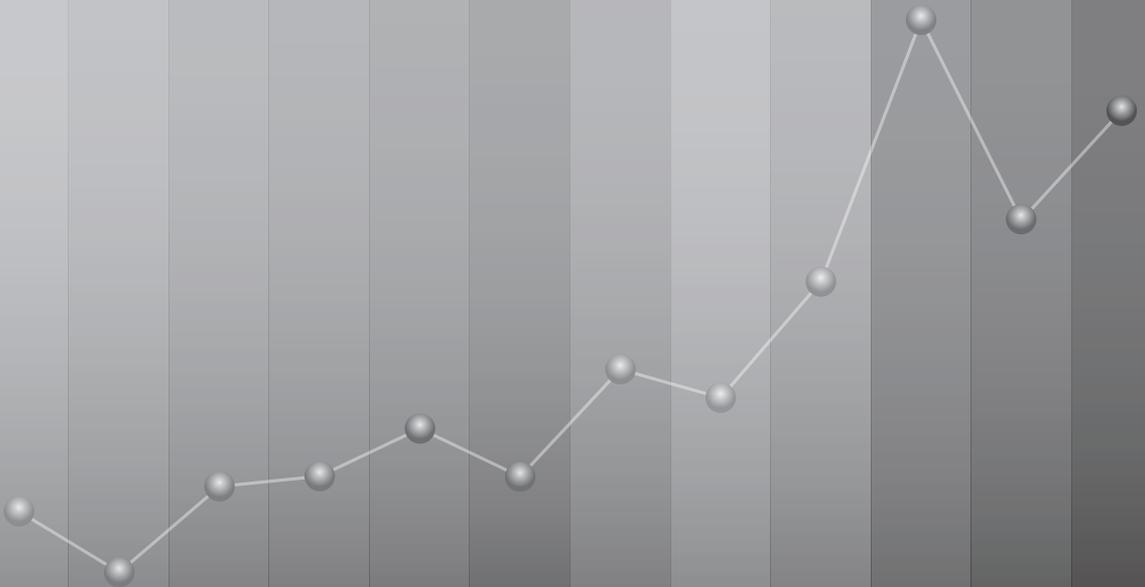


Strategy for Establishing a Link Between the Earned Income Tax Credit and Social Insurance Subsidy Program

December 2012

Jae-Jin Kim, Haywon Lee



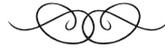
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Jae-Jin Kim

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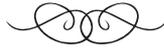
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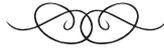
I

Introduction

As economic polarization has grown ever-more pronounced amid an environment of mid- and long-term fiscal uncertainty due to the aging population, low fertility rate and the related pending lowered growth potential, voices have been raised in recent years from all social strata across South Korea calling for the expansion of social welfare. Under these circumstances, the Earned Income Tax Credit (EITC) scheme was introduced in 2008 as a means to support the working poor who may have slipped through the cracks of social insurance and the National Minimum Living Standard Security System while maintaining a minimum potential fiscal burden on the government. Later, the provision of the earned income tax credit was expanded through the revision of related tax law, and starting in 2014 eligibility for the scheme will be further extended to include self-employed small business owners.

This study is aimed at describing a strategy to heighten the effectiveness of the recently-expanded EITC in combination with a social insurance subsidy program targeted at low-wage workers that is presently being initiated by the government. One of the strategies proposed in this study is to link the EITC with the social insurance premium subsidy known as the Duru Nuri Social Insurance Subsidy Program (DNP), on the grounds of the following potential effects: first, it will encourage the working poor already eligible for the EITC to join social insurance programs, thereby

better preparing them for potential social risks including unemployment or old age. Currently, recipients of the EITC direct more than 90 percent of these tax refunds to living expenses or educational expenditures for their children, hence the refund is rarely applied to future financial security. Thus, by being linked to the social insurance subsidy program, the EITC can be projected to resolve the issue of working poverty and the problem of health insurance in old age, while such expected effects will in turn serve as incentives to induce the working poor to more actively participate in the labor market. Second, since both programs target low-paid workers, there exists a significant possibility that the budgets of the EITC and the social insurance subsidy program overlap. If the financial resources of the EITC were directed toward financing the social insurance subsidy program, the budget that had been dedicated to the subsidy program can be repurposed. Third, due to a lack of related statistical information and of information sharing between national insurance corporations and the National Tax Service, it is at present nearly impossible to identify the precise number and scale of workplaces and workers eligible for the EITC program or to verify whether EITC recipients are enrolled in social insurance. If a link between information on national taxation and social insurance is established, this problem can be resolved and the effectiveness of the government program can be enhanced.



II

Earned Income Tax Credit (EITC)

Background for the Introduction of the EITC

The Earned Income Tax Credit (EITC) was introduced as a means to aid those working poor who may have fallen into a blind spot of social insurance and the National Minimum Living Standard Security System while minimizing the financial burden borne by the government. This was undertaken in an environment of mid- and long-term financial health being threatened by an aging population and low birthrate and the related reduced potential for growth, as well as a deepening disparity in wealth.

Prior to the introduction of the EITC, South Korea's social safety net was dual-structured, with the social insurance system (health, pension, employment and workers' compensation insurance) targeting the general public and the National Minimum Living Standard Security System ensuring the destitute a minimum standard of living. The National Minimum Living Standard Security System is intended to allow the impoverished whose income falls below the minimum cost of living to be provided with basic necessities. With this system in place, a social safety net for those in extreme poverty has been ensured, but it has become difficult for the working poor who account for the majority of the near-poor¹⁾—a

1) According to Article 36 of the Enforcement Decree of the National Minimum Living Standard

needy group that has newly emerged following the recent financial crisis—to be protected by the existing social safety net. Since the social insurance system is only able to cover those who contribute insurance premiums, the working poor, who are poorly off and lack the capacity to compile savings, are rarely covered by social insurance unless they manage to pay the related premiums. The EITC is designed to target this group of people who suffer vulnerabilities under the existing social safety net composed of social insurance and public assistance. The program provides financial assistance to this group in order to keep them from slipping into destitution while encouraging them to strive to remain above the poverty line by providing them with an incentive to work.

Introduction and History of the EITC

A. 2009-2011 (Background)

To qualify for the EITC, workers must meet the following four criteria regarding total income, dependent children, home ownership, and asset requirements. The scope of qualification for the scheme and the amount of refund have been expanded from that originally intended in the initial plan set out in the revised Restriction of Special Taxation Act, which was passed in the National Assembly plenary session on December 12, 2008 (see <Table II-1>). The rules for qualification have been eased from “a household with two or more children aged younger than 18” to “a household with one or more children aged younger than 18,” and from “those who do not own a house” to “those with a small house with a market value of 50 million won or below.” In addition, the annual maximum refund has been revised upward from 800,000 to 1.2 million won. The scope of qualification and the amount of refund as expanded from the introduction of the program were maintained from 2009 up to 2011.

Security Act, near-poor individuals are defined as people who are not National Minimum Living Standard Security recipients but whose real income is less than 120 percent of the minimum cost of living.

B. 2012 (Current)

1) Qualification

To become eligible for the EITC, an individual must meet all requirements pertaining to gross income, spouse and dependent children, home ownership and assets. Among households that have earned wage and salary income or business income²⁾ (limited to income generated from insurance solicitation and door-to-door sales) during the relevant taxable period, families that meet all of the requirements with respect to spouse and qualifying children, annual gross income, home ownership and total asset value are allowed to claim the EITC. However, recipients of National Minimum Living Standard Security System benefits (living, housing, and educational expenses) for at least three months, foreigners, and the dependent children of other residents are not eligible for the EITC.

Starting in 2012, eligibility for the EITC has been drastically expanded from couples with at least one dependent child younger than 18 to include childless households. The threshold of gross income and the maximum EITC have also been revised upward to take into consideration rises in the minimum cost of living. The upper limit for gross income and the maximum refund, however, are applied discretely according to the number of children in a household, as part of efforts to encourage childbearing. (Annual gross income must be less than 13 million won with no qualifying children, 17 million won with a qualifying child, 21 million won with two qualifying children, and 25 million won with three or more qualifying children; the maximum EITC is 700,000 won with no qualifying children, 1.4 million won with a child, 1.7 million won with two qualifying children and 2 million won with three or more qualifying children.) The upper limit on home values has also been raised from 50 to 60 million won and small business owners engaging in insurance solicitation or door-to-door sales have become eligible.

2) Business income pursuant to Article 19 of the Income Tax Act or wage and salary income pursuant to Article 20 of the same act.

<Table II-1> Qualifications for the EITC

Requirements	Details				
Spouse and Dependent Children ¹⁾	<ul style="list-style-type: none"> - Individuals with a spouse and no dependent children under 18 years of age - Individuals with a spouse and one or more dependent children aged younger than 18 				
Annual gross income	<ul style="list-style-type: none"> - The total income of a married couple over the previous tax year should amount to less than the upper limit determined according to the number of dependent children 				
	Number of dependent children	Zero	One	Two	Three or more
	Upper limit for total income	13 million won	17 million won	21 million won	25 million won
	<ul style="list-style-type: none"> - Total income: the sum of business income (insurance solicitation and door-to-door sales excluded), other income, interest, dividends or wage income, and income generated from insurance solicitation of door-to-door sales. 				
Home Ownership	<ul style="list-style-type: none"> - As of June 1 of the previous year, no one in the household owns a home or owns only a single small home valued at less than 60 million won. 				
Property Value	<ul style="list-style-type: none"> - As of June 1 of the previous year, the aggregate of the property owned by the full membership of a household is less than 100 million won - Property includes homes, land or structures, vehicles, deposit money for a home lease, financial assets, stocks and bonds, golf club memberships, and the right to acquire real estate. 				

Note: 1) Qualifying children can include adopted children, or grandchildren/siblings who do not have parents or whose parents are unable to support them. Age limits do not apply to a child classified as severely disabled. The annual total income of a qualifying child must be less than one million won.

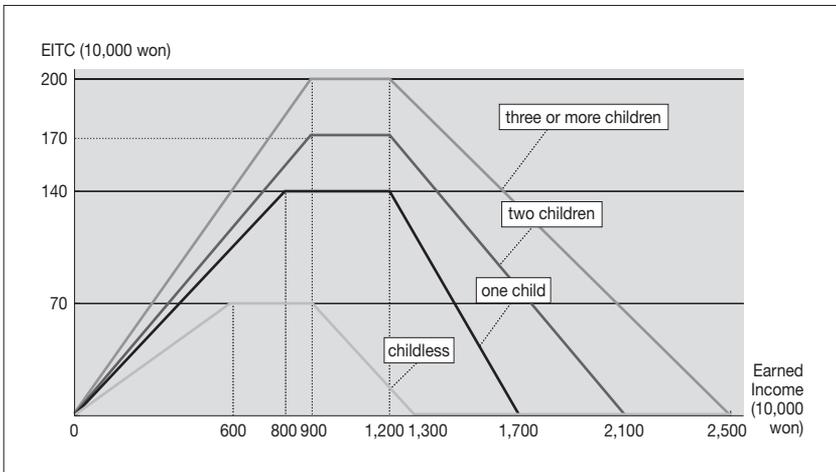
Source: National Tax Service, Earned Income Tax Credit Service (<http://www.etic.go.kr>)

2) Application and Payment

To receive the EITC, those meeting the requirements must file a final return on their global income tax base and a claim for an EITC during the annual period of tax reporting. It is possible for a taxpayer to first apply for the EITC during that period and then file a final return on global income tax base prior to qualification for the EITC being determined. A claimant can apply at the tax office holding jurisdiction over his / her residence, through the website of the EITC service or by telephone or the

Automated Response System. Within three months after the claim is made, granting of the credit is determined through deliberation and the credit is wired/transferred to the applicant's bank account within one month after the conclusion being reached. A valid claim for an EITC can be made by day laborers based on their total wages or by those who were not required to file a final return on global income tax base. When a claim for an EITC is filed, the head of the district tax office adjudicates upon the claim, investigating applications and attached documents, and then determines the EITC amount within three months of the claim being filed (June-August). Within 30 days of the determination is made, the filer is notified of the allowance or disallowance. Following the notification, the credit is provided to the eligible filer prior to the end of September.

[Figure II-1] EITC Amount Payable According to Gross Income (2012)



3 Current Status of the EITC Program

A. Recipients and Payment

From the introduction of the EITC program, the number of recipients declined every year through 2011: a total of 453.7 billion won was provided to 590,000 households in 2009, 436.9 billion won to 566,000 households in 2010 and 402 billion won to 522,000 households in 2011. The fall in the number of recipients is attributable to the requirements remaining unchanged while average household income increased due to rising wages and minimum cost of living.³⁾ However, in 2012, the number of recipients swelled by 213,000 over the previous year and, accordingly, an additional 195.1 billion won was issued. This rise is attributed to the revision of the related law expanding eligibility to include insurance solicitors and door-to-door salespersons, increasing the maximum EITC amount up to two million won according to the number of dependents, enabling childless households to apply for benefits as well as raising the upper limit for qualification for the program.

An examination of the distribution of recipients during the 2009-2011 period shows that the number of households in the phase-in range makes up the largest proportion: more than 46 percent of the overall number of recipients.⁴⁾

The National Tax Service accepts EITC claims in May of every year and approves recipients by the end of September following the determination of whether claimants meet related requirements. Since 2009, the ratio of recipient households to applicants has remained around 80 percent, indicating that the majority of applicants do in fact receive benefits.

3) The annual minimum cost of living for a household with four members increased to 17.27 million won in 2011 from 15.92 million won in 2009.

4) As of November 2012, statistics on the number of recipients and the amount of credit by segment have yet to be produced.

B. Distribution by Age

By age, the proportion of recipients in their 20s has gradually declined, while that of beneficiaries in their 40s or older has increased since the inception of the program. In particular, 2012 witnessed the number of recipients in their 60s growing by 100,000 households from the previous year to 104,000 due to the expansion of eligibility to single-person households of individuals aged 60 or older. As the pace of population aging is projected to accelerate in South Korea, the volume of EITC claimed by the elderly is expected to grow even further in the future. Households headed by individuals in their 30s and 40s account for the majority of recipients, standing between 70 and 80 percent through 2011. As of 2012, the proportion of recipients in their 30s and in their 40s stood at 24.2 percent and 36.7 percent, respectively.

C. Distribution by Employment Type

The distribution of recipients arranged by employment type indicates that the primary group of recipients is day laborers, accounting for 60 percent of overall beneficiaries. Meanwhile, the number of households granted the credit among insurance solicitors⁵⁾ and door-to-door salespersons⁶⁾ who generate business income—the class who newly gained eligibility for the program in 2012—stood at 19,000 or 2.6 percent of total recipients.

D. Distribution by Industry Type

The distribution of recipients arranged by type of business and by year illustrates that workers in the manufacturing and construction industries made up the largest proportion of the body of recipients, marking 40 percent between 2009 and 2012. This is believed to be a

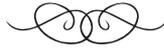
5) Individuals who enroll other in insurance plans as independent brokers and receive allowances according to their results.

6) Individuals who engage in direct sales on behalf of door-to-door distributors and receive allowances according to their results, in accordance with the Door-to-Door Sales, etc. Act.

result of the large body of day laborers—the main recipients of the EITC program—engaged in such industries.

E. Distribution by Frequency of Receiving EITC

As the eligibility requirements for the EITC were eased in 2012, the sum of new recipients added over the course of the program stood at 416,000 households, or 56.6 percent of total recipients. Those receiving an EITC for the four consecutive years since the inception of the program in 2009 totaled 85,000 households or 11.6 percent of overall recipients in 2012.

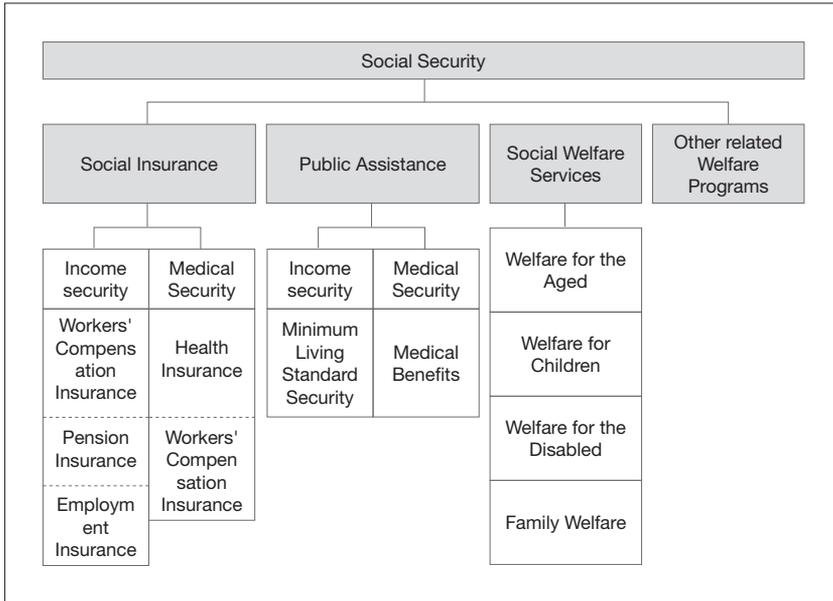


III

Social Insurance System

According to subparagraph 1 of Article 3 of the Framework Act on Social Security, ‘social security’ is defined as “social insurance, public aid, social welfare service and other related welfare systems provided to protect citizens from social harms, such as illness, disability, aging, unemployment and death, as well as to reduce poverty and to improve every citizen’s quality of life.” As a facet of social security, social insurance programs can be defined as a socio-economic system established by the government by means of the mechanism and principle of insurance being used to carry out social policies. The system is aimed at guaranteeing public health and income by providing protection against social risks based on insurance principles. In many respects, social insurance includes primary features that differ from those of private insurance: for example, mandatory participation based on the concept of social solidarity.

[Figure III-1] South Korean Social Security System



Source: Social Insurance Information System (<http://www.4insure.or.kr/>)

1 Four Major Social Insurance Programs

A. Overview

With the aim of providing both income and medical security, South Korea’s social insurance system consists of four major social insurance programs: the pension insurance plan protecting insured members in the event of disability, death, and old age; the employment insurance plan compensating for job loss; the health insurance plan protecting against disease and injury; and the workers’ compensation insurance plan for work-related accidents.

B. Eligibility

1) National Pension Plan⁷⁾

Enrollment in the national pension plan can largely be bisected into two areas: workplace and individual, with insured individuals subdivided into workplace-based insured persons, individually-insured persons, voluntarily-insured persons and voluntarily continuously insured persons.

Obligatorily qualified workplaces⁸⁾ are required to enroll in the national pension plan pursuant to the National Pension Act. The obligation of a workplace to take part in the national pension plan depends on the number of employees: it is mandatory for workplaces with one or more employees to enroll in the national pension plan. Both employers and employees of obligatorily qualifying workplaces are required to contribute to national pension plans, and migrant workers, if eligible, are also required to enroll in the plan. A person who is not workplace-based insured and is a resident of South Korean territory aged between 18 and less than 60 must become individually-insured, but this does not apply to those released from the national pension liability, such as recipients of assistance under the National Minimum Living Standard Security Act.

2) Health Insurance Plan⁹⁾

Health insurance plans in South Korea can largely be divided into employment-provided insurance and locally-provided insurance, and policyholders are accordingly classified into employment-provided policyholders and locally-provided policyholders. Employment-provided

7) See the website of National Pension Service (www.nps.or.kr).

8) These include workplaces or offices employing workers, regardless of whether it considered an individual or corporation according to civil law or commercial law, whether or not it is a corporation according to special law, and whether it is for- or non-profit. State or local governments, schools, foreign firms operating in the domestic market, foreign organizations located within South Korea including embassies where one or more workers are employed and corporations with only a sole representative director are also included.

9) See *The 2011 Handbook of Business at Work*, National Health Insurance Corporation, and the National Health Corporation website (www.nhic.or.kr).

insurance offers coverage to wage earners who work for a wage and maintain their livelihood through that earned income, as well as to their family members. Locally provided insurance is designed to serve the self-employed who maintain their livelihood through earnings generated from self-employed business. Therefore, employment-provided policyholders include employers and employees in workplaces, government employees, and education personnel, along with their dependents, while locally-provided policyholders include farmers and fishery workers, and the self-employed residing in cities excepting employment-provided policyholders, and their dependents as well. Those excluded from health insurance coverage or employment-provided insurance are prescribed in the National Health Insurance Act. Locally-provided insurance plans are mandated by law for those ineligible for employment-provided insurance, regardless of their intention.

3) Employment Insurance and Workers' Compensation Insurance Plans¹⁰⁾

In principle, all businesses or workplaces in South Korea are subject to mandatory coverage by employment insurance. Exceptions, however, are provided by Presidential Decree to businesses and workplaces in view of business size or other considerations. Such businesses and workplaces can still voluntarily apply for employment insurance with the consent of the majority of their workers. Workplaces that fall within the mandatory enrollment criteria are automatically enrolled in employment insurance plans regardless of employers' or employees' volition when the business is initiated or comes to fall under pertinent requirements.

Workers' compensation insurance is mandated by law for all businesses or workplaces employing workers. Most employers are obligated to participate in the insurance, but those who are not required to join the insurance can still opt in to the insurance, as with other forms of social insurance. In such non-obligatory cases, an employer can enroll in the insurance plan under the approval of the Korea Workers' Compensation

10) See *The 2011 White Paper on Employment Insurance, The 2010 Workers' Compensation Insurance Project Yearbook*, Ministry of Employment and Labor.

& Welfare Service and will be insured in a manner similar to obligatory participation.

C. Criteria for Charging Premiums

1) National Pension Plan¹¹⁾

National pension premiums are calculated by multiplying the standard monthly income amount, which is determined through a report by the applicant at the time of enrollment or by regular assessment, by the insurance premium rate. Standard monthly income amount refers to the sum in figures rounded down to the thousands of the monthly income reported by an enrolled person for the determination of premiums or benefits. Standard monthly income is determined within the range of a minimum 240,000 won and maximum of 3.89 million won. In other words, the standard monthly income amount is set at 240,000 won even if reported monthly income falls below that amount and the standard monthly income amount is set at 3.89 million won even if reported monthly income is greater.

In the case of employers (limited to employers maintaining workplaces that are not corporations), relevant income refers to earnings generated from agriculture, forestry, and fishery as well as business income (including real estate rental income) as prescribed in Article 19 (2) of the Income Tax Act. In the case of workers, relevant income refers to income earned by offering labor as prescribed in Article 20 (1) of the Income Tax Act, from which non-taxable income is deducted pursuant to Article 12 (3) of the same act. The standard monthly income amount is set as the monthly average remuneration including annual bonuses reported by an employee, which is agreed upon at the point of labor contracting in the case of a new employee. In the case of an employee hired prior to December 1 of the previous year, the standard monthly income is the division of annual gross income from the previous year by the working days of the previous year, multiplied by 30.

11) See the National Pension Service website (www.nps.or.kr).

2) Health Insurance Plan¹²⁾

The health insurance scheme is divided into employment-provided insurance and locally provided insurance plans, so the criteria for imposing insurance premiums are applied differently according to the plan. Premiums for employment-provided insurance policyholders are determined by multiplying a policyholder's monthly remuneration by the insurance premium rate. Monthly remuneration refers to money and other valuables received by workers from their employers or the state or local government, from which cost-compensatory pay is excluded. Among employment-provided insurance policyholders, in the case of individual representatives of a business entity who are not provided with wages and salaries, monthly remuneration refers to the sum of all business income generated at the workplace in question during the corresponding year, together with real estate rental income. On the other hand, in the case of locally-provided policyholders, insurance premiums are calculated by multiplying a contribution score by value per point. The contribution score is determined based upon a policyholder's income, property, living standard and labor force participation rate. Income includes interest, dividends, business income, earned income, and other income, as well as annuity income, which is based on the income data available from the five major public pension corporations. In the case of locally-provided insurance plans, different methods of calculating insurance premiums are applied to a household whose annual taxable income is five million won or less and a household whose annual taxable income exceeds five million won, leading to insurance premiums being determined by adding up points, which are assigned according to differing grades on each factor determining contribution.

In addition, the monthly remuneration of employment-provided policyholders is set at 280,000 won in the event that the amount is less than 280,000 won and at 78.1 million won in the event that the amount exceeds that sum. The upper and lower limits for the contribution score of locally-

12) See *The 2011 Handbook of Business at Work*, National Health Insurance Corporation, and the National Health Corporation website (www.nhic.or.kr).

provided policyholders are set at 12,680 and 20, respectively.

3) Employment and Workers' Compensation Insurance Plans¹³⁾

The method and criteria for charging premiums for employment insurance and workers' compensation insurance schemes were adjusted when the collection of the four major social insurance premiums was unified on January 1, 2011. Methods for paying contributions have been shifted from a voluntary annual report and payment to a monthly notice and payment, but the former method was maintained for construction and logging businesses. The criteria for calculating contributions charged to all workplaces regardless of business type have changed from 'wage' pursuant to the Labor Standards Act to 'remuneration' pursuant to the Income Tax Act.

D. Insurance Premium Rates

As of 2012, the social insurance premium rates applied to insured workers were 4.5 percent for the national pension, 3.08995 percent for health insurance (long-term care insurance included), and 0.55 percent for employment insurance—totaling about 8.1 percent of standard income.

To the national pension plan, a workplace-based insured person must provide 9 percent of income, with the employee and employer each shouldering half of the total, or 4.5 percent each. Insurance premiums must be paid collectively by an employer every month, rather than by the insured individuals. On the other hand, individually-insured persons, voluntarily-insured persons and voluntarily continuously insured persons must provide 9 percent of their current income as premiums. The health insurance premium rate is 5.8 percent as of 2012. The contribution of an employer-provided policyholder is borne in equal shares by the employer and employee, along with the long-term care insurance premium (6.55 % of the health insurance premium).

13) See *The 2011 White Paper on Employment Insurance, The 2010 Workers' Compensation Insurance Project Yearbook*.

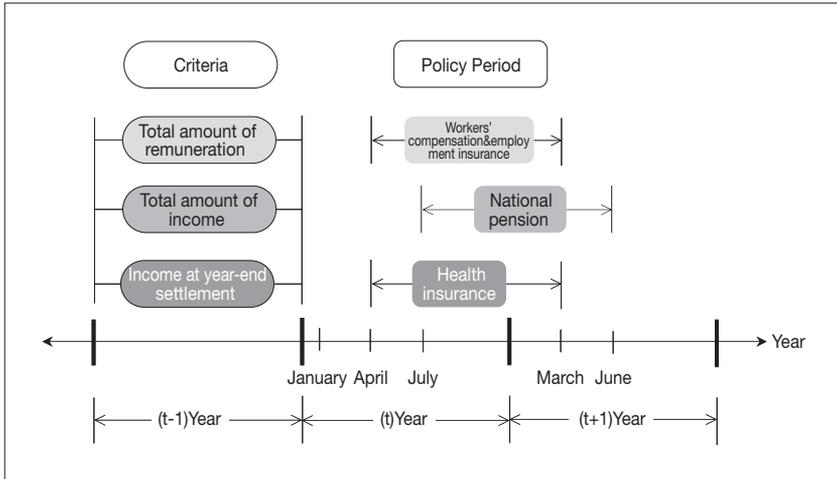
The employment insurance program is divided between unemployment benefits, which are borne 50 / 50 by employers and employees, and employment security and vocational training projects, which are shouldered entirely by employers. A premium rate of 0.55 percent has been applied to unemployment benefits since April 1, 2011. The premium rates for employment security and vocational training projects are determined by business unit according to the scale of businesses (corporation, association, enterprise, etc.), but businesses operating overseas are excluded. To assess the scale of business, the number of regular employees is calculated based on the total number of workers employed in each workplace.

In terms of workers' compensation insurance, employers must, in principle, shoulder the full amount of the premiums. The premium rates are broken down by business type, which are classified according to degree of hazard based on the ratio of insurance benefits to the total amount of payroll for the past three years, as of June 30 each year. (The rating is made public by the Ministry of Employment and Labor on, or around, December 31 every year.)

E. Insurance Premium Calculation

Essentially, premiums for social insurance plans, with the exception of the national pension, are calculated and applied based on income accrued over the previous year and are then adjusted through an ex-post settlement procedure. The ex-post settlement procedure is necessary due to differing calculation and policy periods. [Figure III-2] describes the general calculation period and policy period of the four major social insurance schemes.

[Figure III-2] Calculation Criteria and Policy Period in Social Insurance Schemes



2 Current Status of the Four Major Social Insurance Schemes

As of the end of July of 2012, the total number of enrollees in the national pension plan in South Korea stood at approximately 20.05 million, with workplace-based insured and individually-insured enrollees making up 19.76 million or 98.6 percent of all enrolled persons. This accounts for 76.3 percent of the nation's economically active population (25.90 million as of July 2012).

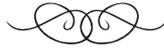
Since the expansion of the national pension program in April 1999 to cover urban residents, aimed at including the entire nation, the total number of people enrolled in national pension plans has steadily increased. A closer examination of the number of insured persons by type indicates that the number of individually-insured persons was greater than that of workplace-based insured persons during the period of 1999-2006, but with the extension of eligibility in 2006 to cover all workplaces maintaining at least one employees, since 2007 the number of workplace-based insured persons has exceeded that of their counterparts.

The population covered by both medical benefits and health

insurance amounted to 51.04 million as of late June 2012. Among them, the number covered by health insurance stood at 49.49 million with employment-provided policyholders at 33.88 million or 68.4 percent of the overall health insurance policyholders and locally provided policyholders at 15.62 million or 31.6 percent. Since the expansion of eligibility to workplaces with less than five employees in July 2003, the number of employer-provided policyholders has steadily increased, while number of locally-provided policyholders has declined. The gap between the two groups has been widening. With the growth of employer-provided policyholders, from 2005 the number of workplaces participating in health insurance program has also swelled by 1.8 times to 1,105,610. The dependency ratio, a measure of the number of dependent family members per health insurance policyholder, stands at 1.46 for employer-provided policyholders and 1.01 for locally-provided policyholders as of June 2012.

The number of workplaces covered by employment insurance had increased by approximately 66,000, or 4.3 percent, to 1.57 million as of August 2012 compared to December 2011. According to the size of workplaces, those maintaining less than five employees comprise the largest portion, with 1.1 million or 70.4 percent, followed by workplaces with five to nine employees with 227,000, or 14.4 percent. That is to say, small-scale workplaces with less than ten workers account for the largest portion, or 84.8 percent of all workplaces covered by employment insurance.

In terms of workers' compensation insurance, since its introduction in 1964, the number of workplaces and workers covered by the program has seen a steady increase. As of the end of 2010, the number of workplaces covered by the insurance program grew by 47,000 or 3.04 percent from the previous year to 1.6 million, while the number of workers enrolled in the insurance program was augmented by 314,000, or 2.26 percent over the previous year, to 14.12 million. By size of workplace, small-scale workplaces with less than ten employees account for 84.3 percent of total workplaces covered by the insurance program, while workers employed in small-sized workplaces make up 24.8 percent of the total number of workers covered by the program.



IV

Duru Nuri Social Insurance Subsidy Program (DNP)¹⁴⁾

Purpose of Introduction

After workers' compensation insurance was installed as South Korea's initial form of social insurance in July 1964, the health insurance scheme, national pension scheme, and employment insurance scheme were inaugurated in June 1977, January 1988, and July 1995, respectively. Even with such social insurance schemes in place, in reality a great number of people are still overlooked by social insurance schemes. Those remaining in a blind spot in social insurance schemes mostly belong to socially disadvantaged groups remaining on an unstable footing in the labor market. Despite being those in the most desperate need of social insurance, in actually they are only marginally provided with social insurance benefits. Accordingly, it is becoming increasingly essential to eliminate blind spots and subsidize social insurance premiums for vulnerable groups so as to provide low-income workers with financial assistance and an incentive to work.

Under these circumstances, the DNP was introduced targeting low-wage workers not enrolled in the national pension and employment

14) See the website of the Duru Nuri Program (<http://insurancesupport.or.kr>). See also the Ministry of Employment and Labor *et al.* (2012) and Yoo Gyeong-joon *et al.* (2012).

insurance plans and thereby exposed to an elevated risk of job loss and an unstable, unprotected old age. The program was designed to encourage such vulnerable groups to participate in insurance schemes by subsidizing their social insurance premiums. After conducting pilot projects in 16 self governing districts and cities¹⁵⁾ between February and June of 2012, the Ministry of Employment and Labor and the Ministry of Health and Welfare expanded the DNP across the nation on July 1, 2012, targeting employees working in small-scale workplaces who are not covered by social insurance schemes such as employment insurance and national pension plans and providing them with a subsidy of up to 50 percent of insurance premiums.

Qualification Requirements

A. Qualified Beneficiaries

The DNP is designed to subsidize the contributions to employment insurance and the national pension scheme of workers in low-paying jobs (average monthly remuneration of between 350,000 and 1.25 million won) at workplaces with less than ten employees. It grants aid amounting to one-third or one-half of the contributions borne by employers and employees for eligible workers: workers whose monthly remuneration stands between 350,000 and less than 1.05 million won are provided with half of their contributions for employment insurance and national pension plans, while one-third of contributions are paid on behalf of workers who monthly bring home between 1.05 million and less than 1.25 million won. In addition, employers who hire workers with low earning potential are entitled to subsidies amounting to one-half or one-third of contributions that they are required to bear.¹⁶⁾

15) Dongdaemun-gu of Seoul, Busanjin-gu of Busan, Dalseo-gu of Daegu, Bupyeong-gu of Incheon, Seo-gu of Daejeon, Nam-gu of Ulsan, Anyang-si, Wonju-si, Cheongju-si, Cheonan-si, Jeonju-si, Mokpo-si, Andong-si, Changwon-si, and Jeju-si

16) The government elected to provide subsidies to employment insurance and national pension schemes among the four major social insurance forms on the following two grounds: First, in

B. Amount of Subsidies and Aid Delivery Methods

1) Amount of Subsidies

The DNP subsidizes a portion of social insurance contributions for eligible low-wage workers, with the amount of subsidies varying according to the amount of monthly remuneration: half of contributions are subsidized for those whose monthly compensation stands between 350,000 and less than 1.05 million won, while one-third of contributions are provided for workers whose remuneration amounts to between 1.05 million and less than 1.25 million won. Employers are not entitled to subsidies for their own personal social insurance premiums, but the program does absorb both a share of the workers' insurance premiums that employers are required to bear and a part of workers' contributions, reducing employers' financial burden in actuality.

2) Aid Delivery Methods

Aid to social insurance contributions is delivered as follows: if employers/employees provide the full amount of contributions assigned for the corresponding month in which they file an application for the program by the statutory due date for payment (10th day of each month), they will be notified of the amount from which that month's subsidy is deducted in the following month. Whether or not applicants pay a contribution is to be judged by workplace.

The subsidy granted is described as "aid from the national treasury for the previous month" on insurance premium bills. If applicants belatedly file a report, the aid cannot be retroactively delivered, but is granted starting from the month in which they apply to the system. Aid is not provided in the event that there is no future premium to be charged due to

terms of health insurance, a majority of people are currently covered by employer-provided or individually-provided insurance or as dependent family members, or through other forms of medical benefits, resulting in smaller blind spots compared to other types of insurance; second, in the case of workers' compensation insurance, treatment and compensation are provided to workers who suffer work-related injuries regardless of whether or not they are enrolled in the insurance at the time of an accident.

discontinuance of business or other reasons.

3 Results and Analysis of Pilot Projects¹⁷⁾

A pilot social insurance subsidy program was conducted in 16 self-governing local areas between February and June in 2012, prior to a nationwide implementation in July of the same year.

In terms of employment insurance, subsidies were granted to 120,678 employees at 48,902 workplaces (44,439 existing insured workplaces and 4,463 newly enrolled workplaces). Among the recipients, 87,471 (72.5 %) were existing insured workers, together with 33,207 (27.5 %) newly enrolled workers. As for the national pension, 157,807 workers from 64,935 workplaces (59,383 existing insured workplaces and 5,552 newly insured workplaces) became entitled to aid. Among those, 116,084 (73.6 %) workers were previously insured and 41,723 (26.4 %) were newly insured persons.

The total amount of subsidies granted to wage earners stood at approximately 20.5 billion won. Of that sum, two billion won was provided as employment insurance premiums to a total 358,978 applicants, while 18.5 billion won was granted as national pension contributions to a total of 443,108 applicants.¹⁸⁾ Out of the total volume of subsidies, existing insured persons received approximately 17 billion won (83 %), while newly insured persons were granted about 3.5 billion won (17 %). In the case of employment insurance, the proportion of aid provided to existing insured persons and to newly insured persons turned out to be 78.1 percent and 21.9 percent, respectively, while the proportions for the national pension contribution stood at 83.5 percent and 16.5 percent, respectively.

Among the full class of eligible workplaces with less than ten employees, the portions of insured workers and subsidized workers

17) Summary of pp. 31-46 of Yoo Gyeong-joon *et al.* (2012).

18) The reason for the considerable discrepancy between the amount of aid for employment insurance and national pension is that although the respective numbers of applicants for the two schemes are similar, the insurance premium rate of the national pension plan (9 percent) is by far higher than that of employment insurance plan (0.25-1.1 percent).

working in premises maintaining less than five employees account for the majority, respectively making up 79 percent and 90 percent of such workers. In particular, insured workers and subsidized workers in the program employed at single-employed workplaces make up the largest groups, with 30 percent and 41 percent of such workers, respectively. The proportions are inversely proportional to the size of the workplaces.

The ratio of subsidized workers to the overall insured persons indicates that cases where all of the insured workers in a workplace constituted subsidized workers made up 62 percent for employment insurance and 66 percent for the national pension scheme.

Changes brought about by the pilot project in the number of newly-insured persons in employment insurance plans show that new enrollment rates of low-paid employees in workplaces with less than ten employees in those areas subject to the pilot program were 9 percent higher than those in other areas. In addition, new enrollment rates among high-paid workers in workplaces eligible for the aid program in these areas were also 8.2 percent higher than those in other areas.¹⁹⁾

19) However, this result is limited by the fact that it was calculated under circumstances where the group of newly insured persons was not precisely identical to the group of workers applying for the pilot aid program, and variables such as changes in the labor market, in the state of low-paid workers and in small workplaces were not controlled (Yoo Gyeong-joon *et al.*, 2012).



Policy Examples in Key Countries of Reducing Social Security Contributions for Low-Income Groups

For a considerable number of years, the provision of reductions in social security contributions by low-paid workers has been aggressively implemented in a number of advanced countries. The OECD officially recommended such a policy as an instrument to promote employment and encourage those with minimal earning potential to participate in the labor market as employment conditions have worsened for low-paid workers amid globalization and rapid advances in knowledge and information technology (OECD, 2005). Such policies have been implemented in such a way as to allow workers with incomes below a certain threshold to be excused from all social security contributions in countries including the U.K., Australia, the Netherlands, Norway, and Ireland. Alternatively, some countries provide social security contribution subsidies for low-paid workers by means of particular policies. The *Werkbonus* of Belgium, the *Mini-job* of Germany, and the *Loi Fillon* of France provide the representative examples of such policies.

The purpose or background of social security contribution subsidy programs varies across countries, and a policy's targeted group can be workers or employers or both according to the country involved. In the event that the main purpose of the policy lies in reducing the labor costs borne by employers, employer-side social security contributions would be reduced, while countries that aim at inducing those with minimal

earning potential to enter the labor market subsidize contributions due from workers. Some countries maintain policies that include both features. Germany is one example of providing reductions to contributions borne by workers as a means to offer monetary incentives to low-wage workers and encourage them to remain in the labor market. France reduces contributions on the employer's end with an aim to promote employer demand for workers with minimal earning potential. Belgium, the U.K. Spain, and the Netherlands have elected to implement a policy of cutting the contributions borne by both employers and employees in order to achieve both work and employment incentives. This section will examine representative social security subsidy programs in advanced countries and compare them with South Korea's DNP in order to derive policy implications.

1 Germany

The so-called 'Mini-job Program' in Germany is a representative example of a social security subsidy program targeting low-paid workers. Introduced in 2003 as a part of the Hartz Reforms addressing high unemployment rates and fiscal erosion, the program was designed to encourage the long-term unemployed subsisting on unemployment benefits or public assistance to participate in the labor market. The term 'mini-job' refers to a low-paying job with an average monthly earned income below 400 euro or to short-term employment with an annual work period not exceeding two months, or 50 days. Workers with 'mini-jobs' are excused from social security contributions and income tax, and their employers foot the bill instead. Those with jobs with monthly wages over 400.01 but less than 800 euros, which are classified as 'midi-jobs,' are entitled to reductions in social security contributions. Within this earnings range, lower wages cause the proportion of employer-side contributions to rise proportionately higher than the employee-side contributions. On the other hand, as wages increase, the proportion borne by the employee rises until the wage reaches the 800 euro threshold to which ordinary contribution rates are applied. Consequently, the reduction rate for midi-

job holders begins with the maximum of approximately 50 percent and then tapers off across the range of income until monthly earnings top 800 euros.

Belgium

Belgium's employment bonus program, 'Werkbonus,' is a further example of this style. Facing low-income individuals' notably low participation rates in the labor market, Belgium has actively implemented policies to induce less-skilled workers into the labor market since the late 1990s. As one of the policies, a social security contribution subsidy program was first put in place in 2000. It began as a tax credit system named CIBRAP, but was replaced by Werkbonus in 2004 as defects in the system design were identified. Werkbonus is operated by a certain bonus (175 euros per month) being granted on a monthly basis to low-paid workers whose monthly income falls below the threshold of 1,472.4 euros (as of 2012), but this sum is actually equivalent to a reduction in social security contribution. The employment bonus is phased out over the income range between 1,472.40 and 2,338.59 euros: it declines by the phasing-out rate of 26.36 percent in the range of 1,472.40 to 1,797.13 euros and by 16.51 percent in the range of 1,797.13 to 2,338.59 euros before cancelling out when monthly income reaches 2,338.59 euros.

France

France has in place a program to provide reductions in social security contributions to employers who hire low-income workers at wages near the minimum wage level, with an aim to promote employment among those with low earning potential. The reason the country elected to grant the benefits to employers rather than to workers lies in the features of the country's social security system, according to which employers' social security burden rates are higher than those of workers. The social security contribution subsidy program was introduced in 1993 amid an economic

recession, and since that point the coverage and subsidy rates have gradually expanded. Currently, the program is being operated based on a law known as ‘Loi Fillon’ enacted in 2003. Reductions in employer social security contributions max out at 26 percent for a wage floor and then are phased out up to a level of 1.6 times this floor. However, the cuts contain an upper limit of 28.1 percent for companies with less than 20 employees.

Other Countries

A style of social security contribution subsidy program has been implemented in countries including Spain, the U.K., the Netherlands, Norway, Australia, Austria, and Ireland that sets an income threshold and waiving the social security contribution liability of workers whose income is below the threshold. The bottom limit for annual income in Spain is 8,978.4 euros (as of 2011) and workers whose earnings fall below this threshold and their employers are exempted from social security contribution liability. Additionally in Spain, other assorted forms of social security contribution subsidy program are in place for vulnerable groups such as aged workers, women, and the disabled. In the U.K., qualified low-wage workers are provided with financial benefits for class 1 national insurance contribution liability. Low-paid workers with a weekly income under the lower earnings limit (102 pounds as of 2011) are exempted from the requirement to pay into the national insurance system. Workers with weekly earnings standing between 102 and 139 pounds are not entitled to the social insurance waiver, but the government does provide them with subsidies to allow them to be considered to have paid into social insurance. These benefits are offered not only to employees but also to employers who hire workers with weekly earnings below the secondary threshold (136 pounds per week).

In the Netherlands, workers whose annual income fails to reach the level of 16,965 euros are granted reductions in social insurance contributions via an employment income tax credit, and their employers are exempted from unemployment insurance contribution liability. Meanwhile, Norway set 39,600 Norwegian kroner as the lower earnings

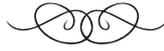
limit for the provision of national insurance subsidies. Australia, where a social insurance contribution is not withdrawn from wages, but the Medicare Levy charged on taxable income serves instead as a social insurance premium, grants exemption from the Medicare Levy to those whose taxable income falls below the national income floor (18,839 Australian dollars for an individual and 31,789 Australian dollars for a family). In Austria, the lower income limit for providing a social insurance subsidy is 374.02 euros per month (as of 2011), and additional reductions in unemployment insurance premiums are also provided to eligible workers. A one percent of tax reduction rate is applied to workers whose monthly income stands above 1,179 but less than 1,286 euros, and a two percent rate to workers who earn more than 1,286 but less than 1,447 euros per month. Workers maintaining a monthly income below 1,179 euros are exempted from unemployment insurance contributions. Lastly, in Ireland, workers whose weekly income is less than 352 euros are freed from social insurance contributions, while employers who hire workers with weekly earnings less than 356 euros are granted a 4.25 percent reduction rate in place of the standard rate of 10.75 percent.

5 Implications

Worthy of note in the examples above is that social insurance subsidy programs designed for low-paid workers are applied first to the most economically vulnerable group. In countries including Germany, the U.K., Spain, the Netherlands, Norway, Australia, Austria, and Ireland, programs are operated in such a manner that exemption—that is, a 100 percent reduction—is granted to workers whose incomes fall below a set threshold. In France and Belgium, diminished social insurance contributions are phased out as workers' incomes rise and the programs no longer apply once income reaches the upper earnings limit. That is to say, differential reduction rates are applied to social security contributions according to worker income, thereby allowing the most vulnerable groups to be provided with the greatest amount of aid.

In contrast, the current reduction rates provided by the DNP stand

at a mere 33 or 50 percent, which do not suffice for subsidy to function as an incentive to encourage workers and employers to join social insurance schemes. Among the countries mentioned above, only France has in place reduction rates smaller than South Korea's, with a maximum rate of 26 percent applied to employers. Therefore, the DNP's effect on lifting the burden upon low-income workers is relatively small compared to those of other countries' programs. In addition, the South Korean program is based on a binary reduction rate system, such as 33 percent and 50 percent on the basis of a 1.05 million won monthly wage, and lack differentiating elements in terms of income. In a situation where the most financially marginalized group is still obliged to pay half of their social insurance contributions, low-income workers retain the incentive to evade participation in social insurance programs. In addition, in order to qualify for the program, requirements pertaining to both the size of workplaces and remuneration threshold must be met. Those who fall short of meeting both requirements will not be entitled to benefits. For example, low-paid workers employed at workplaces with more than ten employees fall within a blind spot in the program. In summary, with both lower coverage magnitude and reduction rates than reported in other countries' programs, the DNP is expected to demonstrate limited effectiveness in accomplishing its purpose of eliminating blind spots in social insurance coverage.



VI

Effects of Job Subsidies and Reductions in Social Insurance Contributions²⁰⁾

Countries in both Europe and in other regions have enacted employment subsidies and cuts in social security contributions in an effort to improve the employment prospects of the long-term unemployed and other vulnerable groups in the labor market. A number of policymakers justify this strategy based on theoretical analysis and simulations which have suggested that such policies wield positive effects on beneficiaries' employment and social mobility opportunities. However, Marx (2005) examined the then-existing research on job subsidies and cuts in social security contributions in EU countries aimed at stimulating the recruitment of the long-term unemployed and other vulnerable groups in the labor market and arrived at the following conclusions. First, that the net employment effects of such measures are found to be substantially less than what the majority of theoretical models and simulations predict, even under relatively pessimistic assumptions, and this finding was consistent across all studies. This is mainly due to the measures' deadweight losses turning out to be greater than expected and substitution effects being lower than projected. Second, there is little evidence that subsidies

20) Based on Marx, I., "Job Subsidies and Cuts in Employers' Social Security Contributions: The Verdict of Empirical Evaluation Studies," paper prepared for the Conference "Changing Social Policies for Low-income Families and Less-skilled Workers in the E.U. and the U.S." at the University of Michigan, April 7-8, 2005.

offered to a certain target group have a positive impact on beneficiaries' future employment prospects. This section will examine social security contribution subsidy programs' impact from this perspective.

1 Deadweight Loss

In the process of advancing strongly targeted measures to grant temporary reductions in or waivers of social security contributions, deadweight losses may occur since a substantial number of the subsidized individuals in question would regardless have found employment if the measures had not been put in place. However, because most studies evaluating deadweight loss in these subsidy measures are based on interviews with employers, it is plausible that they underestimate the deadweight loss as a result of selection distortion and opportunistic responses. Van der Linden (1995) estimated at 53 percent the deadweight loss of a Belgian measure introduced in the early 1990s to provide temporary social security reductions for the employment of long-term unemployed persons, youth, and other vulnerable groups. Van Polanen Petel *et al.* (1999) similarly determined the deadweight loss of a Dutch scheme known as the Verminderend Langdurig Werklozen (VLW), which involves reductions in eligible employers' social security contributions, to be between 27 and 60 percent²¹⁾ and estimated the deadweight loss associated with a different Dutch scheme called SPAK, which involves a permanent reduction in qualified employers' social security contributions, at 93 percent.

2 Substitution Cost

In addition to deadweight loss, social security contribution subsidies may incur substitution cost. When the targeted groups of a subsidy program are tightly demarcated, their employment cost falls below than

21) The broad margin is due to the statistical confidence interval applied.

that of non-subsidized employees. As a result, non-subsidized groups may be passed over out of preference for the subsidized groups. Even if the substitution cost of subsidy programs can be substantial, there are limitations on obtaining reliable estimates due to the aforementioned problems in surveying employers. Preceding studies have offered estimations on the substitution costs of different subsidy programs as follows: Koning *et al.* (1995) suggested the substitution cost of the Dutch RAP to surpass 47 percent. Van der Linden (1997) estimated the substitution cost of the Voordeelbanenplan, a targeted Belgian measure, at 36 percent, while Atkinson and Meager (1994) projected the substitution cost of the British Workstart to be 25 percent.

3 Displacement Cost

Social security contribution subsidy programs can also entail displacement costs when companies not receiving subsidies lose market competitiveness, thereby resulting in job losses. It is also difficult to obtain reliable estimates of displacement cost based on interviews with employers. Available preceding studies suggest estimates of displacement costs, albeit lacking in reliability, at between four and 36 percent. De Koning *et al.* (1995) state that some 28 percent of companies receiving a subsidy under the Dutch Vermeend-Moor Act responded that the subsidy had allowed them to improve their competitiveness. A similar advantage was gained by more than 36 percent of companies claiming subsidies under the Dutch RAP scheme, likely at the expense of competing enterprises. Atkinson and Meager (1994) estimate the displacement cost stemming from the British Workstart at 33 percent.

4 Net Employment Effects: Estimates on the Basis of Time Series

A number of studies have been designed to assess the overall employment effects of social insurance contribution subsidy programs

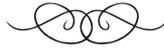
through time series analysis, taking the approach of determining whether the introduction of a particular subsidy program sparked additional job growth. The statistical significance of the evaluations depends on whether other potential explanatory factors such as economic circulation were thoroughly controlled in the tests. Katz (1998) examined through a time series analysis the net effects of the Targeted Job Tax Credit (TJTC), a U.S. program granting substantial tax deductions to companies recruiting additional employees drawn from vulnerable groups, including young people deprived of welfare benefits. By analyzing the effect on people aged between 18 and 24—a vulnerable group in the labor market—the study estimated a net employment effect of around seven percent.

5 Take-up of Subsidies by Employers

The effects of job subsidies and reductions in employers' social security contributions as suggested in empirical evaluations vary. This appears to be closely associated with the scope of the affected group, the generosity of the benefits and the duration of the programs. According to Sianesi (2001), voucher schemes under which employees have the right to claim benefits are likely to prove more effective if they are designed to target specific groups. A survey of Belgian companies recruiting large numbers of low-skilled workers found that many small companies did not take advantage of the measures, which granted considerable albeit temporary reductions in social security contributions, because they reckoned as inapplicable due to their unfamiliarity with such measures (Lamberts, 1993). Lamberts (1993) attributes this unfamiliarity to the complexity of schemes and the frequent amendment of the related legislation. A survey conducted by van Nes *et al.* (1998) shows that in the case of the Dutch program SPAK, 72 percent of all eligible enterprises took advantage of the scheme, and larger companies were more inclined to make use of it than were smaller companies.

6 Transition to the Regular Labor Market

Based on the following grounds, Marx (2005) suggests that employment subsidies do not have a positive effect on the likelihood of beneficiaries shifting from subsidized to regular work. First, beneficiaries are unable to switch out of subsidized work, at least in the short term. Van Ours (2002) reports on an analysis of data drawn from experimental research performed in the Slovak labor market in the 1990s, which indicated that the duration of the transition by subsidized workers to the regular labor market expanded first from six to nine months and then from nine to 12 months. This indicates that while short-term subsidized jobs have a positive effect on regular employment, this effect becomes the opposite as the period of subsidization lengthens. A second factor affecting the poor transition rate from subsidized to regular labor is the stigmatizing effect on subsidized workers suggested in previous research. That is to say, the fact of being subsidized operates negatively for beneficiaries in terms of finding a conventional job, because they are frequently perceived as lacking the ability required to find a normal employment. A third factor is that the work experience acquired through subsidized employment is insufficient for escaping from the so-called “productivity trap.” This indicates that employment subsidies do not suffice to enable the subsidized to clamber out of this trap. It also suggests that the vulnerable position within the labor market of certain groups, including the long-term unemployed, is not simply due to a lack of work experience and contact with the labor market.



VII

Need to Subsidize Social Insurance Contributions for the Working Poor

The term ‘working poor’ refers to those unable to rise above the poverty line due to recurrent spells of unemployment and/or low income despite the ability and willingness to work. Previously, poverty has often been associated with old age, disability, and job loss, but the issue of “in-work poverty” has come to the fore in recent years in South Korea. The widespread prevalence of the working poor—despite work being intended as a pathway out of poverty—suggests that work-first policies initiated by the government do not serve to fully cope with in-work poverty (Lee Byeong-hee *et al.*, 2011).

Lee Byeong-hee *et al.* (2011)²²⁾ defines as informal work²³⁾ those jobs not covered by mandatory social insurance due to the nonperformance of obligation by employers or failure to meet insurance premium payments and investigates features of informal work in order to identify social insurance policies able to address in-work poverty. Based on the results of

22) Lee Byeong-hee *et al.* *Development of Social Indicators by Means of KOWEPS Data*, Korea Institute for Health and Social Affairs, 2011.

23) According to the International Labor Organization (2003), employees are considered to hold informal jobs “if their employment relationship is, in law or in practice, not subject to national labor legislation, income taxation, social protection or entitlement to certain employment benefits (advance notice of dismissal, severance pay, paid annual or sick leave, etc.).” This definition offers a clue to link labor policies to social security policies (Lee Byeong-hee *et al.* (2011) p.199 quoted).

this study,²⁴⁾ this paper will suggest the need to subsidize social insurance premiums through the EITC scheme, which is designed to more firmly establish a social safety net.

1 Informal Work and the Continuity and Recurrence of Poverty²⁵⁾

The poverty rate of those holding informal jobs edged down by 1.2 percentage points from 16.5 percent in 2005 to 15.3 percent in 2009, while that of those with formal jobs declined by 0.2 percentage points from 3.6 percent to 3.4 percent during the same period. As of 2009, however, the poverty rate of those engaging in informal work was 4.5 times higher than that of their counterparts.

An examination of the scale of informal work as of the end of 2009 shows that 38.4 percent of workers engage in informal work, and 19.6 percent of them are not covered by social insurance and 18.8 percent are waived from liability. By type of employment, 33.8 percent of salaried workers took part in informal work and 18.0 percent of them were not covered by social insurance. According to whether or not an individual is in poverty, 73.9 percent of workers in poverty engage in informal work, a much greater share than the 35.4 percent of workers who are not in poverty. While those who hold informal jobs account for 38.4 percent of all workers, the percentage of those holding informal jobs within the population in poverty stands at 73.9 percent; 29.7 percent of them are not covered by social insurance.

A survey on cumulative periods of job experience arranged by

24) Lee Byeong-hee *et al.* (2011) analyzes the poverty of households based on the relative concept of poverty, using the criteria of market income (= earned income + business income + property income + private transfer income) and classifies individuals as being in poverty when their household income adjusted by an "equivalence scale," which divides household income by the square root of household size, falls below half of the median income in their country. The paper defines informal work as jobs not covered by public assistance and employment insurance.

25) Lee Byeong-hee *et al.*, *Development of Social Indicators by Means of KOWEPS Data*, pp. 202-214 quoted.

features of initial employment among those who had been employed for over five years starting from 2005 shows that those who held informal jobs took part in informal work for 3.6 out of the five years and were out of work for a mere 0.5 years. This finding indicates that those with informal jobs are continuously or recurrently excluded from social insurance coverage, and, even if they are included, the duration is only short-term. This implies that their chances of being covered by social insurance are low and suggests a need to provide them with social safety by subsidizing their social insurance contributions.

2 In-work Poverty Rates in OECD Countries²⁶⁾

The OECD defines the working poor, with respect to the household concept, as individuals living in a household whose disposable income falls below 50 percent of the median income in their country and where at least one adult has a job at some point during the year.²⁷⁾

According to the OECD, the average in-work poverty rate in OECD countries stood at around 7.25 percent in 2005. South Korea's in-work poverty rate for that year was 8.21 percent, slightly higher than the OECD average but within the middle rankings. The proportion of working poor out of the overall poor population in South Korea was 71.1 percent, above the OECD average of 62.8 percent. This implies that a relatively large proportion of South Korean workers remain in poverty even as they

26) "OCED Employment Outlook (2009)," pp.173-180 quoted.

27) According to Lee Byeong-hee *et al.* (2012), approaching the in-work poverty issue by household unit includes the advantage of taking into account features of households such as the need for protection of children or disabled persons and the supply of labor by households. There has been controversy over whether this approach is effective in South Korea. However, compared to the definition of the working poor by means of an individual concept, this approach serves as an argument for employment-priority policy, since when households containing no job holder gain a wage earner, such employment's effect of raising the household above the poverty line becomes relatively more pronounced. This approach can also serve as an argument for policies to increase the number of job holders in households based on the tendency of the likelihood of a household with one worker to fall into poverty grows as the number of dependents increases, even when the worker's income is not especially low.

participate actively in the labor market. Lee Byeong-hee (2010) states that even though the working poor are taking part in the labor market, they still remain below the poverty line due to low income and the risk of job loss. Even when escaping poverty, they are highly likely to hover around the poverty line and maintain a high chance of falling back into poverty. In terms of the poverty rate of those reaching retirement age across all OECD countries in the mid-2000s, the rate in South Korea stood at 48.5 percent as of mid-2005, the highest among OECD nations and a remarkable 3.5 times higher than the OECD average of 13.7 percent.

3 Blind Spots in Social Insurance Programs

Eligibility for social insurance in South Korea has been dramatically expanded since the initiation of the schemes, but both systematically and administratively there still exist wide-ranging blind spots, revealing the schemes' inability to provide protection to the entire nation, especially to socially disadvantaged groups including the working poor. The fact that there are individuals who are not covered by social insurance plans for a variety of reasons despite their eligibility, or people who are not allowed to claim benefits due to their failure to pay social insurance premiums implies that the social insurance scheme is failing to function properly as the primary social safety net.

A. Causes for Blind Spots in Social Insurance Programs

The blind spots in social insurance schemes result from assorted causes. The examination by Lee Byeong-hee *et al.* (2011) identifies four categories of individuals who have fallen through the cracks of the scheme. The first type is those who are legally excluded from eligibility for employment insurance and workplace-based national pension and health insurance, such as workers in special employment, house-workers, and part-time employees who work less than 60 hours a month. The second type is those who are uninsured due to an inability to pay social insurance premiums for financial reasons or through their employers'

non-performance of liability. The third type is composed of those who are barred from benefits due to strict eligibility requirements, such as those who fail to meet the unit period of insurance requirement, insured individuals who voluntarily leave their jobs, and those who are not entitled to pension benefits due to a limited period of enrollment. The fourth type is those who receive benefits but in an insufficient amount due to their low wages or brief period of receiving benefits.

Tailored policy approaches are required to suit the types of people who fall within a blind spot, but addressing all four types passes beyond the scope of this paper. The main focus here on the second type of people, those who are legally eligible but for various reasons fail either to be insured or to be entitled with benefits, and the main purpose of this study is to seek strategies to expand their coverage. To this end, the scale of this blind spot should first be observed centering on wage workers.

B. Status of Wage Workers in Blind Spots of Social Insurance

1) Wage Workers' Enrollment Rates in Social Insurance Programs²⁸⁾

As of March 2012, the average proportion of wage workers enrolled in workplace-based social insurance schemes is 66.6 percent in the national pension, 69.7 percent in health insurance and 61.4 percent in employment insurance. When taking into account the proportion of locally or individually provided insured persons (health insurance, national pension), and of the dependents of insured persons (in the case of health insurance), uninsured rates among wage workers reach 27.4 percent in the case of the national pension, 2.3 percent for health insurance and 31.0 percent for employment insurance. Employment insurance exhibits the highest uninsured rates, while health insurance demonstrates the lowest. The low enrollment rate in employment insurance is attributable to the fact that among all employees the insurance plan is applied only to wage workers (71.8 percent of employees as of 2012) and the range of ineligibility among wage workers is set widely compared to other insurance schemes.

28) Statistics Korea, "Supplementary Results of the Economically Active Population Survey."

Meanwhile, the uninsured rate in health insurance schemes is a low 2.3 percent, a figure with locally provided insured persons and dependents of workplace-provided insured persons considered. However, there remains a possibility that the actual proportion of people not covered by benefits could be larger (Yoo Weon-seob, 2010) because there is a sizable number of eligible people who failed to pay insurance premiums for financial reasons and are thus denied benefits.

a) Enrollment Rates of Social Insurance Programs by Employment Type

As of March 2012, the percentage of insured persons among wage earners arranged by employment type is as follows: 79.6 percent of regular workers are enrolled in national pension plans (workplace-based), 81.3 percent have taken out health insurance plans (employment-provided) and 69.9 percent are covered by employment insurance plans. On the other hand, temporary workers display low enrollment rates, with 40.5 percent (national pension), 46.5 percent (health insurance), and 44.4 percent (employment insurance). The percentage of part-time workers lacking social insurance coverage stands at 78.6 percent, 6.0 percent, and 83.5 percent, respectively. Non-typical workers, including dispatched workers and contract workers, exhibit notably low enrollment rates with 59.2 percent, 3.4 percent and 70.7 percent, respectively.

b) Enrollment Rates of Social Insurance Programs by Scale of Business

As of March 2012, the proportion of wage workers enrolled in social insurance schemes tends to grow proportionately higher as the size of the business in question increases. Employees at large-scale enterprises maintaining more than 100 workers exhibit enrollment rates in employer-provided national pension and health insurance plans surpassing 90 percent, with rates of 75-80 percent in employment insurance. On the other hand, employees in small-scale workplaces with less than ten staff members show a rate of below 60 percent enrollment in employer-sponsored insurance plans. Particularly, in the case of employees in smaller workplaces (those with less than five workers) there is a notably low enrollment rate

in employer-provided social insurance: only 26.6 percent are enrolled in national pension plans, 29.3 percent in health insurance plans, and 28.2 in employment insurance plans.

c) Enrollment Rates of Social Insurance Programs by Wage Level

As of August 2010, wage earners' enrollment rates in social insurance schemes tend to grow as their level of earnings increases, and display a considerable disparity in enrollment rates at a threshold of 1.3 times the minimum wage. Low-paid workers whose earnings fall below 130 percent of the minimum wage display substantially reduced enrollment rates, with their enrollment rate in national pension plans standing at 27.0 percent, health insurance plans at 32.5 percent and employment insurance plans at 29.1 percent. On the other hand, the proportion of wage workers who earn 131 to 200 percent of the minimum wage surpasses 50 percent, while those who earn more than 200 percent of the minimum wage show high enrollment rates with 85 percent or more in national pension plans and 71 percent in employment insurance plans.

d) Enrollment Rates of Social Insurance Schemes by Industry Type

As of March 2012, wage workers' enrollment rates in social insurance schemes by industry type exhibit the following trends. The percentage of insured workers engaged in the mining and manufacturing industries, electricity, transportation, telecommunications and financial business stands at more than 80 percent, while enrollment rates are lower in industries such as agriculture, forestry and fisheries, wholesale and retail trade, food and lodging industry. Notably, more than 80 percent of wage earners in the mining and manufacturing industries are enrolled in employer-sponsored social insurance plans, while among wage earners in industries related to agriculture, forestry and fisheries, only 14 percent are enrolled in employer-sponsored national pension plans, with 16.6 percent enrolled in workplace-based health insurance plans and 18.1 percent in employment insurance plans. Enrollment rates in wholesale and retail trade and food and lodging industries fall as low as 40 percent.

2) Number of Wage Workers Enrolled in Social Insurance Programs²⁹⁾

Among wage earners excluding those ineligible for employment insurance, those who are enrolled in all of the social insurance programs, such as national pension, health insurance, and employment insurance, account for around 68 percent as of August 2010, while those who are not enrolled in any of these schemes make up around 26 percent. By employment type, the percentage of regular workers covered by all social insurance programs stands at 77 percent, while that of temporary workers covered by all social insurance programs marks 48.6 percent. As many as 42.5 percent of all temporary workers turn out to be unenrolled in any form of social insurance, indicating the magnitude of the problem of blind spots in the schemes. By size of business, small workplaces with less than five staff members show a proportion of workers covered by all forms of social insurance standing at a mere one-third. Two-thirds are not enrolled in any of the social insurance programs, indicating that exclusion from social insurance benefits has reached a serious level.

29) Citation and edition from Lee Byeong-hee *et al.* (2011). Based on data from "Supplementary Results of the Economically Active Population Survey." (Statistics Korea, August 2010)



VIII

Strategies to Subsidize Social Insurance Premiums Through EITC

1 Targeted Groups

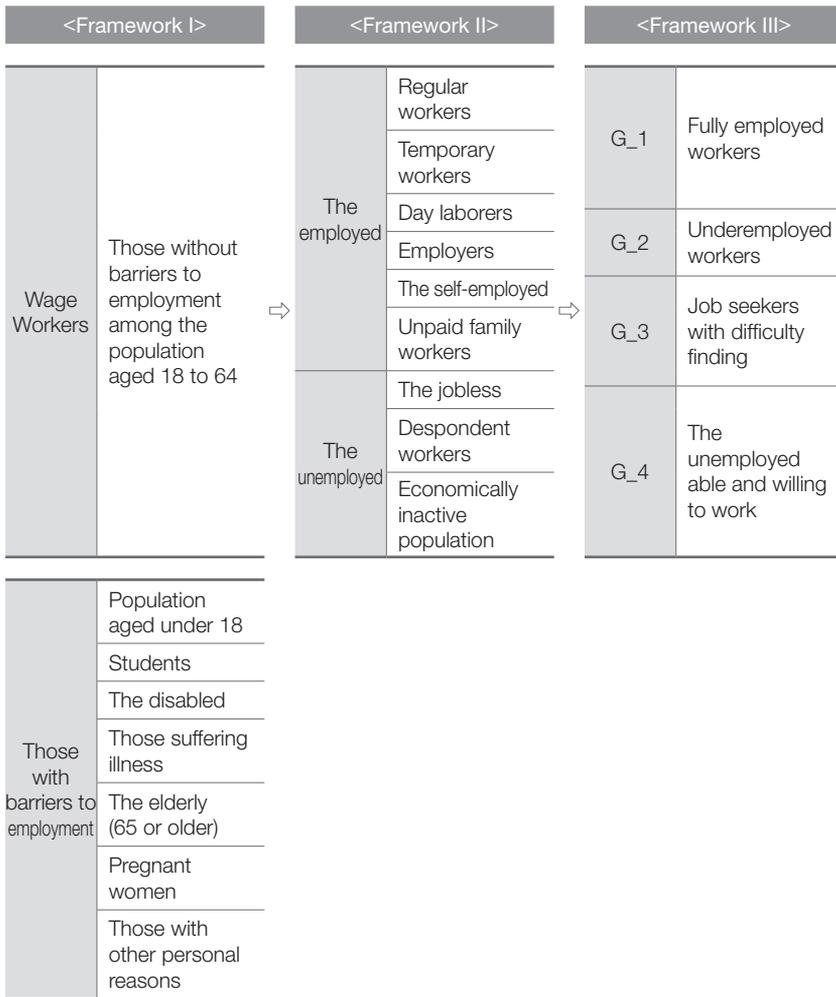
The OECD defines the working poor as individuals living in a household with a disposable income falling below half of the median income prevailing in their country of residence and where at least one adult maintains a job at some point during a given year. No Dae-Myung (2009) organizes the working poor through the three categories of ability to work, employment status, and employment duration as described in [Figure VIII-1]. Conceptual framework I is based on whether or not an individual possesses the ability to work. Conceptual framework II features the classification of the working poor by employment state and status at a specific time based on the principle employment state demonstrated by an individual during a particular year. Conceptual framework III classifies the working poor by their abilities to find a job, as verified through their experience in view of mobility.³⁰⁾

The groups of interest to this paper include the fully employed (employed for 12 months per year), underemployed (employed for 7-11 months per year), and job seekers with difficulty finding employment

30) No Dae-Myung *et al.*, *Study on Reform of Activation Policies in Korea*, Korea Institute for Health and Social Affairs, 2009, pp. 21-23 requested.

(employed for 1-6 months per year), all of whom are identified in framework III from among the working poor engaging in regular, temporary, daily work as identified in framework II, who in turn are drawn from the class of individuals able to work derived in framework I.

[Figure VIII-1] Conceptual Frameworks to Define the Working Poor in South Korea



Source: No Dae-Myung *et al.* (2009), *Study on Reform of Activation Policies in Korea*, p.29 quoted.

Introduced in 2008, the EITC and the DNP are similar in that both schemes target the working poor, a vulnerable group unable to rise above the poverty line despite being employed and possessing both the ability and willingness to work. However, the two programs differ in that the former provides benefits on a household basis while the latter offers subsidies on an individual basis. In order to discuss strategies for linking the EITC with the DNP, it is necessary to understand who is enrolled in social insurance schemes among EITC beneficiaries and who receives the EITC among those provided a social insurance premium subsidy. However, it is difficult to obtain accurate data regarding beneficiaries of the schemes because it is nearly impossible to obtain a clear picture of how many eligible workplaces or workers there are and whether recipients of EITC are enrolled in social insurance due to a lack of related statistics and information sharing between insurance corporations and the National Tax Service.

Comparison Between the EITC and the DNP

The EITC and the DNP are similar in that both schemes target low-paid workers, but they differ in terms of policy purpose and eligibility requirements (see <Table VIII-1>). While the principle intended function of the EITC is to encourage the working poor to participate in the labor market while granting them income support, the purpose of the DNP is to eliminate blind spots overlooked by social insurance for low-paid workers. In terms of aid delivery method, the EITC grants benefits to households, while the DNP provides a subsidy to individual workers or employers. The eligibility requirements are discrete as well: the EITC includes requirements pertaining to annual income, dependent children, and home and other property, while the DNP features requirements for qualification related to monthly remuneration and the size of workplace. To claim an EITC, the annual income of a household must fall within the range between 13 and 25 million won (on a household income basis), while to be entitled to the social insurance subsidy an individual's monthly remuneration must come into the range of between 350,000 and 1.25 million won (annually 4.2 to 15 million won). In terms of amount of subsidy, the EITC ranges from 700,000

up to two million won according to the number of dependent children (as of 2012), while the DNP grants subsidies of up to approximately 300,000 won per annum to the employer and the worker each.

<Table VIII-1> Comparison Between the EITC and the DNP (As of 2012)

		EITC	DNP
Main Purpose		<ul style="list-style-type: none"> - Income support - Work incentive 	<ul style="list-style-type: none"> - Mitigation of the blind spot overlooked by social insurance - Generation of employment
Beneficiaries		Low-income working families	Low-income workers and small-scale employers
Eligibility Requirements	Income	<ul style="list-style-type: none"> - Childless households: annual income less than 13 million won - Households with one child: annual income less than 17 million won - Households with two children: annual income less than 21 million won - Households with three children: annual income less than 25 million won 	<ul style="list-style-type: none"> - Monthly remuneration ranging from 350,000 to 1.25 million won (Annual income ranging from 4.2 to 15 million won)
	Property Value (home)	Less than 100 million won (a house valued at less than 60 million won)	Inapplicable
	Working Hours	Inapplicable	Minimum 15 hours per week
	Size of Workplaces	Inapplicable	Less than 10 staff members
Application		Applied in May, deliberated in June-August, issued prior to the end of September (based on previous year income)	Monthly (based on remuneration of the corresponding month)

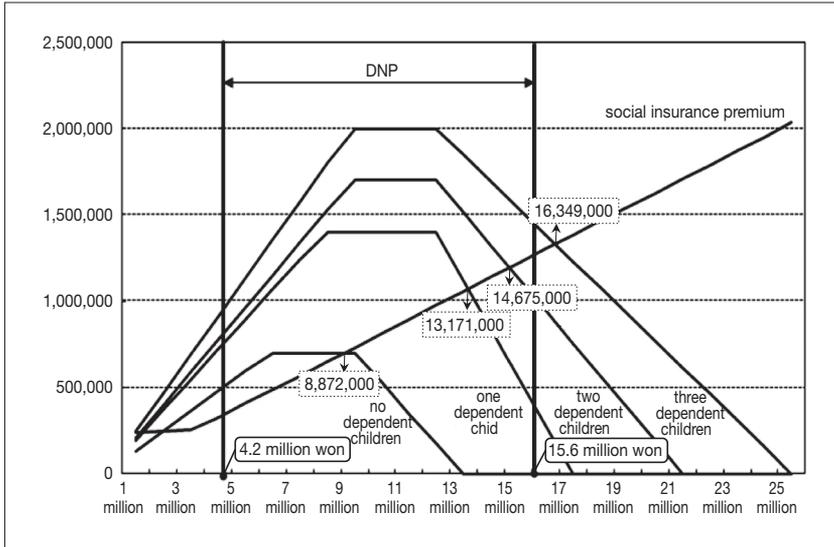
<Table VIII-1> Continue

	EITC	DNP
Amount of Subsidy	<ul style="list-style-type: none"> - Childless households: up to 700,000 won - Households with one child: up to 1.4 million won - Households with two children: up to 1.7 million won - Households with three children: up to 2 million won 	<ul style="list-style-type: none"> - Monthly remuneration ranging from 350,000 to 1.05 million won: half of employment insurance and national pension premium subsidized - Monthly remuneration ranging from 1.05 to 1.25 million won: one-third of employment insurance and national pension premium subsidized
Introduction	2008	July 2012
Executed by	National Tax Service	Respective Social Insurance Corporations

Source: Yoo Gyeong-joon *et al.* (2012) requoted and edited.

[Figure VIII-2] Comparison of Individuals or Families Eligible for the EITC and the DNP

(Unit: won)



Note: There is a limitation to clearly illustrating those who receive benefits from both schemes, not only because the EITC is provided on a household basis while the social insurance subsidy is granted on an individual worker and employer basis, but also because more than 60 percent of recipients of social insurance subsidies are women and thereby likely to be secondary income earners. This figure is aimed at comparing income requirements for eligibility for social insurance subsidy programs with the phase-in, plateau, and phase-out ranges for the EITC according to the number of dependent children.

Referring to Yoo Gyeong-joon *et al.* (2011), <Table VIII-2> compares the features of recipients of the EITC with those of social insurance subsidy program, centering on primary demographic factors. By gender and age, in the case of EITC male recipients slightly exceed their counterparts in number, and recipients in their 30s and 40s account for the largest part with 82.5 percent. On the other hand, in the case of the DNP, the proportion of female recipients far exceeds that of their counterparts, and the proportion of recipients aged younger than 30 and older than 50—those age groups holding the most unstable positions in the labor market—is relatively high. By employment status, the percentage of regular workers receiving social insurance subsidies stands at nine percent, which is far lower than the 39 percent of regular workers who receive the EITC,

while the proportion of social insurance-subsidized temporary workers and other categories stands at as high as 59 percent. Meanwhile, among those who receive social insurance subsidies, the proportion of workers engaging in the manufacturing and construction industry is smaller than that of their counterparts among EITC recipients, while the proportion of subsidized workers engaging in the group defined as the wholesale and retail industry and the food and longing industry is twice as high as that of their counterparts among EITC recipients. The income distribution of recipients of the two programs' pilot projects³¹⁾ demonstrates that 46.8 percent of EITC recipients are found in the phase-in range, 27.9 percent in the plateau range, and 25.3 percent in the phase-out range. In the case of the DNP, 57.8 percent of beneficiaries remain in the plateau range.

31) Note that a one-to-one comparison between the two schemes' recipients by income segment is difficult due to the income threshold for the EITC being set on a household basis of while that for the DNP is on an individual basis.

<Table VIII-2> Characteristics of Recipients of EITC and DNP

(Unit: thousand, %)

		EITC	DNP
Gender	Male	297 (52.7)	372 (29.0)
	Female	222 (42.8)	910 (71.0)
Age	Younger than 30	25 (4.8)	332 (25.9)
	Those in their 30s	177 (34.1)	219 (17.1)
	Those in their 40s	251 (48.4)	341 (26.6)
	Those in their 50s	62 (11.9)	307 (24.0)
	60 or older	4 (0.8)	82 (6.4)
Employment Status	Regular work	203 (39.1)	119 (9.3)
	Day labor	215 (41.4)	407 (31.8)
	Other	101 (19.5)	755 (58.9)
Employment Sector	Manufacturing	108 (20.8)	93 (7.3)
	Construction	102 (19.7)	97 (7.5)
	Wholesale and retail, food and lodging	114 (21.9)	598 (46.7)
	Personal service and other	197 (37.6)	493 (38.5)
Annual Income	Less than 8 million won	249 (46.8)	450 (35.1)
	8 million to 12 million won	145 (27.9)	740 (57.8)
	12 million to 17 million won	139 (25.3)	91 (7.1)
Total		519 (100.0)	1,281 (100.0)

Source: Yoo Gyeong-joon *et al.* (2011) requested. Governmental materials based on a press release by the National Tax Service (September 2011) and "Supplementary Results of the Economically Active Population Survey." (Statistics Korea, August 2010)

3 Expected Effects

The targeted groups and scale of subsidy vary depending on what kind of policy purpose a program carries, i.e. job creation or addressing a blind spot in service. The effects of programs to minimize social insurance premiums also vary from country to country according to policy purpose, aid delivery method, and other circumstances. In general, reductions in social insurance premiums for employers lower non-wage labor costs, thereby increasing the demand for labor, but they are known to entail deadweight loss, substitution cost, and displacement effects. However,

there are few available studies for evaluating such adverse effects. The measurement of deadweight loss is primarily based on interviews with employers, and there is a possibility of underestimation as a result of selection distortion and opportunistic responses. In addition, the response rates of employers are significantly low, necessitating a cautious approach in analyzing the related study findings.³²⁾ Since the measurement of substitution cost and displacement effect is similarly based on interviews with employers, reliable estimates are difficult to obtain. In particular, the assessment of how many non-subsidized employees are laid off to be replaced with subsidized workers, an observation necessary to measure substitution cost, is not a simple task.

The expected effects of the DNP in providing reductions in social insurance premiums not only to newly enrolled persons, but also to existing enrollees and employers are as follows: first, as in other countries, deadweight loss can result as a number of subsidized individuals would have found employment regardless of the subsidy. While the precise measurement of deadweight loss in the DNP is difficult for the aforementioned reason, the entailing such loss is expected to be substantial because the program provides subsidies to a sizable number of existing enrolled persons as well as newly enrolled members, contrary to the program's original purpose of stimulating participation rates among low-paid workers who fall within the blind spot of the social insurance scheme. Since the inception of the subsidy program, the number of newly enrolled workers has steadily increased, but the results of a pilot project for the program carried out between February and June 2012 show that out of the total subsidies of 20.5 billion won, around 16.99 billion or 83 percent was provided to existing enrolled workers, while around 3.49 billion won or 17 percent was granted to newly enrolled workers. The second expected effect is substitution cost resulting from the narrowly-targeted subsidized group, leading to an effect of lowering employment costs for subsidized workers, thereby negatively impacting the recruitment of non-subsidized workers. The substitution effect of the South Korean

32) According to a research paper examining the Dutch social insurance subsidy program, SPAK, the response rate was a mere 10 percent.

program is different in kind from the effect produced by programs in some countries that provide a social insurance subsidy only to the unemployed, but the South Korean program is problematic in that it grants subsidies not only to newly enrolled persons but also to existing enrollees.³³⁾ The third is the displacement effect, which results from job losses ensuing as non-subsidized companies shed market competitiveness. It is believed that displacement cost is not particularly substantial in the South Korean program due to the scope of the target group and scale of subsidies being unremarkable, as well as many of the subsidized workplaces being in need and small in scale. The proportion of workplaces with less than five staff members makes up 79 percent of all subsidized enterprises. In the case of employment insurance, the proportion of subsidized businesses engaging in the wholesale and retail industry and the food and lodging industry accounts for 35.2 percent, implying a high proportion of traditional small businesses among the body of subsidized businesses.

A. Duplicated Budgets

The DNP and the EITC were introduced with the intention of addressing the blind spots in social insurance³⁴⁾ and to encourage the working poor to take part in social insurance schemes, thereby strengthening the function of the social safety net to protect citizens against social risks such as job loss and old age. Two programs with similar purposes and intentions in discrete operation, however, can constitute a burden on national finances. The total funds provided by the EITC in 2012 was approximately 597.1 billion won and the 2013 budget for the social insurance subsidy program amounts to 479.7 billion won. The combined sum of the two programs' budgets reaches somewhere around 1.0668 trillion won. If a health insurance premium subsidy, which is not provided under the current DNP, is added, at least an additional 700 to 800 billion

33) The reason why the DNP aids not only non-insured persons but also existing enrolled persons is to mitigate the risks of a resulting substitution effect of employers dismissing existing enrolled employees with the purpose of replacing them with non-insured persons.

34) See the Korea Institute of Public Finance and the Korea Institute for Health and Social Affairs (2005), p.296.

won will be necessary in the budget. Considering that in the wake of the pilot project some maintain that the current subsidy scope—respectively one-third and one-half of national pension and employment insurance premiums—should be expanded and health insurance premiums should be included in the subsidy program as well in order to improve their effectiveness, the financial burden for the government is highly likely to be amplified in the future if the scope of the program further expands.

B. Deadweight Loss

Introduced to encourage low-paid workers to join social insurance programs and incentivize them to work, unlike its original purpose, the DNP is granting subsidies not only to newly enrolled persons, but also to existing enrollees and is consequently elevating the likelihood of deadweight losses.³⁵⁾ Even though the number of newly enrolled persons has gradually been increasing since the inception of the program,³⁶⁾ the results of the pilot project demonstrate that out of the 20.5 billion won granted up to the completion of the project at the end of June 2012, 16.99 billion won or 83 percent was provided to existing insured persons, while only 3.49 billion won (17 %) went to the newly enrolled. The DNP is expected to enter into full-scale operation in 2013 as the eligibility threshold of average monthly remuneration will be raised to 1.3 million won per month. If the proportion of subsidies supplied to existing insured workers enlarges with the expansion of the program, the deadweight loss is likely to be further compounded.

35) Deadweight loss occurs as a large portion of the workers subsidized would have been employed without any subsidy program. The exact measurement of deadweight loss is difficult to obtain because the related evaluative studies are mainly based on interviews with employers.

36) Since the inception of the DNP, the proportion of newly enrolled workers has gradually increased: it has grown by 2.0 percentage points from 27.5 percent to 29.5 percent in the case of employment insurance and by 1.4 percentage points from 26.4 percent to 27.8 percent in the case of the national pension.

C. Enhancing the Effectiveness of the DNP by Linking it to the National Tax Service Database

Prior to its nationwide introduction in July 2012, a pilot project for the DNP was conducted between February and June of that year in 16 self-governing areas in South Korea. Results of the pilot project arranged according to form of insurance illustrate that a considerable portion of the subsidies was bestowed upon existing insured workplaces and workers. This was a result of the challenges involved in ascertaining the status of non-enrolled workplaces and workers due to a lack of related data and information-sharing between national organizations. According to the original intention of the DNP, the program's main target group should be non-enrolled workplaces and workers. To accomplish the original purpose of the program, there is a need to ascertain the scale of low-paid non-enrolled workers employed in small-scale workplaces with less than ten staff members—those entitled to the subsidy program. If the National Tax Service and social insurance corporations share related information and a link between the two organizations can be established allowing the determination of whether EITC recipients are enrolled in social insurance schemes or whether social insurance subsidized workers receive EITC to be determined, it would promote the effectiveness of the schemes to a great extent.³⁷⁾

D. Alleviating In-work Poverty³⁸⁾

An OECD study (2009) arrived at the conclusion that combining social transfers provided by the social safety system (unemployment benefits) with in-work benefits, i.e., EITC, can be an effective instrument in combatting in-work poverty.

In the mid-2000s, the impacts on in-work poverty of social transfers in OECD countries where social safety systems are in place varied from

37) As of 2012, wage statements (filed quarterly) for around 7.8 million day laborers contain information on workplaces, laborers and wages.

38) OECD, "OECD Employment Outlook 2009," 2009, pp. 185-200.

country to country. However, on average they halved the poverty rate of households including at least one worker. The country that witnessed the greatest poverty alleviation effect was Denmark, with 71.5 percent, while at the other end of the scale was found Mexico with only 8.0 percent. In South Korea, the benefits brought about a 14.8 percent poverty alleviation effect. Even with both out-of-work and in-work benefits in place, South Korea experienced poverty alleviation effects lower than the OECD average, fueling a need to heighten the effectiveness of anti-poverty policy targeting the working poor by enhancing the linkage between the two systems.

Strategies to Provide Social Insurance Subsidies Through the EITC

A. Scope of Subsidization in Insurance Schemes

Social insurance premium deductions or subsidy programs can be divided between those targeting all social insurance schemes and those targeting aspects of the four major social insurance schemes. The DNP provides benefits related to the national pension and employment insurance, which have relatively low enrollment rates and proportionately larger blind spots. The reason health insurance is excluded is that the majority of people are enrolled in health insurance through not only employment-provided methods, but also in its locally provided form, compounded by coverage provided to dependents of employment-provided insurance policyholders.

With no one ineligible for enrollment the health insurance program exhibits a substantially low uninsured rate of 2.3 percent, but there is a high likelihood that the actual uninsured rate may be higher than reflected in this figure due to the considerable number of people unable to pay their premiums and thus experiencing restrictions on their use of medical services.³⁹⁾ Therefore, the social insurance subsidy program connected with

39) Those who fall behind in their health insurance premiums payments for three months are restricted from receiving full benefits.

the EITC needs to be expanded to cover all forms of insurance including national pension, employment insurance, and health insurance premiums borne by workers.

B. Amount of Deduction and Subsidy, and Eligibility

1) Beneficiaries of the DNP

The manner of granting benefits from a scheme combining the EITC and the DNP would be conditional on the amount of social insurance premiums, the amount of EITC receipts— which varies in the phase-in, plateau, and phase-out ranges—and the scope of the forms of social insurance subsidized. That is to say, while the social insurance contributions borne by an employee are proportionate to standard average income, EITC receipts are phased in as earnings approach a threshold and then gradually decline over a range of income levels. The amount of social insurance premiums is greater than EITC receipts in the phase-in and phase-out ranges, regardless of the number of dependent children, and in the plateau range only in the case of childless households. The granting of benefits under the combined plan will be conditional upon the amount of social insurance premiums and EITC receipts, and either the full or a partial amount can be subsidized, or the full amount of deduction or a differential deduction can be applied according to income segments.

Households standing in the phase-in range are mostly in the low-income bracket and in need of protection from the social safety net, so the social insurance subsidy program should target such people. There are three major methods for granting subsidies: first, subsidize the full amount of social insurance premiums. This method has advantages in that it subsidizes social insurance premiums to low-income working families in the phase-in range and simultaneously boosts work incentives by compounding income and wages. In this case, a social insurance premium subsidy through the DNP would not be granted in order to avoid overlaps in budget execution. The second method is to deduct social insurance premiums from the EITC and provide the difference as a subsidy. Since there is no additional contribution to be borne by an EITC recipient, the DNP would not grant

subsidies in this case. The third method is to provide a subsidy for the difference according to the range in which an EITC claimant is included. In the phase-in range, ex-ante deducted social insurance premiums are conditional on the amount of EITC benefits. As the DNP subsidizes half of the national pension and employment insurance contributions of the targeted group, the gap between the contributions borne by workers falling into the phase-in range and the amount of subsidy will be settled starting from the month following an EITC recipient meeting the requirements of the DNP. If there is a shortfall, it will be further subsidized by a social insurance corporation.

In the event that EITC receipts are greater than social insurance contributions regardless of the range to which EITC beneficiaries belong, a method worth considering is deducting social insurance contributions—either the full amount or the differential amount multiplied by a certain rate—from EITC receipts and granting any remainder that may result. In the event of a childless household in the plateau range whose social insurance contributions are greater than their EITC receipts, deduction is considered more desirable than subsidization in the respect of equity. For EITC recipients in the phase-out range with greater social insurance contributions than EITC receipts, deducting the full social insurance contribution or differentially deduct it within the scale of EITC receipts can be applied. In the case of the DNP target group,⁴⁰⁾ considering that the amount of subsidy is conditional upon the social insurance contributions paid by a worker according to EITC receipts, if there occurs a shortfall in an ex-post settling up, which is applied to the month after a worker met the requirements of the DNP, a social insurance corporation can further subsidize this shortfall.

40) Beneficiaries in the phase-in and the plateau range are subsidized at the rate of half of their national pension and employment insurance contributions, while those in the phase-out range are granted one-third of their contributions.

2) Non-Beneficiaries of the DNP

Methods to subsidize social insurance premiums for non-beneficiaries of the DNP can be arranged according to the phase-in, plateau and phase-out ranges as follows. Workers in the phase-in range can be entitled to a full or partial subsidization of their contributions, or alternatively to a full deduction or differential deduction within the limit of their EITC receipts. Households in that range are mostly low-income families in need of social protection, so they should be entitled to a full subsidization or compensation for any shortfall in the event that their social insurance contributions exceed their EITC receipts. Another option is to apply the method of deducting their social insurance contributions from their EITC receipts or differentially deducting that amount multiplied by a predetermined rate. Households in the plateau range other than childless families are entitled to EITC benefits greater than their social insurance contributions, making it plausible to apply the method of ex-ante deducting the full amount of social insurance contributions and repaying the remainder. An alternative would be using the method of differentially deducting according to set deduction rates. Childless households provide social insurance contributions greater than their EITC receipts, so a method of ex-ante deduction of contributions within the amount of their EITC or differentially deducting according to deduction rates can be considered. Households in the phase-out range make social insurance contributions surpassing their EITC receipts more frequently than do households in the phase-in range, implying that they have relatively higher income among the working poor. Therefore, ex-ante deduction within the scope of the EITC or differential deduction according to deduction rates deserves consideration.

C. Deduction Methods and Targeted Group

Implementation plans can be considered in terms of how to deduct social insurance contributions and how to select target workers. One plausible manner of deducting social insurance premiums is to subtract the estimated social insurance premiums for the coming year from EITC

benefits and remit the remainder. Another alternative is to deduct social insurance premiums for the previous year from the EITC only for persons not enrolled the previous year and provide the remainder. In terms of targeted group, it is advisable to obligate all EITC recipients to be subjected to ex-ante deduction and provision of the remainder or to entitle those who voluntarily apply for the program.

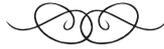
D. Ex-post Settlement

If workers are to receive their EITC in September of a given year based on the previous year's income, the social insurance premiums to be borne by the workers are withheld based on the previous year's income and the resulting premiums are paid between October of the year in question and September of the following year. In such cases, both the EITC and social insurance premiums are calculated on the basis of the previous year's income, but since the policy period differs, it is necessary to undertake ex-post settlement.

In addition, the DNP is operated in such a manner that when eligible workers pay in full by the statutory due day (10th of each month) the social insurance premiums for the corresponding month, when they apply for the program the next month's batch of social insurance premiums from which a subsidy for the corresponding month has been deducted is notified to the workers.⁴¹⁾ As workers qualified to apply for an EITC usually see fluctuations in their income, the composition of the body of beneficiaries are very changeable year to year and the refund period follows the social insurance policy period. As a result, in the case of beneficiaries of both EITC and DNP it is desirable to withhold social insurance premiums from the EITC and then settle premiums afterwards. If the EITC scheme and the DNP are linked, social insurance corporations, the entities subsidizing social insurance premiums, will be provided with related data on EITC claimants by the National Tax Service and can settle insurance premiums,

41) The subsidy is provided on the following month, not the corresponding month when a filer applies for the program, after insurance premiums are paid because an employer's fulfillment of the obligation to pay premiums is a prerequisite for offering their employees social insurance benefits.

which are withheld from EITC receipts based on the previous year's income, ex-post starting from October of the corresponding month. To this end, a linkage and information sharing between the National Tax Service and social insurance corporations should first be established.



IX

Conclusions

The Universal Declaration of Human Rights adopted by the United Nations General Assembly on December 10, 1948 in Paris proclaims social security to be a fundamental right to which all human beings are inherently entitled. Social security in essence refers to social insurance programs, and South Korea's four major social insurance schemes were introduced in this respect in order to assist citizens when they are unable to maintain their income or forced to bear excessive expenses due to social risks including old age, illness, death, disability, and job loss.

Since the introduction of workers' compensation insurance in 1964, South Korea has established a primary social safety net by introducing its health insurance scheme in 1977, the national pension scheme in 1988 and employment insurance scheme in 1995. Coverage has gradually been expanded for these four major social insurance schemes. However, there still exists wide-ranging blind spots in the social insurance schemes in terms of system and administration and in particular the schemes remain not completely well-designed in terms of the protection of the vulnerable, including the working poor. The enrollment rates for social insurance schemes as of March 2012 have reached 66.6 percent for the national pension, 69.7 percent for health insurance and 66.5 percent for employment insurance, indicating that these social insurance programs are not universally functioning as a primary social safety net. In addition,

among wage workers, whereas 79.6 percent of regular workers are enrolled in the national pension along with 81.3 percent in health insurance and 78.3 percent in employment insurance, only 40.5 percent of temporary workers have taken out national pension plans, 46.5 percent health insurance plans, and 45.0 percent employment insurance plans. Notably, the enrollment rates for part-time workers prove particularly low at 13.2 percent for national pension plans, 15.4 percent for health insurance plans and 15.7 percent for employment insurance plans. Atypical workers also exhibit low participation rates in social insurance schemes with 22.1 percent, 31.0 percent and 29.2 percent, respectively.

Even though South Korea maintains the four major social insurance schemes as a primary social safety net and the National Minimum Living Standard Security System as the end social safety net in place, a large proportion of the populace has fallen through the cracks of the social security system as the proportion of temporary employment and day labor has continued to grow apace with an increasing emphasis on flexibility in the labor market since the 1997 Asian financial crisis. The National Minimum Living Standard Security System is in place as the end social safety net to aid in the maintenance of minimum living standard among the population living below the poverty line, but its coverage is highly restricted. For this reason, a considerable number of people living in in-work poverty, including the near poor, are excluded from protection by the National Minimum Living Standard Security System even though they are not covered by social insurance schemes.

The reason underlying the government initiative to introduce the EITC was to protect people residing in the middle zone between the regions covered by social insurance schemes and the National Minimum Living Standard Security System, while still ensuring the containment at a minimum level of the fiscal burden on the government. Alongside the EITC scheme, the DNP entered into full-fledged operation starting in July 2012 after undergoing pilot testing. The program was designed to induce low-paid workers in small-scale workplaces who are exposed to social risks such as job loss and an unstable old age to participate in social insurance schemes by subsidizing their social insurance contributions.

As two schemes with similar purposes and intentions have been

introduced at an interval, however, overlaps in budget have occurred, thereby aggravating the government's funding burden. In addition, the lack of related data and information sharing between the National Tax Service and social insurance corporations have occluded the number of eligible workplaces and workers, as well as whether or not an EITC recipient is enrolled in social insurance programs. While the number of workers newly enrolled in social insurance programs has gradually increased since the inception of the DNP, due to the issues mentioned above, it falls short of fulfilling its original purpose of inducing as many low-paid workers as possible to join social insurance programs, as shown in the results of the DNP pilot projects revealing that approximately 83 percent of the budget was actually provided to existing enrolled workers and a mere 17 percent went to non-enrolled workers. Currently, most uninsured people belong to a socially vulnerable group, engaging in temporary work or day labor. The government is compelled to ensure that they are able to enjoy the benefits of social insurance schemes based on the principle of social insurance even though they, as the working poor, might prefer being provided with cash income on the spot. The government's policy to obligate the population to enroll in social insurance programs such as health insurance and national pension is based on paternalism,⁴²⁾ which limits individual liberty and intervenes in their decisions for their own benefit.

As stated before, if the EITC and the DNP are linked, duplicate funding can be considerably reduced and the effectiveness of the schemes can be greatly heightened. With the two programs combined, related information can be shared between the National Tax Service and social insurance corporations, thereby enabling the DNP to comply with its

42) Often, individuals are unable to carefully prepare for a variety of risks posed by the future or are unable to make reasonable judgments due to lack of information. For this reason, the government should intervene based on its judgment of the best interests of individuals rather than leaving the decision-making to the people involved. Such behavior on the part of the government is called paternalism in the sense that the government intervenes in people's behaviors for their own good. Obligating the citizenry to enroll in social insurance is based not only on the purpose of assuaging market failures and redistribution of income but also on the theory of paternalism. Similar examples are found in government policies to ban smoking, prohibit drug use, mandate the wearing of seat belts and require motorcycle riders to wear helmets.

original purpose by concentrating its subsidies on uninsured workers and strengthening the social safety net for EITC recipients. This policy can be justified from the perspective of paternalism, which mandates people join social insurance schemes for their own good, and, more than anything else, it can serve as an effective tool to ensure protection to the working poor against a variety of social risks, thereby guaranteeing a more stable future life by encouraging them to enroll in social insurance.

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