, wage structure simplification, and so on depending on the situation of each business place for soft landing of the retirement age system is because the labor, management and government are all sharing such a recognition. But, as the possibility for disputes to actually occur between labor and management sides of first-line companies over restructuring of the wage system is not low, it is required to strengthen the coordination and mediation function of the National Labor Relations Commission in relation to the adjustment of the wage system before the extension of the retirement age is enforced.

In the meantime, the limitation of the law revision made this time is clear. When the retirement age of 60 is made mandatory from 2016, the pension gap still exists. The age from which national pension is paid is 61 as of 2013, and will be increased by one to 62 after 5 years, in 2018. That is to say, a contraction occurs wherein the government acknowledges compulsive retirement by reason of age before the age reaches the pension receipt age. ILO considers that the retirement age system which compels workers to retire at a certain age regardless of their ability and intention contains an element of age-discrimination, and recommends its abolishment. The USA and UK have prohibited the mandatory retirement system at a certain age as age discrimination, and most European countries have a voluntary retirement system which allows aged workers themselves to select either work or retirement (pension life). In

It is required to strengthen the coordination and mediation function of the National Labor Relations Commission in relation to the adjustment of the wage system before the extension of the retirement age is enforced.

In the mid/long-term, it is required to make efforts to restructure the retirement age system as a compulsory retirement system into an arbitrary or social retirement age system.

this respect, in the mid/long-term, it is required to prepare for restructuring of the mandatory retirement system into an arbitrary or social retirement system.<sup>2</sup>

2) Germany, France, etc. have a retirement age system in the form of so-called 'social retirement age', in which the retirement age is determined by the age at which receipt of pension is started. That is to say, social retirement age means to allow workers to enjoy social 'right to rest' under benefits such as social welfare being exempted from the obligation to work after working up to a certain age (Chulsoo Lee [2003]).

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