

Changes in the Welfare Policy Environment 2016 and Their Implications

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Low fertility is a phenomenon commonly observed across many advanced countries, but Korea's case deserves special attention in that its total fertility rate (TFR) has remained at sub-1.3 levels for fifteen years straight since 2001. In comparison, Germany's sub-1.3 fertility rate lasted for only 4 years (1992~1995) and Japan's for 3 years (2003~2005). In light of the protracted trend of late marriage and the continued increase in the age at first childbirth, it seems unlikely that Korea's TFR will pick up to any considerable extent in the near future.

Life expectancy at birth for Koreans has increased from 62.1 years in 1970 to 82.4 years in 2014, and is projected to continue to rise, although at a slower pace. The elderly aged 65 and over as a share of the total population first exceeded the 7-percent mark in 2000. Statistics Korea forecasts that elderly Koreans will take up over 14 percent of the population in 2017 and more than 20 percent in 2025. Projections have it that by 2050, the share of 65-year-olds and older will take up 38.2 percent of the population, second only to Japan's 39.6 percent, compared to the OECD average of 25.8 percent.

The working-age population as a share of all Koreans, having reached its pinnacle at 73.1 percent 2012 (the number of working age Koreans will reach its highest at 37.04 million this year) is now on the decline, and, as a result, the old-age dependency ratio will soar in the years ahead.

Economic outlook

Most leading institutes have predicted a growth rate for Korea of about 3 percent in 2016. In light of the economic conditions in and around the country, however, the actual growth rate may not be as high. If anything, there is little cause to be optimistic about Korea's economic future. China's growth has been sluggish of late, the US raised its interest rates at the end of last year, and the euro zone's market recovery has been glacial. All this adds up to an uncertain condition from which it is hard to preclude the possibility of a further slowdown in the Korean economy.

<Table 1> Potential growth estimates for Korea (2015 and 2016), by key institutions

	Bank of Korea	Korea Development Institute	National Assembly Budget Office	International Monetary Fund
2015	2.8%	2.6%	2.6%	2.7%
2016	3.2%	3.0%	3.0%	3.2%

Korea's potential growth rate is projected to decline further in the mid-to-long term, due in part to low birthrate, population aging, and the sagging competitiveness of the manufacturing sector. The National Assembly Budget Office in a 2014 report has forecast that Korea's economic growth rate will fall from the 2-percent range in the 2020s to the 1-percent range by the late 2030s.

The impact of household debt is not confined to household consumption. It is one of the most grievous risks to the national economy. Korean households are found in the second quarter of 2015 to have an estimated total debt of upwards of KRW1,133 trillion. Public debt as a

share of GDP has increased steadily since the beginning of the new millennium, from 17.5 percent (KRW111.2 trillion) to 35.7 percent in 2015.

<Table 2> Korea's public debt in trillion won and as a share of GDP

	2000	2005	2010	2013	2014	2015	2018
Public debt	111.2	247.9	392.2	489.8	527	570.1	691.6
(as a % of GDP)	17.5	27	31	34.3	35.1	35.7	36.3
Central government	100.9	238.8	373.8	464	499.5	544.6	669.5
Local government net debt	10.2	9.2	18.4	25.7	27.4	25.5	22.2
Deficit-type debt	42	100.8	193.3	253.1	282.7	314.2	400.2
Financial debt	69.1	147.1	199	236.7	244.3	255.9	291.4

The increasing household debt and the increasing housing expenditure as a percentage of disposable income have become something of a structural stumbling block to the recovery of domestic consumption. Despite persistent low interest rates, the burden of having to pay back the principal became a constraint on consumption for households, as installment payment mortgages without a grace period rose from 6.4 percent of total bank housing loans in 2010 to 26.5 percent in 2014.

The recent increases in *jeonse* deposits—lump-sum deposits on dwelling units for a given term, usually 2 years—and the increase in the share of those who pay monthly rents are taking up an increasing portion. As of May 2015, monthly rentals accounted for 43 percent of all home lease contracts. As low interest rates persist and expectations for increases in home prices moderate, monthly rentals will continue to displace *jeonse* rentals.

Labor market outlook

The labor market participation rate increased from 61.0 percent in 2010 to 62.4 percent in 2014. The employment rate rose in the same period from 58.7 percent to 60.2 percent. The past three years have seen a sharp increase in youth unemployment rate, from 7.5 percent in 2012 to 9.2 percent in 2015.

<Table 3> Key labor indicators

(Units: thousand persons, %)

	2010	2011	2012	2013	2014
Population aged 15 and over	40,590	41,052	41,582	42,096	42,513
(Increase rate)	1.2	1.1	1.3	1.2	1.0
(Increase in number)	498	462	530	514	417
Economically-active population	24,748	25,099	25,501	25,873	26,536
(Increase rate)	1.5	1.4	1.6	1.5	2.6
(Increase in number)	354	351	402	372	663
Those in employment	23,829	24,244	24,681	25,066	25,599
(Increase rate)	1.4	1.7	1.8	1.6	2.1
(Increase in number)	323	415	437	385	533
Those unemployed	920	855	820	807	937
Non-economically active population	15,841	15,953	16,081	16,223	15,977
(Increase rate)	0.9	0.7	0.8	0.9	-1.5
(Increase in number)	143	112	128	142	-246
Economic participation rate	61.0	61.1	61.3	61.5	62.4
Unemployment rate	3.7	3.4	3.2	3.1	3.5
Employment rate	58.7	59.1	59.4	59.5	60.2

Source: www.kosis.kr

Predictions (by the National Assembly Budget Office, for example) have it that despite the

slow recovery from the economic slowdown in the current circumstances where it is hard to expect any improvement in external conditions, the government's active labor market policy will help raise Korea's labor market participation rate throughout 2016, thereby reducing the unemployment rate to an extent.

However, the jobs shortage are likely to be here to stay, at least for some years to come. Projections based some of the current key indicators—demographic structure, employment rates, and potential growth rates—suggest that the demand for jobs and the supply of workers will approximate a balance before 2020. However, in light of the longstanding oversupply of labor, job shortage may as well continue until before the mid-2020s.

Poverty and inequality

The share of those living below the poverty line (with an income below 50 percent of the national median) has been on the increase ever since the 1997 Asian economic crisis, although the proportion of the poor in urban households with two or more persons has stopped increasing sometime in 2010 and even decreased afterwards. The poverty rate for all Korean households, however, has plateaued at a high level. The Gini coefficient, which indicates the inequality of income distribution across the population, has moved along a similar trajectory. To be more specific, the poverty rate and the income inequality in the working age population are at low levels compared to the OECD average. Both indicators for those aged 65-plus are exceptionally high (higher than in just about any other OECD country).

Increases in poverty and inequality are attributable to such macroeconomic factors as declines in the labor income share, jobless growth, increases in non-regular employment and low-wage workers, population aging, the waning trickle-down effect, and low welfare levels, and to such microeconomic factors as health deterioration, low educational attainment, and the "culture of poverty."

Poverty and inequality levels measured in terms of disposable income can be reduced to some extent with extensive redistributive policy (income transfer programs). Gross social expenditures as a share of GDP for Korea is less than half the OECD average. As a result, the poverty reduction effect of taxes and public income transfers was 14.1 percent in Korea in 2012, compared to the OECD average of 59.9 percent. The inequality-reducing effect of taxes and public transfers was also low at 8.8 percent compared to the OECD average of 31.1 percent.

<Table 4> Poverty-reduction effect of taxes and public transfers in selected OECD countries

	Market income poverty rate (A)	Disposable income poverty rate (B)	Poverty reduction effect ((A-B)/A*100)
Korea	16.3	14.0	14.1
Sweden	26.7	5.3	80.15
France	30.7	7.1	76.87
UK	26.3	8.3	68.44
Germany	33.6	11	67.26
Canada	24.5	11.7	52.24
Australia	32.7	12.4	62.08
Japan	26.9	14.9	44.61
US	26.3	17.1	34.98
OECD average	26.4	10.6	59.85

Source: OECD (<http://stats.oecd.org/index.aspx>)

<Table 5> Inequality-reduction effect of taxes and public transfers in selected OECD countries

	Market income Gini (A)	Disposable income Gini (B)	Poverty reduction effect ((A-B)/A*100)
Korea	0.329	0.300	8.81
Sweden	0.43	0.23	46.51
France	0.48	0.28	41.67
UK	0.46	0.34	26.09
Germany	0.51	0.3	41.18
Canada	0.44	0.32	27.27
Australia	0.48	0.3	37.50
Japan	0.44	0.32	27.27
US	0.48	0.38	20.83
OECD average	0.45	0.31	31.11

Source: OECD (<http://stats.oecd.org/index.aspx>)

It is not entirely clear at this point in time how the patterns of poverty and inequality will play out in Korea, but for now, as employment rates are increasing in particular in women and older people, we can hope with some degree of certainty for an elevation of living standards and reduced poverty in households that contain these individuals. In light of the increasing maturity of existing social welfare programs and the income-redistributive effect of new social policy measures, both poverty and inequality can be expected to fall over time. The increasing maturity of the National Pension and the recently implemented Basic Pension, in particular, may help reduce old-age poverty and poverty gap at least to a little extent before long. To be sure, however, these predictions are not predicated on certainty, as the economic prospects in the main are not entirely promising and the labor market remains persistently unstable.

Outlook for welfare financing

Korea's welfare system is of a "low cost, low benefit" type: in terms of both cost and benefit, Korea's welfare system is below the OECD average. Korea's social expenditures as a share of GDP was 10.4 percent in 2014, less than half the OECD average of 21.6 percent. However, in light of the country's population aging, the rapidly maturing National Pension, and such newly implemented public programs as the Basic Pension, the long-term care insurance, and the child care allowance, social expenditures are projected to keep increasing to reach 29 percent in 2060.

<Table 6> Social expenditures as percentage of GDP in selected OECD countries

	1980	1985	1990	1995	2000	2009	2014	2030	2040	2050	2060
Sweden	27.1	29.5	30.2	32.0	28.4	29.8	28.1	-	-	-	-
Denmark	24.8	23.2	25.1	28.9	26.4	30.2	30.1	-	-	-	-
France	20.8	26.0	25.1	29.3	28.6	32.1	31.9	-	-	-	-
Germany	22.1	22.5	21.7	26.6	26.6	27.8	25.8	-	-	-	-
UK	16.5	19.4	16.7	19.9	18.6	24.1	21.7	-	-	-	-
US	13.2	13.2	13.6	15.5	14.5	19.2	19.2	-	-	-	-
Japan	10.3	11.1	11.1	14.1	16.3	22.2	-	-	-	-	-
Korea	-	-	2.8	3.2	4.8	9.6	10.4	17.9	22.6	26.6	29.0
OECD average	15.5	17.2	17.6	19.5	18.9	22.1	21.6	-	-	-	-

Source: Social Security Committee (2014)

Concluding thoughts and policy implications

Persisted low birth rates may lead to a decline in the school-age population, military human resources, and labor force, pushing up the old-age dependency ratio. Population aging leads to

increases in old-age health spending and pension expenditures and, in turn, may put pressure on consumption and domestic demands, leading to an economic slowdown. The years between 2000 and 2020 are for Korea a period of demographic bonus, when the degree of dependency on the working-age population is at its lowest and when, therefore, the country needs to shore up its mid-to-long-term growth momentum.

The projected decline in mid- to long-term potential growth rate may exert an adverse effect on new employment, negatively affecting household income. The continued increases that we see in Korea's public debt and welfare expenditure point to the need for changes to the tax system. At an estimated KRW12 trillion at the end of 2015, Korea's households debt presents itself as a serious risk to the national economy. Korea's labor market is marked by high percentages of low-wage workers, non-regular workers, and self-employment. Not only could this over-indebted situation stunt social solidarity, but it could also add to instability in households.

An over-reliance on welfare spending may lead to enormous fiscal difficulties. This calls for considering introducing an inequality-indexed tax system—of the sort suggested by Robert Shiller some years ago—whereby taxes are imposed automatically with greater progressivity if the distribution of income turns more unequal. If such a tax system is introduced, employers are likely to increase wages for their workers instead of letting the share of labor income decline on pain of having to pay higher taxes.

Emergency assistance and social insurance programs should be strengthened as a way to keep the middle class afloat. Also, such tax-financed welfare programs as the National Basic Living Security, Basic Pension, and Disability Pension need to be expanded to help those living in poverty lift themselves above the national minimum threshold.

There should be increased linkage between social welfare programs and between social welfare and the labor market. Improved linkage between Community Centers and Employment Security Centers can help reduce working poverty. Also, the current EITC needs to be expanded and linked to proxy pay programs, with a view to reducing gaps in social insurance coverage.