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Alternative Retirement Plans and the Salary Peak System in Korea

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The Korea Chamber of Commerce and Industry proposed the salary peak system to handle aged workers in Korea. The salary peak system provides aged workers with an opportunity to work past their retirement age for a salary less than their peak salary. The salary peak system, however, is related directly to the pension system, which can be divided broadly into defined benefit plans and defined contribution plans. In defined benefit plans, each employee's retirement benefit is predetermined by a specific formula, which includes salaries of last few years of employment. Since salaries of last few years of employment will decline under the salary peak system, the system will not be acceptable to employees unless the pension system is a defined contribution plan which is unaffected by declining salaries of last years of employment. Defined benefit retirement plans may be made compatible by allowing employees to formally retire with the peak salary at an earlier age and be re-hired under the salary peak system. This alternative raises a whole new issue since it will provide an incentive for employers to force aged workers to retire early and rehire them at a lower salary with or without any contribution to the workers' retirement funds.

Keywords : WTO, labor relations, labor standards, labor rights and benefits, labor legislation, trade union movement

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According to the Korea's National Statistical Office, Korea became an aging society as of July 1, 2000 with the number of people aged 65 or older having reached 3.4 million or 7.3 percent of the total population of 46.1 million. Korea is expected to become an aged society by 2019 when 14.4 percent of its population are expected to be 65 years or older. The number of Koreans under the age of 15 fell to 20.6 percent of the total population in 2000 from 34.0 percent in 1980 and 25.6 percent in 1990. The population aging in Korea is due to the decreased fertility rate and the increased life expectancy. The fertility rate fell sharply to 1.2 births per woman of child-bearing age in 2000 from 4.5 births in1970[1], while the life expectancy increased to 72.1 for men and 79.5 for women in 2000, an increase of about 13 years since 1970.[2] The falling fertility rate is, in part, a result of highly successful population control policies of the Korean government which actively campaigned for family planning in the 1960s, passed the Maternal and Child Health Law of 1973 that legalized abortion, and began suspending medical insurance benefits for maternal care for pregnant women with three or more children in 1983.[3] The population aging raised the level of concern over the belief that it will, if not already, slow economic growth, and led Korea's policymakers to re-examine Korea's retirement system as well as its mandatory retirement age.

During the period of rapid economic growth in the 1970s, companies introduced the retirement system to offer an implicit labor contract guaranteeing retirement to secure high-quality workers. At the time the mandatory retirement age was uniformly set at 55.[4] According to the Korea Labor Institute, the current retirement age of the private sector is around 55, although it varies by type of occupation. The two oldest average retirement ages are 57.9 for management staff and 57.7 for R&D/technology employees.[5] Others indicate that "Private sector retirement ages in Korea are set by

1) Lowe-Lee 2003, p. 1.
2) Phang 2003, p. 2.
3) Lowe-Lee 2003, p. 1.
4) Joonmo Cho and Sunwoong Kim, "On Using Mandatory Retirement System to Reduce Workforce in Korea," a paper prepared for the Conference on Flexibility and Performance: International Perspectives on Labor Market Institutions on July 19-20, 2004, Seoul, Korea., p. 12.
5) Workplace Panel Survey, collected by Korea Labor Institute between May and July of 2002, p. 10.

companies according to agreements with their employees with the average mandatory retirement age in 2004 being 57."[6] Also, "most government workers are to retire early at 60 years, with the exception of professional government workers like teachers (62 years) and professors (65 Years)."[7]

When the Roh administration announced its proposal to raise and set the mandatory retirement age at 60, both the Korea Chamber of Commerce and Industry (KCCI) and the Korea Employers Federation opposed the idea by stating that only four out of every 1,000 company workers left their jobs in 2002 because they reached the mandatory retirement age. Interestingly, the proposal is opposed also by labor unions. The Federation of Korean Trade Unions stated that the proposal would not be effective when "A majority of workers are forced to leave their jobs before the agreed retirement age."[8]

What Is the Problem

The KCCI proposed the salary peak system as an alternative to the government proposal to handle aged workers when it released its 2003 report "The Comparative Study on the Cases of the Salary Peak System in Japan and Korea."[9] The salary peak system provides aged workers with an opportunity to work past their retirement age for a salary less than their peak salary. The system as proposed appears to allow employers to determine details of its operation. The report states that although details vary among companies, the salary peak system has been adopted in Japan by 77.5 percent of corporations with 5,000 or more employees, 69.2 percent of corporations with 1,000-4,999 employees, 69.0 percent of employers with 300-999 employees,

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6) Kim Min-hee and Kim Sung-mi, "Employers Oppose Raising Retirement Age," The Korea Herald, January 28, 2004.
7) Kim Ik Ki, "Policy Responses to Low Fertility and Population Aging in Korea," a paper prepared for the Expert Group Meeting on Policy Responses to Population Aging and Population Decline, Population Division, Department of Economic and Social Affairs, United Nations Secretariat, New York, 16-18 October 2000, p. 5.
8) Kim Min-hee and Kim Sung-mi, "Employers Oppose Raising Retirement Age," The Korea Herald, January 28, 2004.
9) www.english.korcham.net.

70.8 percent of employers with 100-299 employees, and 66.0 percent of employers with 30-99 employees.[10] Interestingly, the report states that 89.2 percent of Japanese companies set 60 as the mandatory retirement age.[11] A number of Korean companies have also adopted the salary peak system.[12] The Korea Credit Guarantee Fund with mandatory retirement age of 58, for instance, pays 75% of the peak salary from age 55 to 56, 55% at age 57, 35% at the age 58. After 58, the company allows employees to work as temporary contractors.

The salary peak system is related directly to the pension system. The current pension system in Korea has two main components. One is the National Pension Scheme that began in 1988. The benefit formula of the National Pension Scheme is the following:[13]

Monthly basic pension = $0.15 \times (A + B) \times (1 + 0.05 \times N)$

in which

A = price-indexed average monthly income for the last 3 years prior to retirement;

B = price-indexed average monthly income of the participant during the whole contribution period; and

N = years of contribution minus 20 years in which $N \geq 1$.

The other is the retirement allowance scheme mandatory for firms with five or more workers that began in 1961 and is funded by corporations. The retirement allowance required under the Labor Standards Act "is at least one month's wage (calculated by averaging the employee's last three months' wages) multiplied by the number of years in service."[14] The important point is that pension allowance under both programs varies with the worker's earnings during the last years of employment.

The Hypothesis

10) KCCI 2003, p. 5.
11) KCCI 2003, p. 3.
12) www.english.korcham.net
13) Phang and Shin 2002, pp. 7-8.
14) Phang 2001, p. 31.

The hypothesis of this paper is that the salary peak system is likely to work better with defined contribution retirement plans as opposed to defined benefit retirement plans. In other words,

$$DB = f(Year, Lpay);\ \partial DB/\partial Year > 0 \text{ and } \partial DB/\partial Lpay > 0$$

$$DC = f(C^{EMPLOYERS}, C^{EMPLOYEES});$$

$$\partial DC/\partial Year = 0 \text{ and } \partial DC/\partial Lpay = 0$$

in which

DB = retirement allowance from defined benefit plans

Year = years of employment

Lpay = salary during the last years of employment

DC = retirement allowance from defined contribution plans

$C^{EMPLOYERS}$ = contributions made by employers

$C^{EMPLOYEES}$ = contributions made by employees

The salary peak system lowers the amount of pay during the last years of employment (Lpay), resulting in:

$$\partial DB/\partial Lpay < 0$$

which leads to lower retirement benefits and may discourage workers from participating in the salary peak system.

Defined Benefit and Defined Contribution Plans

In defined benefit plans, each employee’s benefit is predetermined by a specific formula. Usually, the promised benefit is tied to the employee’s average earnings, length of service, and the employee’s earnings during the last years of service. In defined benefit plans, the plan sponsor assumes an obligation for paying a stipulated future benefit. Consequently, the employer accepts any investment risk involved in meeting this obligation. Most defined benefit plans do not have a cost of living adjustment.[15] Defined benefit plans calculate the employee’s retirement benefits based upon formulas. These formulas can be broadly summarized into three.[16] In the flat-benefit formula, the retiree receives a certain amount such as \$12 a month

15) Herz 1995, p16.
16) EBRI 1987, pp.66-67.

multiplied by the years of service. In the career average formula, a retiree receives, for instance, one percent of the employee's earnings up to the social security taxable wage base plus two percent of earnings in excess of the social security taxable wage base for each year of service or plan participation. In the final-pay formula, a retiree receives, for instance, 1.5 percent of the employee's final three to five-year average earnings, times years of service or plan participation. "Today, final-pay formulas are the most commonly used."[17)]

Clearly the retirement benefit payment in the final-pay formula will be affected adversely by the salary peak system that will lower the employee's final three to five-year average earnings since earnings of final years will be declining under the system. Since the final-pay formula is used most widely especially among salaried workers, this formula will have the most significant impact in discouraging workers under this retirement plan from participating in the salary peak system. The career average formula will also have a negative impact on the retirement benefit payment since the declining salary will lower the retirement benefit payment, although the negative impact is offset somewhat by the increasing number of years of service under the salary peak system. The flat-benefit formula is widely adopted by labor unions. On the surface, the flat-benefit formula may not appear to have any adverse impact on the retirement benefit payment. In reality, however, labor unions will not be in any stronger position to negotiate a higher retirement benefit under the salary peak system since a higher retirement benefit and a reduced salary may not be compatible to each other. Further, for defined benefit plans, "Automatic cost-of-living adjustments have always been rare among private employers: only 4 percent of all private pensions included such adjustments in 1993."[18)]

In defined contribution plans, employers contribute to the individual employees? retirement accounts with contributions from the employees being added as a variation. Employers' contributions are usually determined by a percentage of each employee's earnings. The benefit payable at retirement is based on money accumulated in each employee's account. Such accumulated money will reflect employer contributions, employee contributions (if any) and investment gains or losses. The accumulated

17) EBRI 1987, p.67.
18) Herz, 1995, p16.

amount may also include employer contributions forfeited by employees who leave before they become fully vested, to the extent such contributions are reallocated to the accounts of employees who remain.[19] Under defined contribution plans, it is the employee who bears the investment risk for the plan assets although plan sponsors still have a fiduciary responsibility in managing the investments.

Defined contribution plans include thrift and profit sharing such as 401(k), money-purchase pension plans, and employee stock ownership plans. Thrift and profit sharing plan sponsors usually provide for lump-sum distributions at retirement, and money-purchase pension plans may require that pension benefits be taken in the form of a fixed and/or variable annuity.[20] The term 401(k) refers to section 401(k) of the U.S. Internal Revenue Code that allows an employee to set aside a portion of compensation to the employee's pension plan as a pre-tax reduction in salary. The employee defers income tax on the 401(k) contribution until withdrawal. "Deferred profit sharing plans must define employee vesting rights. The Tax Reform Act of 1986 (TRA) requires that profit sharing plans satisfy one of two vesting rules: (1) 100 percent vesting after five years of service, or (2) 20 percent after three years of service, with an additional 20 percent for each subsequent year of service until 100 percent vesting is achieved at the end of seven years of service."[21] A retiree's benefit payment under defined contribution plans is unaffected by the salary peak system since accumulated assets of individual accounts are not reduced by declining salaries.

Note that a typical defined benefit pension plan specifies the annual flow of pension benefit usually as depending on an individual's pre-retirement salary and on other variables. It is the employee's benefit that is defined, thus called defined benefits. A typical defined contribution pension plan specifies the payments or contributions made by the individual and employer into a fund which is invested in securities. The value of the accumulated assets is determined at the time the worker retires and the value is usually converted into an annual flow of income (an annuity). With a DC plan, it is the employer's contributions that are defined, thus called defined contributions.[22] Both defined benefit plans and defined contribution plans are

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19) EBRI 1987, p.65.
20) EBRI 1987, p. 70.
21) EBRI 1987, p. 89.

usually on a “funded” basis, not on a “pay-as-you-go” basis. In a funded system, contributions are used to purchase assets, which are saved to pay for future benefits. In the United States, private pension plans are required by law to be funded. In a pay-as-you-go system, contributions by workers go directly to pay benefits to current retirees in such programs as the social security.[23)]

An Illustration

Table 1 contains a hypothetical illustration of possible benefits a worker could receive if he or she retired with a defined benefit pension plan and with a defined contribution pension plan. Table 1 assumes that the defined benefit plan uses the final-pay formula to determine benefits, the average of last five-year salaries is $40,000, the annual rate of inflation is 3 percent, and the estimated number of years the retiring person will receive benefit is 18 years that begins in 2005.

Column (2) shows the pension under the defined benefit plan with no adjustment for inflation, which is typical of many defined benefit plans. Column (3) indicates the annual amount that is adjusted for inflation. Column (4) is the lump sum payment under the defined contribution plan with the lump sum amount that generates $40,000 during the first year and inflation-adjusted benefits of column (3) thereafter. Column (5) shows the annual balance based on the assumption that the lump sum pension in column (4) is invested with 6 percent annual return and the annual withdrawal is equal to inflation-adjusted pension benefits shown in column (3). Column (6) is the lump sum payment under the defined contribution plan with the lump sum amount that will be exhausted at the end of the 18 years of inflation-adjusted benefits in column (3). Column (7) shows the annual balance based on the assumption that the lump sum pension in column (6) is invested with 6 percent annual return and the annual withdrawal is equal to inflation-adjusted pension benefits shown in column (3).

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22) John Pencavel, “Faculty Retirement Incentives by Colleges and Universities,” prepared for the TIAA-CREF Institute Conference on Recruitment, Retention, and Retirement: The Three R’s of Higher Education in the 21st Century, New York City, April 1-2, 2004, p. 7.

23) Congressional Budget Office, “Long-Range Fiscal Policy Brief,” CBO series of issue summaries No. 12, September 12, 2004, p. 1.

Professionally managed, retirees tend to be better off with defined contribution plans partly because their retirement allowance is likely to be adjusted upward with inflation and partly because retirees can continue to accumulate their retirement fund unaffected by possible decline in their earnings during the last years of their employment under the salary peak system.

Table 1. Illustration of Defined Benefit and Defined Contribution Plans

Year (1)	Defined benefit (2)	Benefit with inflation (3)	Defined contribution option A (4)	Balance with 6% interest (5)	Defined contribution option B (6)	Balance with 6% interest (7)
2005	$40,000	$40,000	$666,667	$666,667	$587,480	$666,667
2006	40,000	41,200	625,467	662,995	546,280	579,057
2007	40,000	42,436	620,559	657,792	536,621	568,818
2008	40,000	43,709	614,083	650,928	525,109	556,616
2009	40,000	45,020	605,908	642,262	511,595	542,291
2010	40,000	46,371	595,891	631,645	495,920	525,675
2011	40,000	47,762	583,883	618,916	477,913	506,588
2012	40,000	49,195	569,721	603,904	457,393	484,836
2013	40,000	50,671	553,233	586,427	434,166	460,216
2014	40,000	52,191	534,236	566,290	408,025	432,506
2015	40,000	53,757	512,534	543,286	378,749	401,474
2016	40,000	55,369	487,916	517,191	346,105	366,871
2017	40,000	57,030	460,161	487,770	309,841	328,431
2018	40,000	58,741	429,029	454,771	269,690	285,871
2019	40,000	60,504	394,267	417,923	225,368	238,890
2020	40,000	62,319	355,605	376,941	176,571	187,165
2021	40,000	64,188	312,753	331,518	122,977	130,356
2022	40,000	66,114	265,404	281,328	64,242	68,096
2023	40,000	68,097	213,231	226,025	0	0

Source: Table developed by Stephen R. Hunt of Morgan Keenan.

History of Retirement Plans in the U.S.

To determine whether any significant institutional changes may affect the composition between defined benefit plans and defined contribution plans, we review the history of retirement practice. This section is intended to demonstrate the changing composition between DB and DC plans in the United States.[24)]

Germany is the birthplace for the state-run retirement system. In 1889, the German government designated 70 as the official retirement age. In 1916, the age was lowered to 65.[25)] The retirement age in the U.S. was created in 1935 when the Committee on Economic Study decided to use 65 as retirement age for the new social security system. The Federal Railroad Retirement System, created by Congress in 1934, also stipulated 65 as the retirement age.[26)]

In 1967, the Age Discrimination in Employment Act (ADEA) prohibited employers from discriminating against workers on the basis of age up to 65. Involuntary retirement provisions were allowed, as long as they were not imposed prior to age 65. In 1974, the Employee Retirement Income Security Act (ERISA) imposed comprehensive standards for retirement plans. Included in this legislation was the provision that plans begin to pay benefits at age 65, which followed the then existing ADEA rules. Since the passage of the Employee Retirement Income Security Act in 1974, there has been a trend toward providing retirement benefits in the form of lump-sum distributions upon departure from a job. This reflects a shift away from defined-benefit pension plans to defined contribution plans.[27)] In 1979, the U.S. Department of Labor Interpretive Bulletin allowed defined benefit plans to stop accruing benefits for employees who work past the plan’s normal retirement age. These laws further reinforced the notion that age 65 was the standard retirement age.

In 1978, the ADEA was amended to provide protection against employment discrimination for ages up to 70. This led employers to amend their defined benefit pension plans to eliminate involuntary retirement provisions prior to age 70. Also in 1978, section 401(k) was added to the Internal Revenue Code, allowing employees to defer income into certain retirement plans. Regulations covering such plans were not finalized until the early 1980s, at which time employers began introducing defined contribution plans with 401(k) features. Such plans do not have an actual

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24) Information in this section was collected by Stephen R. Hunt of Morgan Keenan.

25) Social Security Administration, Social Security Online-History, June 18, 2004, www.ssa.gov/history/age65.html.

26) Social Security Administration, Social Security Online-History, June 18, 2004, www.ssa.gov/history/age65.html.

27) Herz, 1995, p17.

retirement age. In 1983, Social Security laws were changed to raise gradually the age at which full benefits are available to age 67. Effective January 1, 1987, the Amendment of the Age Discrimination In Employment Act of 1967, signed by President Reagan on October 31, 1986, eliminated the age 70 cap on workers 40 years and older protected by the Age Discrimination in Employment Act. Also in 1986, the Omnibus Budget Reconciliation Act required that employers with pension plans provide pension accruals or allocations for employees working beyond age 64.

The age at which a worker becomes eligible for full Social Security retirement benefits, known as the normal retirement age (NRA), depends on the worker's year of birth. For people born before 1938, the NRA was 65. The NRA remains at 66 for workers born between 1944 and 1954 and then begins to increase in two-month increments, reaching 67 for workers born in 1960 or later. Workers can begin receiving permanently reduced monthly retirement benefits as early as age 62. The current 24.2 percent reduction in their monthly benefits will increase to 30 percent when the NRA increases to 67. More than two-thirds of the workers who began receiving Social Security retirement benefits in the past decade started collecting benefits before the NRA.[28)]

Over the years, the private pension system has shifted from defined benefit (DB) plans toward 401(k) type defined contribution (DC) plans. Currently, an estimated 14 percent of all private wage and salary workers in the U.S. are covered by both DB and DC plans, an additional 7 percent by a single DB plan, and 29 percent by DC plan only. The remaining workers are not covered by any retirement plan.[29)] Shifting trends in the U.S. pension plan participation are summarized in table 2, which shows the number of participants, pension plan assets and types of plan from 1980 to 1999. Table 2 data are based on a 2004 publication of the U.S. Employee Benefits Security Administration.

To determine the trend toward defined contribution plans, the percent of participants in defined contribution plans relative to total (DC/Total) is regressed on the annual trend variable (Trend), a dummy representing the 1987Amendment of the

28) H.R. 3821 Bipartisan Retirement Security Act of 2004, p. 6.
29) U.S. Department of Labor, Employee Benefits Security Administration, No. 12, summer 2004 “Private Pension Plan Bulletin”, p. 3.

Table 2. Participants and Assets in Pension Plans by Type

Year	Participants in 1000			Assets in $millions			Assets per person($)	
	Total	Defined Benefit(%)	Defined Contribution (%)	Total	Defined Benefit	Defined Contribution	Defined Benefit	Defined Contribution
1980	57,903	37,979(65.6)	19,924(34.4)	563,551	401,455	162,096	10,570	8,136
1981	60,564	38,903(64.2)	21,661(35.8)	628,916	444,376	184,540	11,423	8,519
1982	63,243	38,633(61.1)	24,610(38.9)	788,987	553,419	235,567	14,325	9,572
1983	69,147	40,025(57.9)	29,122(42.1)	923,470	642,359	281,111	16,049	9,653
1984	73,895	40,980(55.5)	32,915(44.5)	1,044,592	700,669	343,922	17,098	10,449
1985	74,665	39,692(53.2)	34,973(46.8)	1,252,739	826,117	426,622	20,813	12,199
1986	76,672	39,989(52.2)	36,682(47.8)	1,382,910	895,073	487,837	22,383	13,299
1987	78,223	39,958(51.1)	38,265(48.9)	1,402,488	877,269	525,219	21,955	13,726
1988	77,685	40,722(52.4)	36,963(47.6)	1,503,635	911,982	591,653	22,395	16,007
1989	76,405	39,958(52.3)	36,447(47.7)	1,675,597	987,971	687,626	24,725	18,866
1990	76,924	38,832(50.5)	38,091(49.5)	1,674,139	961,904	712,236	24,771	18,698
1991	77,662	39,027(50.3)	38,634(49.7)	1,936,271	1,101,987	834,284	28,237	21,595
1992	81,914	39,531(48.3)	42,383(51.7)	2,094,087	1,146,798	974,289	29,010	22,988
1993	83,870	40,267(48.0)	43,603(52.0)	2,316,272	1,248,180	1,068,092	30,998	24,496
1994	85,117	40,338(47.4)	44,778(52.6)	2,298,556	1,210,856	1,087,700	30,018	24,291
1995	87,452	39,736(45.4)	47,716(54.6)	2,723,735	1,402,079	1,321,657	35,285	27,698
1996	91,716	41,111(44.8)	50,605(55.2)	3,136,281	1,585,397	1,550,884	38,564	30,647
1997	94,985	40,392(42.5)	54,593(57.5)	3,553,757	1,735,604	1,818,152	42,969	33,304
1998	99,455	41,552(41.8)	57,903(58.2)	4,021,849	1,936,600	2,085,250	46,607	36,013
1999	101,794	41,427(40.7)	60,368(59.3)	4,407,805	2,057,539	2,350,266	49,667	38,932

Source : U.S. Department of Labor, Employee Benefits Security Administration, Number 12, Private Pension Plan Bulletin: Abstract of 1999 Form 5500 Annual Reports, Summer 2004, Table E5 on p. 79 and Table E11 on p. 85. Note that asset amounts shown exclude funds held by life insurance companies under allocated group insurance contracts for payment of retirement benefits. These excluded funds make up roughly 10 to 15 percent of total private fund assets.

Age Discrimination In Employment Act that eliminated the mandatory retirement age (D1987+), and the ratio of assets per person under defined contributions relative to assets per person under defined benefits (APDC/APDB):

$$DC/Total = 0.5641 + 0.0127\ Trend + 0.0179\ D_{1987}+ - 0.3061 APDC/APDB$$

(0.0004) (0.0054) (0.0243)

$R^2 = 0.99$

All estimates turned out to be statistically significant. What appears to have happened is that after the adjustment period of about 4 years following the passage of the 1987 Amendment, the number of participants in defined contribution plans increased rapidly, resulting in a slightly decreased assets per person under defined contribution plans.

Further Analysis

Research suggests defined benefit plans have more incentives for workers to retire early than do defined contribution plans. Based on the Employee Benefits Survey data from the Department of Labor, Foster concludes that "Most workers participating in defined benefit pension plans can retire before the normal retirement age and receive a reduced pension. In 1994-1995, 96 percent of those in medium and large private establishments and 87 percent of those in state and local governments participated in plans with early retirement provisions. Among private sector participants with early retirement provisions, the greatest proportion (70 percent) were in plans allowing early retirement at age 55 with 10 years of service."[30] The early retirement under defined benefit plans, found by Foster, is voluntary. The early retirement under defined benefit plans practiced in Korea, however, is likely involuntary.

Some speculate that the wage and compensation structure at most Korean firms are "back-loaded" in that pay is lower than productivity for junior workers and higher than productivity for senor workers. The back-loaded seniority compensation system is likely to lead employers to force their senior employees to retire when they are deemed excessively over-paid and thus employers find it costly to keep them beyond a certain age. "The burden of mandatory retirement allowance that is designed to be steeply increasing along with tenure had been a dominant cost factor to the employer, which had been one of the main reason for the large scale dismissal of old-aged employees from firms observed last several years since the recent economic down turn.[31]

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30) Foster, 1998, p.13.
31) Phang 2003, October 31, 2003, pp. 21-22.

In August 2004, the Korea's Labor Ministry and the pro-government Uri Party proposed creation of a program for individual retirement accounts and allowing civil servants to form labor unions. The new retirement account would supplement the current traditional retirement plan in which employers provide an annual payment and hold the money. Under the new pension system workers would contribute money every month to an individual retirement account. Those who make contributions for at least 10 years will be entitled to benefits when they turn 55. The government plans to implement the system from 2006 for companies with more than five workers and from 2008 for companies with less than five employees to ease those companies' financial burdens.[32] Employers oppose the proposal by claiming that the retirement pension system will impose a heavy burden on them and demand measures such as combining the system and the national pension. Labor unions oppose the proposal by pointing out that the age limit of 55 does not reflect the current job situation where many people in their 40s have been forced to retire. There is a term "saohjeong" in Korea which means the normal retirement age in Korea is 45, reflecting the widely-spread practice of forced early retirement since 1997. According to Phang of the Korea Labor Institute, "Compared with advanced nations, (a) Korean companies show relatively high bankruptcy rate, (b) infrastructure of Korean financial market has not developed fully, and (c) Korean workers have limited information and knowledge on financial markets," and suggests that "when introducing corporate pension system, there is no need to limit company's choices by choosing a certain system in advance. Instead, companies should have the room to choose their own plan based on worker's opinion and companies' situation."[33]

Conclusions

Defined benefit retirement plans are not compatible with the salary peak system since the pension amount under defined benefit plans tends to vary with the employee's salaries during the last years of service which may include the employee's

32) Kim Sung-mi, "Seoul to create new retirement pension program," Korea Herald, Aug. 24, 2004.

33) Phang 2001, p. 35.

post-peak salaries. Even the voluntary phased retirement program in which workers work less hours at reduced pay prior to the normal retirement age "is generally not a good fit with DB plans since DB payouts are linked to final average salary."[34) Defined benefit retirement plans may be made compatible by allowing employees to formally retire with the peak salary at an earlier age and be re-hired under the salary peak system. This alternative, however, raises a whole new issue since it may provide an incentive for employers to force aged workers to retire early and rehire them at a lower salary with or without any contribution to the workers' retirement funds.

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34) TIAA-CREF Institute, "The Faculty Retirement Decision: Financial and Other Considerations," Trends and Issues, September 2004, p. 6.

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