A comparison of the public pension systems of South Korea and Japan from a historical perspective focusing on the basic pension schemes

Ji Young Kang, Jieun Lee

(Graduate school of social welfare at Yonsei University, South Korea)

Abstract

Compared to Western old age security systems, it is a matter of extreme concern for Asian countries to seek out ways to successfully develop and settle their social security systems and deal with economic growth without excessively burdening their national economies. This study draws a comparison between historical developments and recent reforms focusing on public old age security systems in South Korea and Japan. The following are the most prominent features of this comparison. First, both South Korea and Japan introduced Bismarckian accumulated pensions for political reasons. Second, historically the pension scheme in South Korea has been influenced by Japan's, but it can be found some different features. Third, it is very interesting that South Korea and Japan have a special feature of adding a basic pension to an existing income-related pension.

Key words: the basic pension, Bismarckian model, public pension scheme

Introduction

By being categorized as underdeveloped welfare states, Asian countries have remained outside the main focus of scholars in comparative welfare state analysis. Recently, however, interest has been rising in Asian countries' social policies while unique features of their proprietary welfare systems have been accepted and highlighted. Discussions on capitalism and welfare states, long centered on European countries, are beginning to include Asian models (Amable 2003, Hall & Soskice 2001). It is important to view Asian countries as a group with socially, culturally, and historically prominent paths of developing social policy, despite the perception of being underdeveloped welfare states with low welfare expenditures. This kind of change is also occurring among East Asian scholars who are concerned about the features and future prospects of East Asian countries.

Compared to Western old age security systems, those in Asia have a relatively shorter history and remain immature, in spite of facing the reforms needed to simultaneously address aging societies and a global economic crisis. Pension schemes in Asia are exposed to a distinct socio-economic environment than the economic boom in which European countries developed their social security schemes, the so-called ‘golden age of the welfare state’. It is a matter of extreme concern for Asian countries to seek out ways to successfully develop and mature their social security systems and deal with economic growth without placing an excessive burden on their national economies.

Historical perspective on system comparison

This study draws a comparison between the historical developments of public old age security systems and examines the meaning of basic pensions in South Korea and Japan. As to historical development, we review the background of the introduction of funded pension schemes, how the Japanese employees’ pension scheme influenced the South Korean national pension system and the process if differentiation in both countries. In the later part we discuss differences between the two countries’ basic pension systems, reciprocal interaction within national pension schemes, and the meaning of implementing basic pensions in terms of world pension schemes.

This article compares pensions in Japan and South Korea for several reasons. First, the pioneering development of social insurance in Asia by Japan and South Korea has great value. A major feature of developing countries in Asia and the Pacific is their vast informal economies comprised of workers excluded from social security coverage owing to unemployment or the nature of their employment (casual, self-employment, temporary, etc.). (Mukul G. Asaher & Nayantara Pathmarajh-Banna; 2002) Japan initiated pensions in East Asia and boasts the longest history of social security. Also, Japan is one of the most developed among Asian capitalist countries and South Korea has an expanding flow of social expenditures and is making rapid process with social insurance. It is additionally profitable to compare these two countries' systems because both countries face similar challenges, including financial stability, rapidly ageing societies, and slumping economies. This could help both countries in their efforts to seek out a better way to deal out socio-economic and demographical issues.

Second, comparing the pension systems of both nations could explore the divergence of the pension systems and their developmental paths in the two countries. Although Japan provided the model for social security, accumulated reforms in South Korea's institutions could indicate a break with following the Japanese social security system (Lee & 武川正五; 2006). Could this drift be apparent in pension systems as well? Pension systems in both countries have been adapted to the point of being perceived as having different structures. However, by establishing a basic pension, even with the time gap between the two countries, the external structures can be seen to possess common features. Could it be said that these pension schemes with similar historical backgrounds and structures were diverging onto independent paths but are now converging back into similar forms? We examine systemic structures for both countries.

History of the pension schemes

Similarity in implementation of the pensions in terms of purpose and structure

In this comparison, we are interested in two aspects; similarities in the political reasons for developing the pension schemes and in the pension scheme structures themselves. First, Japan and South Korea share the feature of their pension systems being introduced for political reasons. Japan developed its pension to retain laborers in wartime. South Korea, as a late-developing country, was focused on raising capital when it began to consider a funded pension. Generally, the primary socioeconomic factors for the introduction of social security institutions are pointed out to be industrialization, civilization, and ageing (Wilensky, 1975). Along with these, political factors cannot be ignored. Historically, the introduction of social security in some countries has been based on political strategies, such as Germany introducing pensions to placate workers and weaken unions. However South Korea and Japan expeditiously implemented pension schemes despite their lack of experiencing excessive industrialization and ageing. This could indicate that political factors strongly affected the implementation of pensions rather than any socioeconomic factors.

The first pension in Japan as part of a social insurance system was the ‘pension insurance law in 1942, the predecessor of the present employees′ pension. Many disputes on the roots of this pension introduction have been carried out such as accommodating the costs of war or securing labor to raise productivity in line with the systemic changes of that time. The dominant reason for initiation of the pension can be explained as the war being a time of national mobilization. The minimum required contribution period for miners, a group in high demand in wartime, was mediated to reduce it from 20 to 15 years. The initial age for receipt of benefits was lowered from 55 to 50 and the National Treasury was responsible for 20 percent of benefit payments to miners. Immediate intentions of control and preservation of labor were found at the core of institutions of that time**. (Bae)**

During the government-led industrialization process in South Korea, it is believed the impulse to arrange financial resources for industry was dominant. The policy objective of the pension was national capital development (Kim & Sung, 2000). At that time, the government insisted that the justification for national welfare pension insurance lay in the successful economic growth subsequent to the economic development plan of the 1960s. However, it is commonly accepted that the government was in need of financial resources for repayment of foreign loans due to the failure to reap the fruits of the economic development plan. It had a great financial burden to finance heavy industry and the chemical industry. The leadership of the day believed that by introducing a funded pension system, it would be possible to accrue financing in a comparatively short time. The reason why political issues are interconnected with introducing pension systems, either for war or economic development is that as late-developing countries, the role of the state in Japan and South Korea is pronounced.

Second, in terms of structure, the Japanese pension system powerfully affected the original social insurance system in South Korea at the time of implementing social security, including pension, public workers’ pension, workers injury insurance, and health insurance. The model for the South Korean national pension would be the Japanese workers pension in its form prior to 1985 and the model for the public workers’ pension in South Korea would be the Japanese pension for civil servants before 1985. This type of modeling continued into recent times, for example the retirement pension of Japan provided guidelines for the introduction of a retirement pension in South Korea legally begun in 2005 (Bae; 2007).

In 1973 South Korea tried to enact a national welfare pension law but had to delay implementing a pension due to the economic hardships of the decade such as the oil shock. The law of 1973 was the basis for the later national pension law of 1988. At the time South Korea was in the process of implementing its pension system, Employees' pension insurance in Japan was the one of the models of developed systems reviewed. Pension systems in Japan were discussed and delivered in a national policy report named "Mapping out the national pension scheme and its ripple effect on the economy".

Patterned after Employees' pension insurance in Japan, which was revised in 1954, the South Korean national pension was structured as a two-layer system with fixed rate and remuneration-based proportional tiers. This is highly significant in that most countries with income-related pension systems make use of Bismarckian models with limited redistributive functions (Kim & Kim, 2007). The pension scheme in South Korea, however, has a history of two-part of pension schemes, income-related and redistributive. The Japanese employees' pension lost its redistributive function after the reform of 1985. If South Korea had considered the Japanese pension scheme after its reform, it is possible that South Korea would have designed pension system different from the one that now exists.

Issues of the basic pension in the two countries

Launching basic pension systems as special features of Bismarckian model

Although they began with highly similar pension schemes, these schemes have been adapted to their respective social and political situations. Because both countries have undergone repeated pension reforms and Japan implemented a basic pension, the schemes have started to drift apart, especially in terms of pension structure and pillar. However, introduction of the basic old-age pension in South Korea opened a new phase. In this section, we discuss the meaning of the implementation of the basic pension scheme, compared first between the two countries and then in terms of world pension scheme development.

First it may be a critical point that both of these pension systems were modified heterogeneously; they have once again returned to having a great deal in common. Introducing a basic pension is a powerful effort to unify diversified pension schemes. After South Korea's implementation of a pension imitating the Japanese pension scheme, pension systems in both countries started to deviate due to the different social interactions and backgrounds of Japan and South Korea. Japan has greater political decentralization than South Korea, and from the beginning developed a decentralized pension system for groups such as employees, the self-employed, and civil servants **(**Lee & 武川正五; 2006).

From late 1950 until the first oil shock of 1973, Japan witnessed outstanding economic growth. Compared to Japan' pension history, South Korea began economic development in 1970 and in 1988 introduced the national pension scheme. Considering the point of implementation of the employee's pension, the prototype of the national pension scheme in South Korea, South Korea is 30 years from Japan in terms of pension development. However, it cannot be asserted that the pension scheme of South Korea has been simply imitative, because systemic points have been customized, at least until South Korea's recent reform of the basic pension.

Development of the pension scheme in Japan is characterized by diversification with expanding coverage and benefit level adjustment. With the revision of 1959, compulsory coverage of the entire population was established, including farmers and employees of small and medium-sized enterprises. Although all people are covered by the pension scheme, it is simply a segregated pension imposing dual economic structures such as employment condition and income, along with differences of region and classes. Each pension has been operated with significant gaps in terms of financial stability and adequacy of benefit. Seeking ways to resolve these conflicts within given population structures and economic trends has for forty years been at the root of Japan's social security adaptations. The subsequent development of the pension is the history of attempts to complement the social security by establishing a new system, the basic pension **(**Lee & 武川正五; 2006)**.**

In contrast to the Japanese pension scheme, South Korea made an effort from the beginning to include the entire class into a single scheme, with the exception of a few special work types such as civil servants and the military. Rapidly expanding coverage triggered conflict between the workplace-based insured and individually-insured persons. Individually-insured persons are usually self-employed and their income cannot be precisely measured. Furthermore, the workplace-based insured have tax deduced directly from their salaries. This becomes a problem because the South Korean pension scheme has a redistributive component based on the average of standard monthly incomes. With the introduction of a basic old-age pension in 2008, the structure of the pension schemes grew similar to Japan's pension scheme. It could be a point of convergence for the two.

Second, it is important to note that Japan and South Korea have followed a different path than most of the world. The two countries first implemented and developed income-related pension systems and then later introduced social security systems for the aged. Among OECD countries, 25 have chosen to set up basic pension systems and in most of those countries the basic pension started first and an income-related pension system was added later to secure a proper level of benefits

Many countries with Beveridgian pension schemes[1], (such as Sweden, Norway, and Canada) became more Bismakckian in the late 1950s and 1960s when they added a supplementary second public pillar. This caused the basic pension to become less important and made the systems have more in common with the Bismarck model typical of the Alpine nations. (Martin Schludi; 2005)

In that case, why do South Korea and Japan have the special feature of adding a basic pension upon an income-related pension? This should be distinguished from Beveridgian-model countries supplementing their income-related pensions because that effort was undertaken in an economic boom. It also differs from the Biskmarckian model in that Alpine nations' pension systems

---

[1] Pension arrangements differ greatly in their institutional design. The two distinct modes of pension provisions are generally referred to as the Bismarckian and the Beveridgian models. Pension systems of the Beveridgian type have features which aim at preventing poverty and providing universal benefits. In contrast, Bismarkcian pension systems provide earnings-related benefits to specific groups. In these schemes pensions mostly secure high income replacement rates. These two very different models have had convergence trends by adopting different principles; for Beveridgian systems providing higher benefits by adding a second pillar and for Biskmarckian systems by insuring expanded populations.

had introduced linkage to population structure and pension benefit level or NDC system as part of an effort to reduce benefit levels.

Countries like Germany and Italy have a higher income replacement rate. When moving into an aging society, it becomes difficult to manage benefits and contributions with a pay-as-you-go scheme. Compared with Germany and Italy, South Korea and Japan retain large reserves of funds[2] making it unnecessary to develop complicated pension adjustment methods, even in the face of an aging society. It is important to note that Japan and South Korea already possess systems with Beveridgian characteristics, such as retirement grants compelled by law (Wonsup Kim, Suwan Kim, Eunsun Joo & Youngjun choi; 2007). By elaborating the retirement grant system into a retirement pension, the possibility appeared of introducing a new pillar of old-age security. Also, as the pensions are relatively immature, it may be easier to add up the new system with less transition costs[3]. For South Korea consolidating the basic pension has been accelerated by advice from the World Bank, which highly recommends multiplier pension schemes for greater flexibility. In the case of Japan, it is part of the efforts to reduce the pension gaps between job types. It may be a very natural choice to deal with the trend of the state being unable to afford an individual's entire old age security due to aging populations and worldwide economic hardship. Due to its immaturity, it is very important to manage in order to provide proper pension benefit levels.

Analysis of the basic pension systems of Japan and South Korea in terms of the public pension schemes

Pension schemes in the two countries appear highly similar; there is a basic pension and an income-related pension. However, examining the pension schemes of the National Pension Scheme

[2] Western European countries lost their reserved fund because of World War 2 and the global depression, leading them to resort to a pay-as-you-go system.

[3] This is very properly applied to South Korea, because South Korea has a shorter pension scheme history compared to European countries and Japan, and from the year of 2008 beneficiaries of full-old age pension benefits are granted transition costs relatively lower than those of other countries. This opinion has spread since the time of reform in 2007.

(South Korea) and the Employees' Pension Scheme (Japan), some significant contrasts appear.

First, it is important to note that the South Korean scheme embeds greater income redistribution functions in the benefit formula, since it is constituted of a basic pension component and an income redistribution component. Due to this structure, South Korea has a relatively higher income-replacement rate for the low-income insured than does Japan. (OECD; 2007)

Second, the basic pension scheme in Japan is based on contributions while the basic pension scheme in South Korea is based on taxes. Coverage of the basic pension in Japan is of persons from 20 to 60 years old and, as of 2004, 70,290,000 persons are insured. The period of required payment contributions is greater than 25 years and people become eligible for benefits after age 65. The benefit level after 40 years of contribution is about 20 percent of the average income of workers. The basic old age pension in South Korea is characterized by being offered to 60% of the population over 65 years old, as selected by a means test. Its nature is to reduce poverty and secure the income of the contemporary elderly, thus it does not require a period of contribution.

Table. 1. Comparison of pension schemes in Japan and South Korea

		Japan	South Korea
Structure		Employees' pension (income-related) + basic pension (based on contribution)	Income-related + basic pension (based on taxes)
Coverage		3,2490,000 persons as of 2004 [4] for the employee's pension 70,290,000 persons as of 2004 for the basic pension	Insured persons: 18,367,000 persons as of 2007 Exception from contribution payment: 511,000 persons
Benefits	Basic	20% of average income of workers benefit level after 40 years contribution	5% of the average earnings of the insured of the national pension

4 2007 Japan in Figures

Statisitics Bureau,

Ministry of Internal Affairs and Communications, Japan

	Income-related	Average monthly salary × 5.481/1000 × number of enrollment years (2004, Ministry health, labor and welfare,)	1.5(A+B)(1+0.05n) - From 2008 to 2028, the indicator 1.5 will be decreasing to 1.2 - A: average monthly salary of full population of insured - B: average monthly salary of an insured individual - n: number of enrollment months

What is the meaning for both countries of launching the basic pension? Why did the two countries develop the new schemes? The period before the establishment of a basic pension scheme in Japan has a distinguishing characteristic: segregation through different pension systems for different groups. In the revision of 1954, Employees' Pension Insurance was restructured. In 1961, the National Pension Scheme for self-employed, agriculture, forestry, and fishery-related workers was established. Due to the differences in work style and income between the insured of these two systems, and for other reasons as well, the insurance premium payment, benefit payment, and more were handled by different methods from that time forward. In the revision of 1985, Basic Pension was established as a common system for all citizens. By choosing to add new systems for each working group rather than revise the systems into one which includes most of the population, Japan had diversified its pension systems. This brought some difficult problems to light. Because of this segregation, increasing systemic differences arose, triggering different benefit levels, provision ages, payment rates, and overlapping benefits, all of which could lead to improper old age income security for the insured and beneficiaries. As to financial structure, gaps between pensions have been widening because of changing industry structures and diversified structures for different types of economic activities.

In South Korea, the background of the introduction of the basic pension scheme is mostly based on reducing a blind spot, which means a broad population within the contemporary elderly cohort is not secured and future cohorts have less probability of being secured due to the long period of exception from contribution payments and refusal to make contributions. South Korea developed a funded pension scheme, choosing the trade-off of abandoning the securing of the old-age cohort existing at the time of pension implementation. The relative ageing of society is presently increasing sharply and the elderly population has greater exposure to poverty than other groups. Compared to total households, the poverty rate of the elderly class is approximately two times higher (Bureau of Statistics in South Korea;2007).

A basic pension scheme designed to be drawn from taxes had been proposed as a solution for this blind spot. Because of the financial burden, political debate between the ruling and opposition parties had been centered here. Finally, a basic pension scheme has been implemented, but not one fully based on taxes. Its coverage has been narrowed from the entire aged population to 60%, while benefits will increase from 5% of the average earnings of the insured in 2008 to 10% by 2028. This can also be seen as partial compensation for the 60% income replacement rate of the national pension for 40-year contributors being adjusted to 40% in the reform of 2007.

There should be further research into how much the unique basic pension system of each country effects the solving of problems with the respective pension schemes and how well it functions within the public pension scheme as a whole.

Conclusion

As Asian countries which are latecomers in the world economy, the developmental history of South Korea’s and Japan’s pensions is different from that of European countries. The first feature is the introduction of the pension scheme being integrated with political consideration. This is comparable with European pension history, because pension schemes or social welfare policies have been operated as political tools to deal with labor unions or social democratic parties. The distinction lies in the more powerful role of the state in the less-developed countries as pension schemes were introduced not solely for labor or left-wing parties, but rather for the development of the whole country.

Second, because of similarities in geopolitical situations and the history of Japan’s colonization of South Korea, the pension scheme in South Korea has been influenced by Japan's. Although they currently have different structures of pensions, it is clear that Japan's employees' pension had been model for South Korea's national pension scheme.

Third, it is very interesting that South Korea and Japan have a special feature of adding a basic pension to an existing income-related pension. Among OECD countries, 25 countries have chosen to set up basic pension systems and in most of those countries the basic pension began first while an income-related pension system was added later to ensure proper benefit levels. It could be explained that with relatively newly introduced pension schemes, transition costs are less and Japan and South Korea already have systems which have the Beveridgian model's characteristics of retirements grants compelled by law. Developing the retirement grant system to include a retirement pension offered the possibility of introducing a new pillar of old-age security.

Although both countries have short histories of pension schemes, they have made great progress. They still face difficulties, including managing rapidly aging societies, huge refusal of payments, and uncovering proper benefit levels, but the experience of both countries' can help other developing Asian countries to settle social security in their own fashions.

Reference

Bruno Amable (2003), The diversity of Modern capitalism, Oxford University Press

Harold L. Wilensky(1975), The welfare state and equality: structural and ideological roots of public expenditures, University of California Press

Hyekyoung Lee & 武川正五(2006), A study of welfare state regime in south Korea and Japan, Yonsei University press (in Korean)

Junho Bae(2007) 'A study on restructuring the old age security in Korea', General study on structuring old-age security scheme in Korea, KDI (in Korean)

Martin Schludi(2005), The reform of Biskmarckian pension system, Amstedam university press

Mukul G. Asaher, Nayantara Pathmarajh-Banna(2002), Social security in Asia and the Pacific: Managing diversity and securing the future, ISSA, Vol. 55

Peter Hall and David Soskice (2001), Varieties of capitalism: the institutional foundations of comparative advantage, Oxford University Press

Suckmyoung Yoon & Eunsun Joo (2002), International comparison on types of the public pension-the dual pension systems, Korean National pension research center (in Korean)

Sangheon Roh(2004), Legal Reforms relating to pension in Japan, Korea legislation research institute, 2004 (in Korean)

Taesung Kim & Jinsoo Kim (2007), Social security, Chung-mok (in Korean)

Taesung Kim & Kyung-rung Sung (2000) A study on the welfare state, Nanam (in Korean)

Yongha Lee(2007), A study of international comparison on benefit levels of the national pension, Korean National pension research center (in Korean)

Wonsup Kim, Suwan Kim, Eunsun Joo & Youngjun choi (2007) changes of multi-pillar systems in the pension scheme and improvement strategies, Korean National pension research center (in Korean)

Japan Statisitics Bureau, 2007 Japan in Figures

Korea development Institute (1986) Mapping out the national pension scheme and its ripple effect on the economy (in Korean)

OECD, Pension at a glance 2007

Ministry of health, labor and welfare in Japan

http://www.mhlw.go.jp/english/index.html

Korean national pension service

http://www.nps.or.kr/

Korea national statistical office

http://www.nso.go.kr/